MANAGEMENT'S DISCUSSION & ANALYSIS

For the Fiscal Year Ended May 31, 2014

Introduction

This Management Discussion and Analysis (MD&A) explains the material changes in Thermal Energy International Inc.'s ("Thermal Energy" or the "Company") financial position and results of operations for the fiscal year ended May 31, 2014 (or "FY 2014"), and compares the FY 2014 financial results to the previous year ended May 31, 2013 (or "FY 2013"). The consolidated financial statements and notes to the consolidated financial statements constitute an integral part of the discussion and should be read in conjunction with this MD&A. Unless otherwise indicated, all comparisons to the fourth quarter of FY 2014 are against the fourth quarter of FY 2013. Additional information relating to the Company is available on SEDAR at www.sedar.com.

Currency

All financial information in this report is stated in Canadian Dollars, which is both the presentation and functional currency of the Company. Approximately 55% of our operations, assets and liabilities are denominated in British Pound Sterling. As such, foreign currency fluctuations affect the reported values of individual lines on our statement of financial position and income statement. When the Canadian dollar strengthens, the reported values decrease and the opposite occurs when the Canadian dollar weakens.

Review and Approval by the Board of Directors

The Board of Directors, on recommendation of the Audit Committee, approved the content of this MD&A on September 23, 2014. Disclosure contained in this document is current to this date, unless otherwise stated.

Forward-Looking Statements

This MD&A may include statements that are forward-looking. These statements are not guarantees of future performance and are subject to risks and uncertainties that could cause actual results to differ materially from those in the forward-looking statements. We discuss the principal risks of our business in Section 7 of this MD&A. We cannot provide any assurance that forecasted financial or operational performance will actually be achieved. If it is achieved, we cannot provide assurance that it will result in an increase in our share price. See Section 8 entitled "Forward-Looking Information".

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1. Our Business

1.1 Company Overview

Thermal Energy, established in 1991, is an innovative cleantech company and a global provider of proprietary and proven energy and water efficiency and emission reduction products and solutions to the industrial, commercial and institutional markets. The Company is headquartered in Ottawa, Canada, with offices in the U.K., Italy, U.S., China and sales worldwide.

Thermal Energy engages clients through a unique mix of process, energy, environmental and financial expertise to save our customers money and improve their bottom lines by reducing their fuel use and carbon emissions. The Company's award winning products have an excellent track record of longevity, proven reliability and performance and have been shown to provide: significant energy savings; improved water efficiency; reduced greenhouse gas emissions; lower maintenance costs; improved product quality; and increased production efficiency. Thermal Energy's products are effective in a wide range of industries and applications.

More information on Thermal Energy can be found at www.thermalenergy.com. **GEM®, FLU-ACE®, THERMALONOx™**, and **DRY-REX™** are trademarks of Thermal Energy.

1.2 Core Businesses

The Company operates in the energy efficiency industry in North America, Europe, China and the rest of the world. The Company markets, sells, engineers, fabricates, constructs, installs and supports two technology lines – heat recovery solutions (**FLU-ACE®**) and condensate return system solutions (GEM® steam traps). The Company is also developing a third technology line - low temperature biomass drying systems (**DRY-REX™)**.

Before 2007, the Company concentrated mainly on the selling of heat recovery systems but had begun selling GEM® product through a distribution agreement with Gardner Energy Management Limited, based in the U.K. In 2008, the Company acquired Gardner Energy Management Limited, which sells the GEM® product throughout the world. As part of this transaction, the Company also acquired the 67% share of GEMchem Ltd, a UK-based water treatment company providing services within the UK only.

The acquisition of Gardner Energy Management Limited resulted in the Company having two primary operational bases, one in Ottawa, Canada covering North America and China, and the other in Bristol, United Kingdom, covering Europe and the rest of the world. Although the Ottawa base is deemed to be the centre of excellence for the heat recovery side of the business, and Bristol the center of excellence for condensate return system solutions, continuous cross-training means that both bases have expertise across both major product lines.

Although the Company markets its products throughout the world, the majority of sales are from within North America and Europe, due to the proximity to the Company's bases. While this continues to be the key focus, the Company also continues to look for new distributors in regions deemed to have potential.

1.3 Strategy

The Company's mission is to be a best-in-class provider of return on investment-driven thermal energy efficiency technology and solutions to the industrial, institutional, and commercial sectors, helping our clients around the world improve their bottom line, move towards sustainable operations and reduce their environmental and carbon foot print. The Company's products and services are "best-in-class" with world-wide application in a broad range of sectors.

The Company has representation in 28 countries around the world but our current focus is on the key markets of North America, Europe and the Middle East. Despite significant growth over the last few years, Thermal Energy's penetration in these markets remains low and therefore the Company plans to continue growing our sales and distribution capabilities in these markets while at the same time begin to build our business in other energy-intensive markets around the world.

We have sold our proprietary and proven products to hundreds of companies and institutions, including approximately 50 large multinational companies in the pharmaceutical, food and beverage, pulp and paper, chemical and petrochemical sectors. So far the Company has only partially penetrated 100 of the more than 2,000 global sites of these multi-national companies. Thermal Energy has executed a corporate-wide global roll-out of our product with two of these multi-national companies and is currently working with additional companies with the goal of executing similar corporate roll-outs.

With a global sales and distribution network the Company also has the opportunity to introduce new synergistic products and services, and acquire complementary products and businesses that can be distributed through our existing network.

Finally, the Company is also developing a number of recurring revenue streams such as rental and shared savings programs as well as service and maintenance programs.

2. Performance Measures

The Company believes the following performance measures provide useful information to both management and investors to better understand the financial performance and financial position of the Company.

2.1 Adjusted Operating Cash Flow

Adjusted operating cash flow (defined as income (loss) for the period, plus items not involving cash but excluding any changes in working capital items, plus finance lease payments received) is a performance measure used to gauge the cash generating capability of the Company. The impact changes in working capital items has on cash balances is excluded from the calculation of operating cash flow because changes in working capital items are usually only temporary and can fluctuate significantly from period to period and therefore are not a good indicator of the Company's longer term cash generating capabilities.

It is important to note that cash flow is not the same as net income, which includes transactions that did not involve actual cash outflows and excludes some transactions that did involve actual cash inflows. The calculation of adjusted operating cash flow starts with net income as identified in the Consolidated Statements of Comprehensive Income and then adds or subtracts a number of items identified in the Statement of Cash Flows. Adjusted operating cash flow does not have a standardized meaning prescribed by generally accepted accounting principles or International Financial Reporting Standards and therefore may not be comparable to similar measures presented by other companies. The most directly comparable measure calculated in accordance with generally accepted accounting principles within the financial statements is net cash provided (used) in operating activities, as disclosed in the statement of cash flows.

