SMARTCOOL™

Smartcool Systems Inc. (TSX-V: SSC)
Management Discussion and Analysis

2014 Second Quarter (ending June 30)

www.smartcool.net

Smartcool Systems Inc.
7155 Kingsway
PO Box 54523 Highgate PO
Burnaby, BC
V5E 4J6 Canada

TEL +1 604 669 1388
TOLL-FREE +1 888 669 1388
FAX +1 604 602 0674
EMAIL officeCanada@smartcool.net

SMARTCOOL™

Management's Discussion and Analysis

The following is management's discussion and analysis ("MD&A") of the operating and financial results of Smartcool Systems Inc. for the three months ended June 30, 2014. This information is provided as of August 26, 2014.

This MD&A should be read in conjunction with the Company's condensed consolidated financial statements for the three months ended June 30, 2014, its audited consolidated financial statements for the years ended December 31, 2013 and 2012 together with accompanying notes. These documents and additional information about Smartcool can be located on the SEDAR website at www.sedar.com or the Company's website at www.smartcool.net .

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Business Overview

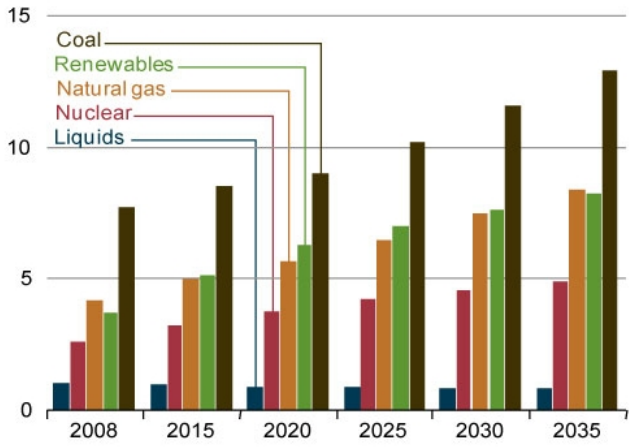
Smartcool Systems Inc. is a clean technology company specializing in the development and distribution of energy efficiency solutions for air conditioning, refrigeration and heat pump systems (HVAC).

Smartcool was established in 2004, beginning as the North American distributor for the Energy Saving Module (ESM)™, a unique energy efficiency retrofit developed by Abbotly Technologies Pty Ltd of Australia. In 2006, Smartcool purchased the assets of Abbotly, including the intellectual property of the ESM™, and became the sole manufacturer and master distributor. In 2009, Smartcool's research and development cumulated in the delivery of the ECO^3™ to market, a new product specifically designed to bring unprecedented energy efficiency to small scale HVAC systems.

Energy Issues

Smartcool has focused on developing energy efficiency solutions to address the critical energy issues facing the world today and in the future. Electricity is a crucial part of the global economy and our communities. The worldwide demand for electricity has increased by 5.4% since 2010, with developing countries averaging a 9.5% growth in demand. Coal continues to be the most widely used fuel for electricity generation, followed by natural gas. Electricity generated by these fossil fuels releases vast amounts of greenhouse gases into the atmosphere, contributing to climate change and general air pollution.

EIA World Net Electricity Generation by Fuel 2008-2035
(in trillion kWh)



An instinctive solution is to switch to renewable energy sources, not only for environmental reasons but also due to issues of energy security. Electricity generation by renewable resources such as hydro, wind, waves and solar is increasing by an average of 3% each year thanks to government incentives. However, as the Energy Information Administration explains, "Although renewable energy sources have positive environmental and energy security attributes, most renewable technologies other than hydroelectricity are not able to compete economically with fossil fuels during the projection period except in a few regions or in niche markets."[1]

On average, residential electricity rates around the globe have increased by 150% from 2005 to 2008.[2] Combined with environmental concerns surrounding fossil fuel generated electricity, it is

[1] Energy Information Administration, *International Energy Outlook 2011*, Published Sept. 19, 2011 http://www.eia.gov/forecasts/ieo/electricity.cfm
[2] Energy Information Administration, *Electricity Prices for Households*, Updated June 10, 2010 http://www.eia.gov/emeu/international/elecprih.html

clear that a solution to high energy consumption is urgently needed. Energy efficiency is the only option which is both cost effective and can be implemented rapidly.

Smartcool's Energy Efficiency Solutions

Smartcool focuses on reducing the electricity used by refrigeration, air conditioning and heat pumps (HVAC). For target customer industries, such as supermarkets, these systems consume well over 50% of their total energy usage. Even for customers less dependent on HVAC, the systems still account for roughly 20% of their energy bill. The ability to save energy with Smartcool's energy efficiency technology represents a major opportunity to cut operating expenses for any customer, typically giving them a return on their investment averaging 18 to 36 months. Electricity generated for buildings produces more greenhouse gases than any other source, so cutting HVAC energy consumption can also have a significant impact on the environment.

Smartcool's ECO^3™ and ESM™ are retrofit products, meaning that they are installed by wiring in between the existing thermostat and the compressor in the HVAC system, rather than replacing any expensive equipment. Once installed, the products immediately begin monitoring the cooling cycle of the compressor to identify inefficiencies and opportunities for saving energy. Even the most modern systems have pre-existing inefficiencies that can only be resolved by the intellectual property provided in Smartcool's products. The ECO^3™ and ESM™ dynamically adjust the cooling cycle to save customers energy without any impact to the temperature performance of the HVAC system.