2.2 EBITDAS

Management believes that EBITDAS (earnings before interest, taxation, depreciation, amortization, impairment of goodwill and other intangible assets, share-based compensation expense and net write down of lease) is a useful performance measure as it approximates cash generated from operations, before tax, capital expenditures and changes in working capital and excludes non-operating items. EBITDAS also assists comparison among companies as it eliminates the differences in earnings due to how a company is financed. EBITDAS does not have a standardized meaning prescribed by generally accepted accounting principles or International Financial Reporting Standards and therefore may not be comparable to similar measures presented by other companies. . The most directly comparable measure calculated in accordance with generally accepted accounting principles within the financial statements is income (loss) before income taxes, as disclosed in the statements of comprehensive income.

2.3 Order Backlog

Order backlog is a useful performance measure that Management uses as an indicator of the short term future revenue of our Company resulting from already recognized orders. However, there is no comparable IFRS financial measure for order backlog. The Company includes in "order backlog" any purchase orders that have been received by the Company but have not yet been reflected as revenue in the Company's published quarterly financial statements. Order backlog does not have a standardized meaning prescribed by generally accepted accounting principles or International Financial Reporting Standards and therefore may not be comparable to similar measures presented by other companies

3. Performance

3.1 Summary of Fourth Quarter Results

	Q4 2014	Q4 2013
	$	$
Revenue	**4,717,007**	1,879,450
Cost of Sales	**(1,979,439)**	(1,133,092)
Gross Profit	**2,737,568**	746,358
Administration, selling, marketing and business development expenses	**(1,959,732)**	(1,282,528)
Research and development expenses	**(111,546)**	(19,865)
Operating income (loss) before impairment	**666,290**	(556,035)
Impairment	**-**	(2,305,000)
Operating income (loss)	**666,290**	(2,861,035)
Finance Revenue	**29,705**	51,452
Income (loss) before income taxes	**695,995**	(2,809,583)
Income taxes (expense) recovery	**1,403**	123,027
Net income (loss) for the period	**697,398**	(2,686,556)
Exchange differences on translation of overseas operations	**(49,356)**	30,612
Total comprehensive income (loss) for the period	**648,042**	(2,655,944)

Revenues and Gross Profits

Revenues were $4,717,007 in the quarter ended May 31, 2014, representing an increase of $2,837,557, or 151%, compared to $1,879,450 in the quarter ended May 31, 2013. Sales of heat recovery systems increased by $2,164,249 (167.7%) over the same period in the previous year, while sales of GEM® Condensate return systems increased by $673,308 (114.4%).

Revenues from sales of heat recovery systems in the current quarter included projects at two sites of a major Fortune 500 food and beverage company, as announced September 16, 2013, the substantial completion of an installation at a major pulp and paper company as announced June 3, 2013, plus two hospital conversions and an equipment sale to a global diversified mining and materials company, as announced December 18, 2013. This compared to one site conversion for the same major Fortune 500 food and beverage company, the conversion of a site at another major food and beverage company, plus one hospital conversion in the previous year.

GEM® Condensate return system sales for the final quarter of FY 2014 increased over the same period of the previous year due mainly to the fulfilment of two orders received from a global diversified healthcare company, as announced February 18, 2014 and May 12, 2014, plus a further site conversion of a Fortune 500 food and beverage company, as well as increased sales across the rest of the world.

The gross profit of $2,737,568 in the quarter ended May 31, 2014 represented an increase of $1,991,210, or 266.8%, from the $746,358 achieved in the quarter ended May 31, 2013. This increase was the result not only of higher revenues, but also increased margins on heat recovery projects in the current period. These results expressed as a percentage of sales were 58.0% in the final quarter of FY 2014 compared with 39.7% in the final quarter of FY 2013.

Expenses

Administration, selling, marketing and business development expenses in the quarter ended May 31, 2014 totaled $1,959,732 compared with $1,282,528 in the quarter ended May 31, 2013, an increase of $677,204. This increase was predominantly the result of commissions on the increased revenues, plus recruitment costs and travel expenses of additional sales and marketing staff, and staff incentive, as well as reduced foreign exchange gains resulting from the strengthening of Sterling against the Canadian Dollar. These cost increases were partially offset by $nil amortization of intangible assets which were fully amortized in the first quarter of FY 2014.

Research and development costs of $111,546 in the final quarter of FY 2014 compared to net costs of $19,865 in the final quarter of FY 2013. The final quarter of the prior year saw the receipt of a credit of $58,042 relating to government funding through ISTP Canada. No such credit was received in the current period. The Company had previously received an offer of government funding through ISTP Canada, as announced February 8, 2012. The funding agreement was signed by both parties on January 21, 2013. Funding is credited to research and development costs when it is received.

Impairment of goodwill in the final quarter of FY 2014 was $nil, compared to $2,166,000 in the same period of the prior year. The prior year charge resulted from lower revenues over the prior two years caused by a re-organization of the UK based sales group, including two key UK sales managers relocating to North America, plus the global recession which continues to impact the European economy particularly hard. The annual impairment test which was conducted at the end of FY 2014 revealed that no further impairment has arisen, due to improved revenues and a stable sales force across the UK and North America.

Impairment of intangible assets in the final quarter of FY 2014 was $nil compared to $139,000 in the final quarter of FY 2013. The intangible assets are specifically Names and Trademarks relating to the GEM® product. As with the goodwill impairment, the impairment charge in the prior year was the result of lower revenues over the preceding two years caused by a re-organization of the UK based sales group plus the global recession which continued to impact the European economy particularly hard. The annual impairment test which was conducted at the end of FY 2014 revealed that no further impairment has arisen, due to improved revenues and a stable sales force across the UK and North America.

Finance revenue in the fourth quarter of FY 2014 of $29,705 compared to $51,452 recognized in the fourth quarter of FY 2013. The interest rate implicit in the lease of 14.3% is applied against the reducing finance lease receivable balance, hence lower finance revenues as the term of the agreement progresses.

Income before income taxes for the quarter ended May 31, 2014 was $695,995 compared to a loss of $2,809,583 in the same quarter of the previous year. The loss in the final quarter of the previous year included a combined expense of $2,305,000 relating to impairment of goodwill and intangible assets. The rest of the improvement in income before taxes was a direct result of the increased revenues, allowing for the staff incentive.

Income tax recovery in the fourth quarter of FY 2014 was $1,403, compared to a recovery of $123,027 in the fourth quarter of FY 2013. This was the result of much improved operations within the UK entity in the final quarter of FY 2014.

Net income for the fourth quarter of FY 2014 was $697,398 compared to a net loss of $2,686,556 in the same quarter of the previous year.

Comprehensive income was $648,042 for the final quarter of FY 2014 compared to a loss of $2,655,944 for the final quarter of FY 2013.

3.2 Review of Year End Results

Revenues and Gross Profits

Revenues were $13,150,810 in FY 2014 compared to $8,210,234 in FY 2013, an increase of $4,940,576, or 60.2%. Sales of heat recovery systems increased in the year by $3,651,112 (77.4%), while sales of GEM® Condensate return systems increased by $1,289,464 (36.9%).

The $8,369,102 heat recovery systems revenues achieved in FY 2014 includes revenues from projects at two sites of a major Fortune 500 food and beverage company, as announced September 16, 2013, plus the substantial completion of an installation at a major pulp and paper company as announced June 3, 2013, as well as revenue from projects at three major hospitals. Other than three hospital sales in the previous year plus the extension of the Greenpower Purchase Agreement with Fortress Specialty Cellulose, as announced November 29, 2012, there were no significant projects similar to those mentioned above.

GEM® Condensate return systems sales in FY 2014 were $4,781,708 compared to $3,492,244 in FY 2013. The increase resulted from the fulfilment of orders received from a major food and beverage manufacturer, as announced July 3, 2013; a global premium beer company, as announced February 10, 2014; a global diversified healthcare company, as announced February 18, 2014 and May 12, 2014; and a Fortune 500 food and beverage company, as announced September 13, 2013, as well as general increases throughout the rest of the world.

The gross profit of $6,973,620 in FY 2014 represents an increase of $1,996,168, or 40.1%, from the $4,977,452 achieved in FY 2013. These results expressed as a percentage of sales were 53.0% in FY 2014 compared with 60.6% in FY 2013. The higher gross profit as a percentage of sales in the previous year was due to the recognition of the lease agreement extension with Fortress Specialty Cellulose, which carried very little cost. Heat recovery margins overall were improved in the current year over previous years.

Expenses

Administration, selling, marketing and business development expenses in FY 2014 totaled $6,186,962, compared to $5,637,392 in FY 2013. This increase of $549,570, or 9.7%, was predominantly due to commissions on the increased revenues, plus recruitment costs and travel expenses of additional sales and marketing staff, as well as staff incentive. These cost increases were partially offset by savings in staff training, investor relations costs, legal costs and the amortization of intangible assets which are now fully amortized, as well as foreign exchange gains resulting from the strengthening of Sterling against the Canadian Dollar.

Research and development costs in FY 2014 totaled $211,917 compared to $184,388 in FY 2013. The ISTP project, which commenced in January 2013, as announced February 2012, continued throughout the current year, as well as various smaller projects developing complementary products to our existing portfolio. During the current year, the company received government funding of $61,689 towards the ISTP project as well as a $56,875 SR&ED credit. Funding is credited to research and development costs when it is received.

Finance revenue in FY 2014 was $133,678, an increase of $25,222 over the $108,456 received in FY2013. The increase followed the extension to the lease agreement with Fortress Specialty Cellulose which was effected part way through FY 2013.

Impairment of goodwill in the year ended May 31, 2014 was $nil, compared to $2,166,000 in the year ended May 31, 2013. The prior year charge resulted from lower revenues over the prior two years caused by a re-organization of the UK based sales group, including two key UK sales managers relocating to North America, plus the global recession which continued to impact the European economy particularly hard throughout FY 2013. The annual impairment test which was conducted at the end of FY 2014 revealed that no further impairment has arisen, due to improved revenues and a stable sales force across the UK and North America.

Impairment of intangible assets in the year ended May 31, 2014 was $nil compared to $139,000 in the year ended May 31, 2013. The intangible assets are specifically Names and Trademarks relating to the

GEM® product. As with the goodwill impairment, the impairment charge in the prior year was the result of lower revenues over the preceding two years caused by a re-organization of the UK based sales group plus the global recession which impacted the European economy particularly hard. The annual impairment test which was conducted at the end of FY 2014 revealed that no further impairment has arisen, due to improved revenues and a stable sales force across the UK and North America.

Income before income taxes for the fiscal year ended May 31, 2014 was $708,419 compared to a loss of $3,040,872 for the fiscal year ended May 31, 2013. The improvement of $3,749,291 is the result of the increased revenues in the year along with no impairment charges relating to goodwill and intangible assets.

Income tax charge in the FY 2014 was $74,396 compared to a recovery of $192,050. This increase in tax expense is the direct result of much improved operations in the UK entity compared to FY 2013.

Net income for FY 2014 was $634,023 compared to a net loss in the year ended May 31, 2013 of $2,848,822.

Comprehensive income was $978,267 compared to a comprehensive loss in the year ended May 31, 2013 of $2,895,746. In addition to the improved performance of the company, as detailed above, the strengthening of the UK Pound Sterling against the Canadian Dollar gave rise to an exchange gain on translation of overseas operations of $344,244 in the current year, compared to a loss of $46,924 in the previous year.

Liquidity & Capital Resources

The working capital was $2,770,280 at May 31, 2014 compared to working capital of $1,552,021 at May 31, 2013 – an increase of $1,218,259, with the Company's net cash position (Cash and cash equivalents less Bank loans) increasing by $742,022 from $1,304,395 at May 31, 2013 to $2,046,417 as at May 31, 2014.

The Company's working capital position over the last eight quarters can be summarized as follows:

	Aug 31, 2012 $	Nov 30, 2012 $	Feb 28, 2013 $	May 31, 2013 $	Aug 31, 2013 $	Nov 30, 2013 $	Feb 28, 2014 $	May 31, 2014 $
Current Assets	4,534,637	3,814,265	4,537,306	3,642,680	3,604,594	6,184,899	5,729,213	5,273,288
Current Liabilities	2,800,733	2,770,537	2,761,564	2,090,659	2,199,528	4,361,002	3,899,718	2,503,008
Working Capital	1,733,904	1,043,728	1,775,742	1,552,021	1,405,066	1,823,897	1,829,495	2,770,280

FY 2014 Changes

Current assets increased in FY 2014 by $1,630,608 to $5,273,288. Cash increased by $742,022, while trade receivables increased by $631,017 mainly as a result of GEM shipments dispatched towards the end of the year, May 2014 invoicing relating to the heat recovery project at the pulp and paper mill, plus the strengthening of the British pound against the Canadian dollar. Unbilled receivables increased by $156,888 due to timing of billing on contracts and prepayments and other miscellaneous receivables increased by $108,587 due mainly to sales tax receivable in the UK. Current liabilities meanwhile increased by $412,349 to $2,503,008, mainly due to increases in accounts payable of $237,161 predominantly relating to the heat recovery project at the pulp and paper mill and accruals of $444,910 including increased UK commissions payable and the staff incentive provision. These increases were partially offset by a decrease of $189,971 in other government remittances payable, which included UK sales taxes payable in May 2013 of $210,350 relating to heat recovery invoices raised in the last quarter of the year, plus smaller decreases in finance lease payable, deferred revenue, current tax liabilities and pensions and other employers obligations totaling $79,751.