The ECO^3™



The ESM™



With the ECO^3™ and ESM™, customers see all the benefits of energy efficiency, without any risks. The technology has undergone extensive independent third party testing by highly reputable organizations such as Oak Ridge National Laboratories, the University of Miami for Florida Power & Light, and the Los Angeles Department of Power & Water. These tests have proven unequivocally that the technology provides energy savings with no risks, as do over 30,000 installations worldwide.

For more information on Smartcool's technology, visit www.smartcool.net or for information specific to the ECO^3™, visit www.smartcooleco3.com

The Market Strategy

Smartcool's ECO^3™ and ESM™ are cost effective energy efficiency solutions for any air conditioning, refrigeration or heat pump system. The few other energy efficiency products geared towards the HVAC market, do not offer the full package of benefits that the ECO^3™ and ESM™ provide. Other products on the market do not provide the same degree of safety, and can cause temperature and humidity performance to be affected. They all lack the wide range of compatibility held by the ECO^3™ and ESM™, which can be installed on any HVAC system. Perhaps most significantly, other products cannot easily prove consistent energy savings. Smartcool's energy savings can be instantly verified on the product display screens, letting customers monitor energy savings as they happen. This is a critical feature for utility rebate

qualification, which Smartcool has already received from major utilities like Florida Power & Light, Southern California Edison and Con Edison. These factors give Smartcool exclusive access to an immense market.

Direct Sales

The company distributes its products directly to major clients, providing them with superior project management and service as they roll out Smartcool products to their facilities. For direct sales, Smartcool targets specific industries such as food retailers, telecommunications, commercial real estate and hospitality, where HVAC energy usage tends to represent a very high percentage of a client's operating budget. In Europe, Smartcool has built a strong portfolio of direct sales to Fortune 500 clients such as Sainsbury's and Tesco.



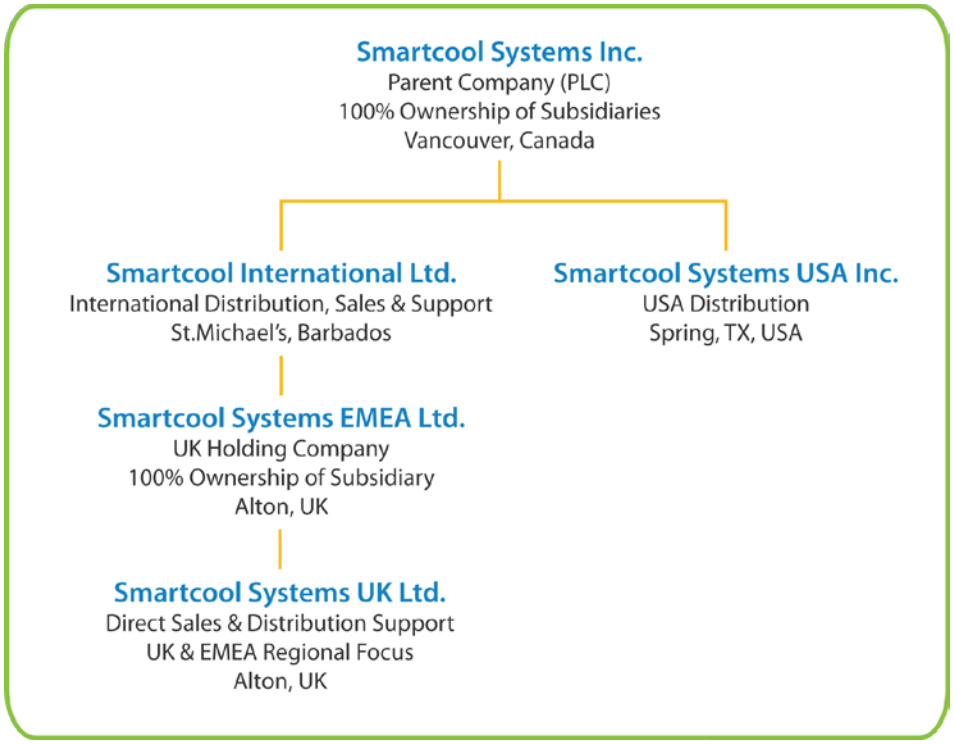
Distribution Sales

Smartcool has developed an intricate network of distributors to target regional markets. Distributors are provided both technical and sales training by Smartcool and receive ongoing support. Distributors have the advantage of detailed regional knowledge, allowing them to build strong client portfolios across the residential sector as well as in industries like food retail, climate controlled storage, hospitality and commercial real estate. Smartcool's distributors have continued to expand their businesses in Australia, India, UAE, Saudi Arabia, Eastern Europe, France, South Africa, and the US (particularly Florida, California and the Mid-West). Distributors have also proven instrumental in launching key accounts for Smartcool, like Telefonica, GE Healthcare, Dell, Saudi Aramco, 7-Eleven, JW Marriott and more.