As at May 31, 2014, $100,984 (6.4%) of the Company's trade receivables balance was over 90 days past due. None of the overdue balance is considered impaired as at May 31, 2014.

At May 31, 2014, the Company has operating lease commitments as shown below. The Company had no purchase obligations:

	Total $	Less than 1 year $	1-5 years $	More than 5 years $
Operating Leases	426,161	142,738	283,423	nil

Net cash provided by operating activities in the year ended May 31, 2014 was $462,689. Net cash provided by investing activities of $386,903 comprised $441,562 finance lease principal payments received less $54,659 paid for additions to property, plant and equipment, mostly computer equipment and portable equipment for analysis of steam systems. A total of $115,620 was used in investing activities, for the repurchase of Class A common shares under the Normal Course Issuer Bid, as announced October 28, 2013. After allowing positive $8,050 for the effect of exchange rate fluctuations on cash and cash equivalents, the net result of the above activities was an increase in cash balance of $742,022.

Adjusted operating cash inflow (defined as net income or loss attributable to the owners of the parent, plus items not involving cash, after net tax and interest cash inflows or outflows, plus finance lease payments received) for the year ended May 31, 2014 was $1,349,123. After adjusting this for $444,872 of negative changes in non-cash working capital items, foreign exchange adjustments and other non-cash equity items, and deducting $54,659 for the purchase of fixed assets, and $115,620 used for the repurchase of Class A common shares, and adding $8,050 to allow for the effect of exchange rate fluctuations on cash and cash equivalents, the net cash inflow was $742,022, increasing the net cash balance as at May 31, 2014 to $2,046,417 from $1,304,395 as at May 31, 2013.

In addition to its net cash balance of $2,046,417 as at May 31, 2014 the Company also had an estimated $186,000 of unused borrowing capacity under its bank loans. With cash balances and unused borrowing capacity of approximately $2,232,417, management believes that it has sufficient capital resources to fund existing operations and anticipated capital requirements in FY 2015. Order backlog as at May 31, 2014 was approximately $1.8 million compared to $1.4 million at the same time last year. As at September 23, 2014, the Company had $3.9 million in purchase orders that had not yet been reflected as revenue in the Company's published quarterly financial statements.

The Company's ability to realize its assets and discharge its liabilities depends on any combination of the following: the continued financial support of its shareholders, its ability to arrange long-term financing and its ability to generate sufficient cash from operations. No assurance can be given that any such additional funding will be available or that, if available, it can be obtained on terms favorable to the Company.

Management is concentrating on building upon the revenue growth experienced in years FY 2010 through to FY 2014 and continuing to manage expenditures in order to produce positive cash flows from operations in order to meet the Company's obligations. The Company earned an income from operations in the year ended May 31, 2014.

A reconciliation of Net cash provided (used) in operating activities to adjusted operating cash flow is shown below:

	2012 $	2013 $	2014 $
Net cash provided (used) in operating activities	(115,205)	(763,924)	462,689
Changes in working capital	427,883	(1,332,548)	444,872
Finance lease principal payments received	554,076	712,213	441,562
Adjusted operating cash flow	866,754	(1,384,259)	1,349,123

Net Investment in Lease

The Company's net investment in lease includes the following:

	May 31, 2014 $	May 31, 2013 $
Total estimated minimum lease payments receivable	962,274	1,507,952
Less: unearned income	(57,235)	(161,351)
	905,039	1,346,601
Less: current portion	(765,509)	(761,404)
	139,530	585,197

Finance lease receivable relates to one arrangement. The estimated minimum lease payments receivable in this lease represent the estimated monthly energy outputs of the leased asset and are based on assumptions regarding the efficiency of the asset, the operations of the plant in which it is located and penalty payments resulting from temporary plant shut-downs. On December 31, 2012, the lease with Fortress Specialty Cellulose, as signed on June 29, 2010, expired. On November 27, 2012, an agreement was signed whereby the customer agreed to purchase the recovered energy for a further two years, after which the customer has the option to renew for an additional 24 months on substantially the same terms or purchase the asset from the Company. This new agreement was recorded in accordance with the previous lease, resulting in an increase to net investment in lease of $1,546,318. In subsequent periods, until the expiry of the new lease on December 31, 2014, finance revenue will be recognized within the income statement at the interest rate implicit in the lease.

On December 22, 2013, the site commenced a market downtime for a period of ten weeks, following the imposition of an interim duty in China on the import of Canadian dissolving pulp, further to which on April 11, 2014, an agreement was made to further extend the existing lease by five months to May 2015, in order to ensure both continued savings for the customer and total payments to the Company as defined within the previous extension

Future estimated minimum lease payments receivable, and expected residual value of equipment at the end of the lease, under the sales-type lease are as follows:

	$
Less than one year	822,744
Between two and five years	-
Residual value of equipment	139,530
	962,274

The estimated residual value of the equipment at the end of the new lease has been determined by assigning depreciation rates to various pieces of the equipment in order to derive a reasonable expected selling price or re-use value for the equipment upon the termination of the agreement. The residual value of the equipment is not guaranteed.

Related Party Transactions

Options outstanding for Directors (excluding the CEO) as at May 31, 2014 were 1,500,000 of which 833,333 were exercisable. There were no warrants outstanding for Directors.

Options outstanding for Senior Management (including the CEO) as at May 31, 2014 were 10,379,360 of which 5,435,000 were exercisable. There were no warrants outstanding for Senior Management.

Directors and Senior Management Compensation

During the year ended May 31, 2014 compensation arrangements for directors was as follows:

$15,000 per annum per Director plus an additional $9,000 per annum payable to the Chairman of the Board, $6,000 per annum payable to the chairperson of the Audit Committee and $1,000 payable for each in-person meeting.

During the year ended May 31, 2014 Directors fees paid were $90,000. Fees to the Chairperson of the Audit Committee were $6,000; fees paid to the Chairman were $9,000; and a total of $32,000 was paid for in-person meetings.

Compensation paid to directors and officers during the year ended May 31, (inclusive of the amounts described above but excluding stock based compensation) was as follows:

	Salaries and fees		Incentives		Other short-term benefits		Total	
	2014	2013	**2014**	2013	**2014**	2013	**2014**	2013
	$	$	**$**	$	**$**	$	**$**	$
Directors								
M. Williams	**28,000**	27,804	**-**	-	**-**	-	**28,000**	27,804
J. Ansell	**-**	12,214	**-**	-	**-**	-	**-**	12,214
J. Kelly	**31,000**	32,203	**-**	-	**-**	-	**31,000**	32,203
D. Gibbs	**19,000**	22,003	**-**	-	**-**	-	**19,000**	22,003
W. Ollerhead	**21,000**	22,003	**-**	-	**-**	-	**21,000**	22,003
B. Linton	**19,000**	11,993	**-**	-	**-**	-	**19,000**	11,993
J. Schoenmakers	**19,000**	11,993	**-**	-	**-**	-	**19,000**	11,993
Total	**137,000**	140,213	**-**	-	**-**	-	**137,000**	140,213
Senior Management								
W. Crossland	**240,000**	240,000	**51,917**	-	**3,705**	3,309	**295,622**	243,309
J. Flynn	**142,661**	126,556	**28,285**	-	**26,439**	20,483	**197,385**	147,039
R. Triebe	**149,220**	139,051	**28,285**	-	**7,176**	5,955	**184,681**	145,006
S. Mawby	**140,075**	117,773	**28,285**	-	**26,005**	18,155	**194,365**	135,928
M. Francoeur	**111,395**	108,938	**28,285**	-	**4,289**	4,096	**143,969**	113,034
G. Bailey (left Jan 2014)	**89,931**	117,773	**-**	-	**11,831**	18,155	**101,762**	135,928
Total	**873,282**	850,091	**165,057**	-	**79,445**	70,153	**1,117,784**	920,244
Total Related Party Transactions	**1,010,282**	990,304	**165,057**	-	**79,445**	70,153	**1,254,784**	1,060,457

Other short-term benefits include cash payments for social security costs, employee benefits, and payments made into defined contribution pension plans of the Company's UK based subsidiaries.

Normal Course Issuer Bid

On October 28, 2013, the Company announced its intent to conduct a Normal Course Issuer Bid ("NCIB"). The NCIB was approved by the TSX Venture Exchange on October 30, 2013. During the 12-month period commencing October 31, 2013 and ending October 31, 2014, the Company may purchase on the TSX up to 13,513,869 common shares, representing approximately 10% of the then issued and outstanding common shares. The actual number of common shares purchased, if any, and the timing of such purchases will be determined by the Company by considering market conditions, share prices, its cash position, and other factors.

In the year ended May 31, 2014 the Company purchased 2,060,000 common shares for a total purchase price of $115,620.

Segmented Information

In the years ended May 31, 2014 and May 31, 2013, the Company operated in the energy efficiency industry in North America, Europe, China and the rest of the world. The Company markets, sells, engineers, fabricates, constructs, installs and supports two technology lines – heat recovery solutions and condensate return system solutions. The Company is also developing a third technology line - low temperature biomass drying systems. Assets are located in Canada, Europe and China.

Management reporting comprises analysis of revenue and gross profit by product segment within two distinct geographical areas. All other items of revenue and expenses are considered on a geographical and/or global basis in making strategic decisions regarding the Company's future. The Company has two operational bases ("reporting units"), one in Canada covering North America and China, and the other in Bristol, United Kingdom, covering Europe and the rest of the world. These areas are determined by proximity of the region to the reporting unit, plus the location of the contracts in existence with agents and distributors in the respective areas and the historical relationships with those agents and distributors. Corporate costs that cannot easily be attributed to either of the two reporting units are included in reconciling items. The chief operating decision maker focuses on revenues and costs by geographical segments, but manages assets and liabilities on a global basis.

Segment information for the year ended May 31, 2014 and the comparative period are detailed in the table below.

	North America and China		Europe and Rest of World		Reconciling Items		Total	
	2014	2013	**2014**	2013	**2014**	2013	**2014**	2013
	$	$	**$**	$	**$**	$	**$**	$
Total revenue from external customers	**6,487,172**	3,124,092	**6,663,638**	5,086,142	**-**	-	**13,150,810**	8,210,234
Cost of sales	**(3,595,556)**	(781,190)	**(2,581,634)**	(2,451,592)	**-**	-	**(6,177,190)**	(3,232,782)
Gross profit	**2,891,616**	2,342,902	**4,082,004**	2,634,550	**-**	-	**6,973,620**	4,977,452
Amortization of intangible assets	**-**	-	**(8,303)**	(98,295)	**-**	-	**(8,303)**	(98,295)
Impairment of goodwill	**-**	-	**-**	(2,166,000)				(2,166,000)
Impairment of other intangible assets	**-**	-	**-**	(139,000)				(139,000)
Other expenses	**(2,336,212)**	(2,048,389)	**(2,861,207)**	(2,452,556)	**(1,193,157)**	(1,222,540)	**(6,390,576)**	(5,723,485)
Finance revenue	**133,678**	108,456	**-**	-	**-**	-	**133,678**	108,456
Profit (loss) before taxes	**689,082**	402,969	**1,212,494**	(2,221,301)	**(1,193,157)**	(1,222,540)	**708,419**	(3,040,872)
Tax (expense) recovery	**(8,662)**	(57,517)	**(90,672)**	105,892	**24,938**	143,675	**(74,396)**	192,050
Net income (loss)	**680,420**	345,452	**1,121,822**	(2,115,409)	**(1,168,219)**	(1,078,865)	**634,023**	(2,848,822)
Attributable to:								
Owners of the parent	**685,743**	374,050	**1,109,472**	(2,120,208)	**(1,168,219)**	(1,078,865)	**626,996**	(2,825,023)
Non-controlling interest	**(5,323)**	(28,598)	**12,350**	4,799	**-**	-	**7,027**	(23,799)

Reconciling items comprise the following:

	Year ended May 31	
	2014	2013
	$	$
Corporate admin costs	**874,646**	832,155
Stock-based compensation	**120,825**	152,977
Professional fees	**137,465**	141,325
Depreciation of property, plant and equipment	**38,401**	45,623
Bank charges and interest	**44,921**	39,346
Foreign exchange differences	**(23,101)**	11,114
Total	**1,193,157**	1,222,540

Corporate administration costs include directors' fees, all costs relating to both the CEO and CFO, directors and officers insurance, corporate legal costs, public relations costs, professional fees relating to group tax planning and corporate filing costs as well as the Annual General Meeting.

During the year ended May 31, 2014, the company had one customer in North America and China that accounted for 25.7% and one customer in Europe and the rest of the world that accounted for 9.9% of total revenue for the year.