Corporate Structure

Smartcool has gone through several phases of growth to reach its current structure. Smartcool Systems Inc. is the publicly traded parent company, with four wholly owned subsidiaries:

International, USA, EMEA and UK. Smartcool International Ltd. holds the intellectual property and is the master distributor of Smartcool's product line. Smartcool Systems USA Inc. distributes the technology within the United States, using a network of local distributors to deliver the products to market.



Smartcool Systems EMEA was formed in 2008 and is the master distributor for Europe, the Middle East, Africa and the Indian Sub-Continent. In February 2011, Smartcool EMEA acquired all the outstanding shares of Smartcool Systems UK Ltd., a previously independent distributor with extensive technical expertise in Smartcool products.

Smartcool EMEA now conducts business as Smartcool Systems UK Ltd., directly managing a large portfolio of well established customer accounts. This improves gross revenue and profitability for Smartcool. Another significant factor in the acquisition is leveraging the considerable technical abilities of the UK team to assist in continuing the research and development of the Smartcool product line, and providing the best possible service and support to Fortune 500 clients and distribution channels. Smartcool EMEA / UK is headquartered in Alton, UK, providing Smartcool a strong base from which to serve Europe, its fastest growing market.

Financial Overview

Prospective installations have not materialized as expected and revenue for the three months ended June 30, 2014 was $199,545 compared to $491,253 for the same period of 2013.

Net loss for the quarter increased to $529,169 ($0.01 per share) from $429,905 ($0.01 per share) for the second quarter of 2013. Operating expenses decreased to $503,888 from $553,449 for the second quarter of 2013. Total assets decreased to $ 3,963,086 from $4,177,175 at the end of 2013. The Company had $38,382 in cash and cash equivalents at the end of the quarter, compared to $28,036 at the end of 2013.

Current liabilities at the end of the quarter were $1,381,345 (December 31, 2013 - $1,264,361) which includes current portion of acquisition obligations, vehicle finance, debentures, and tenant inducement totaling $ 427,753 (December 31, 2013 - $332,173). Long-term liabilities were $ 650,421 (December 31, 2013 - $787,581), consisting of acquisition obligations $214,235, vehicle finance 11,680 and deferred tax liability of $424,326.

All the fiscal quarters below have been prepared using IFRS:

	Sep 2013 ($)	Dec 2013 ($)	Mar 2014 ($)	Jun 2014 ($)
Total revenues	676,122	356,979	494,194	199,545
Net income (loss)	(292,688)	1,969,646	(280,067)	(529,169)
Income (loss) per share – basic & diluted	(0.00)	0.02	(0.00)	(0.01)
	Sep 2012 ($)	**Dec 2012 ($)**	**Mar 2013 ($)**	**Jun 2013 ($)**
Total revenues	1,645,225	1,197,968	143,602	491,253
Net income (loss)	(46,203)	(467,682)	(838,757)	(429,905)
Income (loss) per share – basic & diluted	(0.00)	(0.01)	(0.01)	(0.01)

Selected Annual Information

The following is selected information on Smartcool's financial performance for the past three years. This financial information is derived from the audited financial statements of the Company and have been prepared using IFRS.

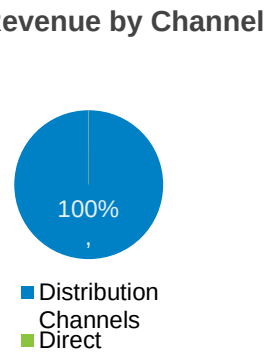
	Dec. 31, 2011	Dec. 31, 2012	Dec. 31, 2013
Revenue	$3,943,794	$4,212,750	$1,667,957
Selling, General & Administrative	$4,355,436	$3,209,334	$2,308,343
Net Income (Loss)	$(5,217,928)	$(1,932,272)	$408,295
Net income (loss) – per share (basic and diluted)	$(0.09)	$(0.03)	$0.01
Total assets	$7,365,680	$5,467,176	$4,177,175
Total long term liabilities	$860,932	$500,188	$787,581
Cash dividends	$0	$0	$0

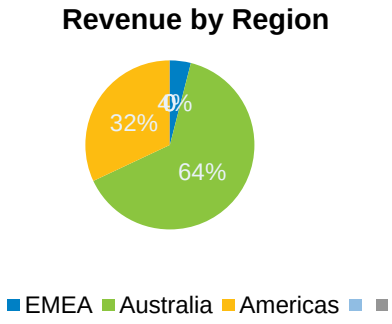
Summary of Operating Results

Revenue

Smartcool sells its products both directly to major customers, and through a network of independent distributors.

Distribution sales for the three months ended June 30, 2014 were $199,545 or 100% of total revenue, compared to $400,639 or 82% of total revenue for the same period of the previous year. Though a couple of new distribution channels have been established during the period, there were limited recurring sales from existing channels. There were no direct sales within the UK market for the quarter compared to $90,614 or 18% of total revenue for the second quarter of the previous year.





Revenue from the EMEA (Europe, Middle East, Africa, & India) region for the quarter was $7,193 compared to $114,488 for the second quarter of the previous year. Though interest in Smartcool products continued to be strong and a number of sales quotes have been requested, prospective customers seemed to prefer a slow decision making process, resulting in no closed sales for the period.

Revenue from the Australia region was $128,530, compared to $252,324 for the same quarter of the previous year. This distribution channel experienced a similar issue with many projects remaining pending at the

end of the quarter. Revenue from the Americas region was $63,822 compared to $124,441 for the second quarter of the previous year.