During the year ended May 31, 2013, the company had one customer in Europe and the rest of the world that accounted for 17.0% of total revenue for the year.

Further geographical analysis:

	Revenues for the year ended		Property, plant and equipment as at		Goodwill and other intangible assets as at		Finance lease receivable (non-current) as at	
	May 31, 2014	May 31, 2013	**May 31, 2014**	May 31, 2013	**May 31, 2014**	May 31, 2013	**May 31, 2014**	May 31, 2013
	$	$	**$**	$	**$**	$	**$**	$
Canada	**3,480,287**	1,873,417	**48,964**	22,301	**-**	-	**139,530**	585,197
U.S.A.	**2,985,040**	1,198,950	**-**	-	**-**	-	**-**	-
U.K.	**5,731,390**	4,358,514	**13,626**	23,169	**1,959,270**	1,706,449	**-**	-
Italy	**336,648**	199,060	**-**	-	**-**	-	**-**	-
Netherlands	**109,127**	91,683	**-**	-	**-**	-	**-**	-
Ireland	**105,925**	103,841	**-**	-	**-**	-	**-**	-
Germany	**67,761**	13,863	**-**	-	**-**	-	**-**	-
Rest of Europe	**13,695**	45,397	**-**	-	**-**	-	**-**	-
India	**203,583**	156,970	**-**	-	**-**	-	**-**	-
Kenya	**70,258**	44,311	**-**	-	**-**	-	**-**	-
China	**21,846**	51,725	**-**	-	**-**	-	**-**	-
Turkey	**8,723**	23,531	**-**	-	**-**	-	**-**	-
Pakistan	**-**	22,874	**-**	-	**-**	-	**-**	-
Rest of World	**16,527**	26,098	**-**	-	**-**	-	**-**	-
Total	**13,150,810**	8,210,234	**62,590**	45,470	**1,959,270**	1,706,449	**139,530**	585,197

Material Segmentation Variances

Revenue

North America and China: revenue for the year ended May 31, 2014 was $6,487,173 compared to $3,124,092 for FY 2013. Heat recovery revenue increased by $3,054,169 despite the same period of the previous year containing $1,546,318 relating to the Greenpower Purchase Agreement extension signed on November 29, 2012. FY 2014 includes revenue from projects at two sites of a major Fortune 500 food and beverage company, as announced September 16, 2013, plus the substantial completion of an installation at a major pulp and paper company as announced June 3, 2013. Revenue from sales of GEM® products meanwhile also increased by $308,912 as the sales force continued to gain strength in North America.

Europe and the rest of the world: revenue for the year ended May 31, 2014 was $6,663,637 compared to $5,086,142 for the previous year. Heat recovery revenue increased by $596,943 in FY 2014, which saw three hospital conversions at higher values than the two installations in FY 2013. The increased revenue from these conversions more than made up for a decrease in revenues from sales to a major food manufacturer in the previous year. Revenue from sales of GEM® products increased by $980,552, representing an increase in sales from orders received from a major food and beverage manufacturer, as announced July 3, 2013 and a global premium beer company, as announced February 10, 2014 as well as general increases throughout the region.

Segment Income (loss) Before Tax

North America and China: Gross profit increased by $548,714 in FY 2014 over the previous year, despite the previous year including the revenue recognized on commencement of the two year extension to the Greenpower Purchase Agreement with Fortress Specialty Cellulose, which carried little cost. The increase was due to increased revenues as well as greater margins achieved on heat recovery projects in the current year. Other expenses in the region increased by $287,823 (14.1%) mainly due to commissions payable and travel costs associated with the increased sales activity, plus an incentive payable to non-sales staff. With finance revenue increasing by $25,222, the resulting in segment income before tax of $689,082 represented an increase of to $286,113 over the previous year.

Europe and the rest of the world: gross profit increased in the year ended May 31, 2014 over the previous year by $1,447,454, as a result of increased revenues. Increased commissions plus incentive payable to non-sales staff contributed to an increase in other expenses of $408,651, 16.7% higher than the prior year. In contrast, the full amortization of intangible assets in the first month of FY 2014 meant a charge of just $8,303 in the current period, compared with $98,296 in the year ended May 31, 2013. The previous year also included the impairment of both goodwill and other intangible assets totaling $2,305,000, for which there was no corresponding charge in FY 2014. The resulting pre-tax profit of $1,212,494 compared to a loss of $2,221,301 for the prior year.

Other expenses within Reconciling items, which incorporates all costs not specifically attributable to either regional operational center, decreased in FY 2014 from the prior year by $29,383. There were no notable changes other than increased exchange gains resulting from the strengthening of Sterling against the Canadian Dollar, plus reduced investor relations costs.

Selected Annual Information

The following table shows selected consolidated financial data for the three most recently completed financial years.

Financial information for the years ending May 31, 2012, 2013 and 2014

	2012 $	2013 $	2014 $
Revenue	13,152,687	8,210,234	13,150,810
Gross Profit	5,648,371	4,977,452	6,973,620
Gross Profit Percentage	42.9%	60.6%	53.0%
EBITDAS(1)	449,142	(435,049)	879,244
Total net income (loss) attributable to owners of the parent	101,429	(2,825,023)	626,996
Net profit (loss) per share – basic and diluted	0.001	(0.017)	0.004
Total assets	9,974,155	6,032,496	7,445,964
Total long term financial liabilities	0	0	0
Cash dividends declared per share	0.00	0.00	0.00
Adjusted operating cash flow(2)	866,754	(1,384,259)	1,349,123

(1) EBITDAS represents earnings before interest, taxation, depreciation, amortization, impairment of goodwill and other intangible assets, share-based compensation expense and net write down of lease.

(2) Adjusted operating cash flow represents net income (loss) plus items not involving cash, plus lease payments received, adjusted for the recognition of the extension of the finance lease agreement.