For the six months ended June 30, 2014, revenue from the EMEA (Europe, Middle East Africa, & India) region was $286,849, compared to $$185,325 for the same period of 2013. Revenue from Australia was $259,397, compared to $252,324. Revenue from the North America was $147,493 compared to $197,206.

Distribution sales for the six months were $ 454,502 or 66% of total revenue, compared to $492,349 for the first six months of 2013 and direct sales were $ 239,237 or 34% of revenue, compared to $142,506 for the same period of 2013.

Gross profit

Gross profit for the three months ended June 30, 2014 was $161,276 compared to $410,261 for the same period of the previous year, a decrease of $248,984 or 61%. Profit margin for the three months was 81%, compared to 84% for the same period of the previous year. Gross profit for six months ended June 30, 2014 was $585,246 compared to $508,133 for the same period of the previous year, an increase of $77,113 or 15%. Profit margin for the six months was 84%, compared to 80% for the same period of the previous year.

General and administrative expenses

	Three months ended June 30 2014	Three months ended June 30 2013	Change	%
Advertising and promotion	$7,292	$2,731	$4,561	167%
Bad debts	$0	$4,371	($4,371)	(100%)
Consulting	$95,597	$57,153	$38,444	67%
Filing and transfer fees	$3,891	$6,599	($2,708)	(41%)
Insurance	$7,145	$14,665	($7,520)	(51%)
Interest	$3	$1,210	($1,207)	(100%)
Investor relations	$13,473	$98	$13,375	13648%
Product certification	$2,617	$1,202	$1,415	118%
Professional fees	$7,311	$16,274	($8,963)	(55%)
Office and supplies	$19,113	$27,403	($8,290)	(30%)
Rent	$49,418	$59,679	($10,261)	(17%)
Salaries and benefits	$260,387	$321,839	($61,452)	(19%)
Telephone	$9,961	$6,863	$3,098	45%
Travelling	$27,679	$33,361	($5,682)	(17%)
Total selling, general & admin expenses	**503,888**	**553,448**	**(49,560)**	**(9%)**
Share-based compensation	26,486	35,408	(8,922)	(25%)
Research & Development	0	-	0	(0%)
Amortization & depreciation	182,497	261,706	(79,209)	(30%)
Total operating expenses	**$712,871**	**$850,562**	**($137,691)**	(16%)

	Six months ended June 30 2014	Six months ended June 30 2013	Change	%
Advertising and promotion	$17,608	$9,344	8,264	88%
Bad debts	0	4,371	(4,371)	(100%)
Consulting	167,591	115,974	51,617	45%
Filing and transfer fees	10,298	16,221	(5,923)	(37%)
Insurance	16,156	25,958	(9,802)	(38%)
Interest	22	1,210	(1,188)	(98%)
Investor relations	15,393	1,465	13,928	951%
Product certification	2,617	2,385	232	10%
Professional fees	28,214	17,360	10,854	63%
Office and supplies	39,869	56,736	(16,867)	(30%)
Rent	102,057	122,020	(19,963)	(16%)
Salaries and benefits	543,696	712,103	(168,407)	(24%)
Telephone	20,603	20,010	593	3%
Travelling	65,404	78,395	(12,991)	(17%)
Total selling, general & admin expenses	1,029,530	1,183,552	(154,022)	(13%)
Share-based compensation	67,592	42,575	25,017	59%
Research & Development	7,227	21,376	(14,149)	(66%)
Amortization & depreciation	366,487	521,161	(154,674)	(30%)
Total operating expenses	**$1,470,836**	**$1,768,664**	**($297,828)**	**(17%)**

General and administrative ("G & A") expenses for the three months ended June 30, 2014 were reduced to $503,888 from $553,448 for the same period of the previous year, a decrease of $49,560 or 9%. The decrease was attributable to the overall reduction in business volume with the exception of investor relations and business developments activities. Investor relations expense increased by $13,375 and business development consulting fee increased by $38,444 due to the engagement of two consulting firms in the period.
Despite an increase of $58,884 in revenue, general and administrative ("G & A") expenses for the six months ended June 30, 2014 were reduced to $1,029,530 from $1,183,552 for the same period of the previous year. Cost reduction measures taken earlier proved to be beneficial at all revenue levels.

Net loss

Net loss for the three months ended June 30, 2014 was $529,169, compared to $429,905 for the same period of the previous year. The increase in net loss was a result of reduced revenue.
The loss per share (basic and diluted) for the three months was $0.01, no change from the loss per share $0.01 for the same period of the previous year.

Net loss for the six months ended June 30, 2014 was $809,237 compared to $1,268,662 for the same period of the previous year, a decrease of $459,425 or 36%. The reduction was primarily a result of more effective cost controls.
The loss per share (basic and diluted) for the six months was $0.01 compared to $0.02 for the same period of the previous year.

Loss per share is calculated based on the weighted average number of common shares outstanding throughout the period.