A reconciliation of Net income (loss) to EBITDAS is shown below:

	2012 $	2013 $	2014 $
Total net income (loss) attributable to owners of the parent	101,429	(2,825,023)	626,996
Total net income (loss) attributable to non-controlling interest	(16,698)	(23,799)	7,027
Interest paid	3,169	3,982	4,750
Interest received	(149)	(54)	(1,453)
Taxation	38,551	(192,050)	74,396
Depreciation	45,851	45,623	38,401
Amortization	99,126	98,295	8,303
Impairment of goodwill and intangible assets	-	2,305,000	-
Share based compensation	123,105	152,977	120,824
Net investment in finance lease	54,758	-	-
EBITDAS	449,142	(435,049)	879,244

In FY 2014, despite revenues just falling short of the previous record set in the year ended May 31, 2012, gross profit was $1,325,249 greater than in FY 2012 due in part to greater GEM revenues and in part to improved margins on heat recovery projects, which were also better than in FY 2013. FY 2014 saw six substantially complete installations of heat recovery systems compared to four in FY 2013. Although GEM sales to hospitals remained consistent from last year, the company enjoyed increases across all regions, partly due to orders received from a major food and beverage manufacturer, as announced July 3, 2013; a global premium beer company, as announced February 10, 2014; a global diversified healthcare company, as announced February 18, 2014 and May 12, 2014; and a Fortune 500 food and beverage company, as announced September 13, 2013, and partly due to the strengthening of the North American sales force as well as increased sales from agents and distributors within the rest of the world. Other expenses increased mainly due to additional commissions on the increased revenues, plus recruitment costs and travel expenses of additional sales and marketing staff, as well as staff incentive, for which there was no cost last year due to the losses made. Total assets increased during the year by $1,413,468, mainly resulting from increases in cash and trade receivables which were pushed up by GEM despatches at the end of FY 2014.

In FY 2013, revenues fell by $4,942,453, mainly due to the Fibrek project and the St. George NHS project which, combined, provided $7,797,215 in FY 2012. That said, the year saw three major hospitals ordering heat recovery systems, matching the number of sites in the previous year, plus the extension of the Greenpower Purchase Agreement contributed $1,561,998 towards revenue, with very little associated cost. Although revenue fell by $4,942,453, gross profit only decreased by $670,919 due to the profit recognized with respect to the Greenpower Purchase Agreement extension. This meant an improvement on gross profit as a percentage of revenues from 42.9% in FY 2012 to 60.6% in FY 2013. Other expenses increased mainly as a result of increased staff numbers plus the impairment charges relating to goodwill and other intangible assets. Total assets decreased by $3,941,659 during FY 2013, due mainly to cash received from outstanding Fibrek invoices as at May 31, 2012 being used to settle outstanding liabilities relating to Fibrek, as well as tax liabilities relating to FY 2012 and other accrued payments, plus the reduction in goodwill and other intangible assets relating to the impairment charges recorded in the year.

FY 2012 saw revenues increase by $3,452,091 from the previous year and produced the first ever net profit attributable to owners of the parent of $101,429. The increased sales resulted in an increase in gross profit of $973,753. This was diminished by increased expenses, mainly from the need to increase the numbers of sales and supporting staff. Although a number of new staff were sales staff, revenues (and consequently profits) will not be immediately enjoyed, due to the learning curve associated with our business and so, certainly initially at least, these additions served to reduce net income. Total assets increased by $1,275,192 in the year due mainly to outstanding invoices receivable on the Fibrek project at year end.

Quarterly financial information (unaudited)
For the eight quarters ended May 31, 2014

Quarter ended	31-May-14 $	28-Feb-14 $	30-Nov-13 $	31-Aug-13 $
Revenue	4,717,007	2,897,535	4,014,145	1,522,123
Gross Profit	2,737,568	1,391,171	1,874,869	970,012
Gross Profit Percentage	58.0%	48.3%	46.7%	63.7%
EBITDAS(1)	709,637	144,664	311,366	(286,423)
Total net income (loss)	654,740	57,304	238,079	(323,127)
Income (loss) per share, basic and diluted	0.004	0.000	0.001	(0.002)

Quarter ended	31-May-13 $	28-Feb-13 $	30-Nov-12 $	31-Aug-12 $
Revenue	1,879,450	4,208,723	1,259,984	862,077
Gross Profit	746,358	2,906,414	799,717	524,963
Gross Profit Percentage	39.7%	69.1%	63.5%	60.9%
EBITDAS(1)	(424,414)	1,573,398	(682,929)	(901,104)
Total net income (loss)	(2,685,427)	1,476,814	(778,011)	(838,399)
Income (loss) per share, basic and diluted	(0.016)	0.009	(0.005)	(0.005)

(1) EBITDAS represents earnings before interest, taxation, depreciation, amortization, share-based compensation expense and net write down of lease.

Trend Analysis:

The final quarter of FY 2014, ended May 31, 2014, saw revenues of $4,717,007, an increase of $1,819,472 over the previous quarter. Revenues from sales of heat recovery systems almost doubled, with the majority coming from substantial installation at the pulp and paper company along with the substantial completion of installations at two hospitals. GEM revenues also increased by around 13%, despite lower revenues in the quarter from hospitals and the major beer company, due to sales to a global diversified healthcare company as well as general increases in North America and the rest of the world. The resulting gross profit was an improvement of $1,346,397 over the previous quarter. Other costs increased by $788,762 due to commissions on the increased sales plus an incentive provision for non-sales staff, plus increased travel costs, as well as the lack of government credits relating to ISTP and SR&ED claims received in the prior quarter. These differences, combined with an increase in finance revenue from the previous quarter of $9,141 and a decrease in incomes taxes of $30,660 as U.K. profits were offset against brought forward losses, led to a net income increase of $597,436 over the third quarter of FY 2014.

The quarter ended February 28, 2014 saw a decrease in revenue from the previous quarter of $1,116,610 to $2,897,535. Heat recovery revenue fell by $884,143 due to the prior quarter including major equipment delivery to the pulp and paper company plus the substantial completion of a hospital conversion. The current quarter included the commencement of projects at two further hospitals for which substantial completion is expected in the final quarter of FY 2014. Also lessening the decrease in revenue in the third quarter was the substantial completion of the projects at two sites of a major food and beverage company. GEM® revenue fell by $232,467 from the second quarter, despite sales to a major beer company and a large hospital, due to the previous quarter including a number of larger sales within the US which were not repeated in the current quarter. These decreases in revenue led to a fall in gross profit from the previous quarter of $483,698, which was partially offset by reductions in total costs of $322,121 including commissions payable, audit fees plus the AGM being held in the previous quarter, plus the receipt of credits from SR&ED and ISTP Canada for research and development activities, as well as positive exchange differences arising from the strengthening of Sterling against the Canadian Dollar. These differences, combined with a decrease in finance revenue from the previous quarter of $18,416 and an increase in incomes taxes of $782 led to a net income reduction of $180,775 from the second quarter of FY 2014.