Comprehensive income
Comprehensive loss for the three months ended June 30, 2014 was $511,724 (June 30, 2013 - $477,133) consisting of net operating loss $529,169 and foreign currency translation adjustment $17,445. As the functional currencies of Smartcool EMEA, Smartcool UK and Smartcool USA are different from the reporting currency (Canadian dollar), their monetary assets and liabilities as well as non-monetary assets and liabilities in the consolidated financial statements must be translated into the reporting currency based on June 30, 2014 exchange rate under IFRS. This method of foreign currency translation resulted in the above adjustment which is classified as a component of equity.
Comprehensive loss for the six months ended June 30, 2014 was $740,750, consisting of net operating loss $809,237 and foreign currency translation adjustment $68,487, compared to comprehensive loss of $1,274,610 for the same period of 2013.

Amortization and depreciation
Amortization expenses for the three months ended June 30, 2014 were $182,497 compared to $261,706 for the same quarter of the previous year. Amortization on property and equipment was $12,257 (June 30, 2013 - $16,296) and amortization of intangible assets was $170,240 (June 30, 2013 - $245,410).
Amortization expenses for the six months ended June 30, 2014 were $366,487 compared to $521,161 for the same period of 2013. Depreciation of property and equipment was $26,497 (June 30, 2013 - $35,857) and amortization of intangible assets was $339,990 (June 30, 2013 - $485,304).

The decrease in amortization of intangible assets was a result of the reassessment of the useful life of distribution rights from TECC and Smartcool UK in 2013.

Share-based compensation
Share-based compensation costs for the three months ended June 30, 2014 were $26,486, compared to $35,408 for the same period of previous year, a decrease of $8,922. Compensation costs were greater in 2013 due to June 17, 2013 modification of the exercise price of 3,525,000 stock options granted between 2009 and 2012.
Share-based compensation costs for the six months ended June 30, 2014 were $67,592, compared to $42,575 for the same period of 2013, an increase of $25,017. The increase was primarily a result of the grant of 1,200,000 stock options to two consulting firms in March 2014. These firms provide consulting services to help Smartcool build strategic alliances with groups interested in participating in market research, product development and distribution for new markets and products. The firms also provide services directed at better communication of Smartcool's strategies and progress.

Capital expenditures

There were no capital expenditures for the three months ended June 30, 2014 (June 30, 2013 - $525). During the six months ended June 30, 2014, the company purchased a vehicle, resulting in capital expenditure of $17,224 (June 30, 2013 - $2,499).

Liquidity and Capital Resources

As at June 30, 2014, the Company had $38,382 in cash and cash equivalents (December 31, 2013 - $28,036). Working capital deficit at June 30, 2014 was $727,525 compared to $674,067 at December 31, 2013.

The Company's net cash flow used in operating activities during the three months ended June 30, 2014 was $385,161, increased by $200,129 or 108% from $185,032 for the same period of 2013. The average monthly burn for the three months was $128,000 compared to $62,000 in the second quarter of 2013. Cash resources consumed in the period were for the financing of operations.

The Company was unable to make debenture and acquisition obligation payments as scheduled. These payments include debenture interest payments totaling $7,223, scheduled for June 1, 2014, two debenture principal payments totaling $60,192, scheduled for March 1 and June 1, 2014, three UK acquisition obligation instalments totaling £45,000 scheduled for Apr 30, May 30 and June 30, 2014. The Company is in the process of renegotiating the terms of these delayed payments. Certain terms of the short-term loan are being negotiated as well.

To ensure that Smartcool continues to be a going concern with adequate working capital in the next 12 months, the Company is planning on obtaining additional capital. A non-brokered private placement has been completed in April 2014 and gross proceeds of $486,500 has been raised.

The timing of future payments related to financial liabilities is outlined in the table below:

	Total	1 year	1-2 years
Trade payables	$ 678,800	$678,800	$-
Premises leases	159,066	115,240	43,826
Short-term loan	65,038	65,038	-
Vehicle loan	10,628	5,314	5,314
Debentures	240,785	240,785	-
Obligations under acquisition contracts	294,003	211,828	82,175
Total	$ 1,448,320	$ 1,317,005	131,315

Outstanding Share Data

The authorized share capital of the Company is an unlimited number of common shares without par value. As at June 30, 2014 the Company had 89,017,297 (December 31, 2013 –

79,287,297) common shares outstanding. The weighted average number of common shares outstanding for the three months ended June 30, 2014 was 86,451,143 (June 30, 2013 – 64,616,967).

As at August 26, 2014 the outstanding shares were 89,017,297 and diluted were 101,695,797.

Warrants and Stock Options

As at June 30, 2014, there were 5,466,000 (December 31, 2013 – 851,000) share purchase warrants and 7,225,000 (December 31, 2013 – 6,435,000) stock options outstanding which collectively could result in the issuance of 12,691,000 common shares if these warrants and stock options are exercised. The outstanding options have a weighted average exercise price of $0.07. The outstanding warrants have weighted average exercise price of $0.11.

As at June 30, 2014 there were 4,925,000 (December 31, 2013 - 4,282,500) exercisable options with a weighted average exercise price of $0.08 (December 31, 2013 - $0.09). During the three months ended June 30, 2014 the Company granted no options (June 30, 2013 – 30,000 with weighted average fair value of $0.05).
As at August 26, 2014, there are 5,466,000 outstanding warrants and 7,212,500 outstanding options. The outstanding options have weighted average exercise price of $0.07.

Intangible Assets

Smartcool UK
On February 28, 2011, the Company acquired all the outstanding shares of the third party distributor Smartcool Systems UK Ltd., which held the exclusive rights for sale of ESM™ products to customers in the UK and Ireland.

In consideration, the Company agreed to pay cash consideration of $4,410,745 (£2,840,438) and non-cash consideration of $227,675 (£143,891) in the form of 1,000,000 share purchase warrants. $2,922,622 (£1,840,438) was paid in cash upon closing. The remaining balance of $1,582,200 (£1,000,000) will be paid in four equal payments quarterly with the last one on March 1, 2012.
Total discounted consideration was $4,638,420 (£2,924,822).

The Company was unable to make payments as scheduled. As at December 10, 2013, principal balance of $1,744,600 (£1,000,000) and accrued interest of $285,274 (£163,517) were outstanding. The Company was able to negotiate a debt reduction; the existing obligation was extinguished and replaced with two new obligations. These new obligations have principal amounts of $130,845 (£75,000), which is non-interest bearing, secured, and will be paid in installments over 6 months, and $53,210 (£30,500), which is non-interest bearing, unsecured, and will be paid in installments over 5 years. Fees of $2,291,510 (£1,300,000) will be payable by the Company if it defaults on any of the prepayment terms with respect to the obligation with a principal amount of £75,000. As at June 30, 2014 three installments totaling £45,000 have not been made as scheduled and the Company is the process of negotiating an extension of the term.

The allocation of the purchase price is based on management's estimates and certain assumptions with respect to the fair value increment associated with the assets acquired and the liabilities assumed. The finalized, discounted purchase price allocation is summarized as follows:

	CAD
Purchase of all outstanding shares of Smartcool	4,410,745
Fair value of warrants issued	227,675
	4,638,420
Allocation of the purchase price	
Net working capital	850,484
Property and equipment	103,230
Distribution rights	2,570,862
Customer relationship	1,058,584
Goodwill	1,213,285
Finance leases	(79,460)
Deferred tax liability	(1,078,565)
	4,638,420

During the year ended December 31, 2013, the useful life of the intangible assets from Smartcool UK was reassessed to be 12 years (2012 – 5 years).

T.E.C.C. Services

On July 11, 2008, the Company formed Smartcool EMEA, which acquired distribution rights for the ESM™ from T.E.C.C. Services Ltd. ("TECC"). TECC held exclusive rights to sell the ESM™ to existing distributors in the United Kingdom, Spain, Portugal, and the Middle East, as well as to develop new distributors in these regions. A consideration of $1,738,750 (£1,035,000) was payable in cash and $532,067 (£265,000) was payable in the form of common shares of the Company. Upon closing, payment of $873,393 (£435,000) was made and 743,709 shares were issued. The remaining balance of $1,204,680 (£600,000) was due in scheduled installments over four years with the last payment due on July 16, 2012. These installments were 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 in 2009 and again in 2012 to accrue interest at Royal Bank of Canada prime rate plus 4% and to adjust timing and amount of repayments.

As at December 10, 2013, the balance of $886,714 (£508,217), including accrued interest of $145,181 (£83,217), was outstanding. The Company was able to negotiate a debt reduction; the existing obligation was extinguished and replaced with two new obligations. These new obligations have principal amounts of $226,798 (£130,000) and $112,527 (£64,500), are non-interest bearing, unsecured, and will be paid in annual installments over 5 years starting December 15, 2014.

During the year ended December 31, 2013, the useful life of the distribution rights from TECC was reassessed to be 9.5 years (2012 – 9 years).

Abbotly Technologies Pty
The Company acquired $2,278,350 of intangible assets in relation to the acquisition of Abbotly Technologies Pty Ltd.

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. As a result of this impairment recognition, the total cost of distribution rights was reduced by $148,799 to $1,835,702. As at March 31, 2014, distribution rights consist of:

ESM™ Distribution agreements	$1,835,702
Other distribution rights	$26,040
Total	**$1,861,742**

During the year ended December 31, 2013, the useful life of the ESM intellectual property was reassessed to be 13.5 years (2012 – 10 years), and the useful life of the worldwide distribution rights to be 13.5 to 15 years (2012 – 10 to 15 years).

No impairments were recorded in 2013 and 2012 and the impairment loss recognized in 2008 was not reversed upon transition to IFRS.

Impairment

Impairment of Long-Lived Assets
Smartcool amortizes long-lived assets over the estimated useful life of the asset. Evaluation of all long-lived assets occurred periodically for impairment in accordance with IAS 36.

Under IFRS, long-lived assets including property and equipment and intangible assets with a finite life are assessed for indications of impairment at the end of each reporting period. If such indications exist, then the recoverable amount of the asset or cash-generating unit ("CGU") is estimated.

An impairment loss is recognized when the carrying amount of the asset or CGU exceeds its recoverable amount. A CGU is the smallest identifiable group of assets that generates cash inflows that are largely independent of cash inflows from other assets or groups of assets. The recoverable amount of an asset or CGU is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and risks specific to the asset or CGU.

Impairment losses are recognized in respect of CGU's are first allocated to reduce the carrying amount of any goodwill allocated to cash generating units, and then to reduce the carrying

amount of the other assets in the unit on a pro-rata basis. Impairment losses are recognized in profit and loss for the period it is identified.

Intangible assets with an indefinite life are reviewed for impairment annually, or more frequently, if events or changes in circumstances indicate that the asset might be impaired. The asset is written down when the carrying amount exceeds its recoverable amount. Goodwill is reviewed for impairment annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired. Impairment is determined by assessing the recoverable amount of the cash-generating unit to which the goodwill relates. Where the recoverable amount of the cash-generating unit is less than the carrying amount, an impairment loss is recognized in the statement of operations.

The Company's definite life intangible assets are ESM™ intellectual property, ESM™ distribution contracts and ESM™ supplier contracts that we acquired from Abbotly USA and Abbotly Technologies Pty, and assets acquired from TECC Services and Smartcool UK. As our revenue is primarily derived from the sales of ESM™ products, revenue associated with the above intangible assets is readily identifiable. Revenue from existing distribution channels is projected based on minimum purchase requirements in conjunction with forecasts provided by the distributors themselves. Revenue expected from potential distribution channels is based on business development progress. Cost of goods sold projections are based on our expected margin and operating costs projections based on 2013 cost structures. The undiscounted cash flows supported the recoverability of our definite life intangible assets.

Impairment of Intangible Assets

On February 28, 2011, the Company acquired $4,842,731 of intangible assets in relation to the acquisition of Smartcool UK as described in note 3 of December 31, 2011 consolidated financial statements.

Management has performed a review of the carrying value of these assets. As discrepancies between revenue projections and actual operating results in 2011 resulting in significant uncertainty in future cash generation of these assets, an impairment loss was recorded for the year based on cash flow projections as at December 31, 2011. The value of goodwill was written off and the other assets were reduced as follows:

	Impairment
Distribution rights-General	$104,919
Distribution rights-Major customer	347,740
Customer relationship	188,484
Goodwill	1,213,285
Total impairment for year ended December 31, 2011	**$1,854,428**

There were no impairment losses recorded for the year ended December 31, 2013 and 2012 and the impairment loss recognized in 2011 was not reversed.

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 $201,953 (US$180,000), 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.

On December 31, 2012, the Company decided that the distribution agreement, expiring on March 6, 2013, will not be renewed under the terms set out in the existing agreement.

During the year ended December 31, 2013, management performed a review of the carrying value of these assets and an impairment loss of $Nil (2012 - $83,787) was recognized.

Critical Accounting Policies & Estimates

Business combinations

The identifiable assets, liabilities and contingent liabilities of a subsidiary, joint venture entity or an associate, which can be measured reliably, are recorded at their provisional fair values at the date of acquisition. Goodwill is the fair value of the consideration transferred (including contingent and previously held non-controlling interests) less the fair value of the Company's share of identifiable net assets on acquisition. Transaction costs incurred in connection with the business combination are expensed. Provisional fair values are finalized within twelve months of the acquisition date.

Where the fair value of the identifiable net assets acquired exceeds the cost of the acquisition, the surplus, which represents the discount on the acquisition, is recognized directly in the statement of operations and total comprehensive loss in the period of acquisition.

Revenue Recognition

Revenue from the sale and installation of the ESM™ and ECO3™ is recognized when the ESM™ & ECO3™ have been installed, significant risks and rewards of ownership of the equipment have been transferred to the customer, the Company does not retain continuing managerial involvement or effective control over the equipment, the sales price can be determined and probably collectible, and the cost of the transaction can be measured reliably.

Revenue from the international distribution of the ESM™ & ECO3™ is recognized when the equipment has been shipped, title has been transferred, the sales price has been determined and the cost of the equipment can be measured reliably. Revenue is also recognized when equipment has been ordered and laid away as instructed by the customer, the sales price has been determined and a significant portion of it has been paid. Provisions are established for

estimated warranty costs at the time revenue is recognized. The Company records deferred revenue when cash is received in advance of the above revenue recognition criteria being met.

Share-based Payments

The fair value of all stock options granted to employees is determined using the Black-Scholes option pricing model, and the resulting value is charged to operations over the vesting period.

The fair value of options granted to non-employees is determined using fair value of the goods or services received. The resulting value is charged to operations when a performance commitment is made or the options are fully vested and non-forfeitable, whichever is earliest, and the expense is recognized over the period in which the goods or services from the non-employees are received. A corresponding increase in equity reserve is recorded when stock options are expensed. When stock options are exercised, share capital is credited by the sum of the consideration paid and the related portion previously recorded in equity reserve. At the time of grant, the expense is determined based on estimated forfeiture rate. The expense will be adjusted to recognize the effect of actual forfeitures as they occur.

The fair value of warrants issued to agents for their finder's fee is determined using the Black-Scholes option pricing model and the resulting value is charged to share issuance costs.

Intangible assets

Intangible assets are recorded at cost and include the ESM™ brand, ESM™ intellectual property, distribution agreements, supplier agreements and customer relationship. The ESM™ brand has been determined to have an indefinite life and is not amortized. The remaining intangible assets with finite lives are amortized on a straight-line basis. During the year ended 31 December 2013, management re-assessed the useful lives of the remaining intangible assets as follows:

	2013	2012
ESM™ Intellectual property	13.5 years	10 years
North American distribution rights	10 years	10 years
TECC and United Kingdom distribution rights	9.5 - 12 years	5 - 9 years
Distribution agreements	13.5 - 15 years	10 - 15 years
Supplier agreements	13.5 years	10 years
Customer relationship	12 years	5 years

Total amortization for the quarter ended June 30, 2014 of $170,240 (June 30, 2013 - $245,410) was included under net income (loss) for the year on the statement of operations.

Use of estimates and judgments

The preparation of these consolidated financial statements in accordance with IFRS requires the use of certain critical accounting estimates and assumptions. It also requires management to exercise judgment in applying the Company's accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are outlined below. Actual results may differ from those estimates.

Significant estimates are used for, but not limited to, assessment of impairment of intangible assets and recoverability of long-lived assets, determination of present value of obligations under acquisition contract, determination of fair value of debentures, valuation of stock options and warrants, recoverability of trade and other receivables, inventory valuation, determination of valuation allowance for income tax assets, amortization rates and methods and ability to continue as a going concern.

Judgments made by management in the application of IFRS that have a significant effect on the consolidated financial statements and estimates with a significant risk of material adjustment in the current and following fiscal years are discussed below:

- Useful lives – the useful lives of intangible assets and the related depreciation
- Impairment – the assessment of impairment of intangible assets and goodwill
- Inventory valuation – the provision for obsolescence of inventory and net realizable value
- Receivable valuation – the recoverability of trade receivables
- Share-based payments – the inputs used in accounting for share-based payments
- Debentures – discount rate used in fair value calculation of the debentures
- Contingencies – any future contingencies and commitments
- Going concern – the assessment of the Company's ability to continue as a going concern

Changes in accounting policies

A number of standards and amendments were issued effective for accounting periods beginning on or after January 1, 2014. Many of these updates are not applicable to the Company. As of January 1, 2014, the Company adopted the following IFRS standards and amendments:

- Amendments to IAS 32 - Offsetting Financial Assets and Financial Liabilities clarifies that an
  entity currently has a legally enforceable right to set-off if that right is:
  a) not contingent on a future event; and
  b) enforceable both in the normal course of business and in the event of default, insolvency or bankruptcy of the entity and all counterparties.

- IFRS 10 (Amendment), "Consolidated Financial Statements" includes an exception to specific consolidation requirements for investment entities.

The adoption of the above standards did not have a significant impact on the Company's consolidated financial statements.

Accounting Standards Issued but not yet Effective

At the date of authorization of these consolidated financial statements, the IASB and IFRIC have issued the following new and revised standard and amendments which are not yet effective:

- IFRS 9, "Financial Instruments", is a new financial instruments standard effective for annual periods beginning on or after January 1, 2015 that replaces IAS 39 and IFRIC 9 for classification and measurement of financial assets and financial liabilities.
  IFRS 9 was amended in November 2013, to include guidance on hedge accounting, allow entities to early adopt the requirement to recognize changes in fair value attributable to changes in an entity's own credit risk in other comprehensive income without having to adopt the remainder of IFRS 9, and to remove the previous mandatory effective date for adoption of January 1, 2015. The new mandatory effective date will be determined once the classification and measurement and impairment phases of IFRS 9 are finalized. In February 2014, the IASB tentatively decided that IFRS 9 would be mandatorily effective for fiscal years beginning on or after January 1, 2018.

- IFRS 15 – Revenue from Contracts with Customers. This standard replaces IAS 11 Construction Contracts, IAS 18 Revenue, IFRIC 13 Customer Loyalty Programmes, IFRIC 15 Agreements for the Construction of Real Estate, IFRIC 18 Transfer of Assets from Customers, and SIC 31Revenue – Barter Transactions Involving Advertising Services.
  IFRS 15 contains a single model that applies to contracts with customers and two approaches to recognizing revenue: at a point in time or over time. The model features a contract-based five-step analysis of transactions to determine the timing and amount of revenue recognized. The new standard applies to contracts with customers. It does not apply to insurance contracts, financial instruments or lease contracts, which fall in the scope of other IFRSs. The new standard is effective for fiscal years ending on or after December 31, 2017 and is available for early adoption.

Off-balance sheet arrangements

The Company has no off-balance sheet arrangements that would require disclosure.

Forward-looking statements

This MD&A contains forward-looking information and statements regarding the future results of operations and marketing activities. Forward-looking statements generally can be identified by the use of forward-looking terminology such as “may”, “will”, “expect”, “intend”, “anticipate”, “plan”, “foresee”, “believe” or similar terminology. Although these forward-looking statements are based on what management believes to be current and reasonable assumptions, they involve known and unknown risks, uncertainties and other factors that may cause the actual results and performance to differ materially from those stated, anticipated, or implied in these forward-looking statements. Readers are cautioned not to place undue reliance on forward-looking information as no assurances can be given to future results, performances, or achievements.

The forward-looking statements included in this MD&A speak only as of the date of this document. The Company does not undertake any obligation to publicly update or revise any of these forward-looking statements to reflect events or circumstances after this date except when required by applicable legislation.

Additional Information

Additional information relating to the Company, including the Company’s latest Annual Financial Statements and news releases can be located on the Company’s website at www.smartcool.net or on the SEDAR website at www.sedar.com.