Revenue of $4,014,145 in the second quarter of FY 2014 represented an increase of $2,492,022 over the $1,522,123 recorded in the previous quarter. Heat recovery revenue increased by $2,210,453, with the commencement of projects at two sites of a major food and beverage company in the quarter, alongside the continuance of work at a major pulp and paper company. In addition, one hospital was virtually completed within the second quarter, whereas the first quarter saw the completion of a hospital which had started in the last quarter of FY 2013. GEM Revenues increased in the current quarter over the previous quarter by $281,569. With revenue from hospitals and the major food company order, as announced July 3, 2013, remaining fairly constant, the majority of the increase is attributable to North America. These increases in revenue gave rise to an increase in gross profit over the prior quarter of $904,857. Increased costs of $292,505 were mainly attributable to sales commission, plus the AGM which was held in the second quarter, along with tradeshow costs, and combined with the improved gross profit and a slight fall in finance revenue of $5,443, plus an increase in tax charge for the quarter of $10,072 resulted in a total net income improvement of $596,837 over the first quarter of FY 2014.

The first quarter of FY 2014 saw a decrease in heat recovery revenue from the previous quarter with the completion of the major hospital project which had commenced in the last quarter of FY 2013 and revenue from the major pulp and paper company as announced June 3, 2013 not matching the substantial completion of the three projects in the prior quarter. This decrease of $831,611 was partially offset by an increase in GEM® revenues of $474,283. A decrease in revenues from a major food and beverage manufacturer of $110,139 was more than offset by revenues from another food and beverage manufacturer plus a major hospital. GEM® sales within North America were down from the prior quarter, although orders were received awaiting sizing information, while revenues within Europe more than doubled, mostly within the U.K. and Italy, through directly employed sales personnel. Despite a drop in revenues, gross profit increased by $223,654 as a result of the product mix. Increased commission from increased gross profit plus audit fees billed in the first quarter of the year consumed some of the increased gross profit, resulting in an improvement in EBITDAS of $137,991 from the last quarter of FY 2013.

The final quarter of FY 2013, ended May 31, 2013, experienced a drop in revenue of $2,329,273 from the previous quarter, which had seen the Fortress Greenpower Purchase Agreement extension plus the completion of the installation of a heat recovery system at a major hospital, providing combined revenue of $2,600,072. This decrease in heat recovery systems revenue was offset by $700,574 coming from other heat recovery projects, including the commencement of a further major hospital conversion plus the completion of installations at two major food and beverage manufacturers. GEM® sales meanwhile fell by $429,775 from the third quarter due to the third quarter including a full site conversion at the major hospital at which the heat recovery system was also installed in Q3. The impairment charge which resulted from the annual testing for impairment of both goodwill and other intangible assets was recorded in the final quarter of FY 2013. This charge is a non-cash item and therefore did not adversely affect either the cash balance or EBITDAS. As other expenses remained at a similar level to the third quarter, other than commission payable, the resulting reduction in EBITDAS was directly related to the reduction in revenue. Due to the U.K. subsidiary making a loss in the final quarter, the change in total net loss/income was eased by a provision for recoverable income tax.

The third quarter of FY 2013 produced $2,948,739 more revenue than the second quarter. Heat recovery revenues increased by $3,094,436, with $1,546,318 relating to the Fortress Greenpower Purchase Agreement extension, $230,757 relating to the sale of equipment to a major U.K. food manufacturer and $1,295,113 relating to sales to the National Health Service in the U.K.. GEM® sales fell in the quarter by $145,697, despite an increase in sales to the National Health Service, due to unusually higher sales within the rest of the world plus a site conversion to a major pharmaceutical manufacturer in the second quarter. As a result of these increased revenues, in particular the Greenpower Purchase Agreement extension, gross profit rose in the third quarter by $2,106,697 over the previous quarter. EBITDAS increased by $2,256,327, slightly better than the gross profit increase due to the prior quarter expenses including invoices relating to the audit of the FY 2012 financial statements and the AGM. Net income of $1,476,814 in the third quarter represented an improvement of $2,254,825 over the second quarter.

Revenues increased in the second quarter of FY 2013 by $397,907 over the previous quarter. A slight decrease in heat recovery revenues was more than compensated for by an increase in GEM® revenues, mainly due to an increase in revenues from sales to the NHS in the U.K., plus increased sales within the rest of the world. The effect of this revenue increase on gross profit was an additional $274,754 over the previous quarter. EBITDAS saw an improvement of $218,175 - $56,579 less than the gross profit increase, mainly due to costs in the second quarter relating to the AGM, as well as increased commissions on the increased GEM® sales plus the receipt of invoices relating to the audit of the FY 2012 financial statements. The decrease in net loss of $60,388 was less than the EBITDAS improvement as a result of U.K. tax losses being absorbed in the first quarter, allowing for no further tax credit from previous years despite losses incurred in the current year.

In the first quarter of FY 2013, revenues fell from the last quarter of FY 2012 by $2,598,801, representing mainly heat recovery revenue from Fibrek and GEM® revenues from U.K. sites of a major food manufacturer realized in the quarter ended May 31, 2012. The consequent reduction in gross profit of $783,444 along with a slight increase in other expenses net of finance revenue of $34,014, resulted in an increased loss of $817,458 over the previous quarter. Historically, the first quarter of the year has relatively lower GEM® sales than in other quarters due to summer vacations, and management had forecast a significant loss in this quarter.

4. Business Outlook

- In June 2012, the Company received an order for approximately $562,000 from a publicly owned hospital for a heat recovery solution. This order was partially completed in FY 2013 and the customer is currently deciding on changes it may wish to be made before the project is continued. It is not yet known when this project may be completed.

- On June 3, 2013, the Company announced it had received a purchase order valued at approximately $3.6 million for the installation of a heat recovery system at a major North American pulp and paper company. The heat recovery system was expected to be installed and revenue earned by the end of FY 2014. As at May 31, 2014, the project was over 90% complete.

- On July 10, 2014, the Company announced that it had received a purchase order valued at approximately $225,000 from a leading Fortune 500 food and beverage conglomerate for the purchase of GEM® steam traps. The order is expected to be fulfilled and revenue earned over the next six months. Over the last 24 months Thermal Energy has now received 13 purchase orders totaling approximately $2.6 million from this customer for GEM® steam trap and FLU-ACE® heat recovery systems at nine different sites.

- On July 15, 2014, the Company announced that it had received a purchase order valued at approximately $246,000 from a major publicly-owned hospital. On September 10, 2013, the Company announced that it had received purchase orders from this hospital for both a heat recovery system and a GEM® steam trap system totaling approximately $780,000. This latest order is for an expansion to the heat recovery system installation that was completed in May, 2014.

- On August 27, 2014, the Company announced that it had received a purchase order valued at approximately $810,000 from a leading Fortune 500 food and beverage conglomerate for the installation of a heat recovery system at one of its facilities. The order is expected to be fulfilled and revenue earned over the next six months.

- The Company is currently developing energy efficiency projects on a paid or exclusive basis at 18 different sites for 15 different customers. This compares to 15 sites for 10 customers in September

2013, 7 sites for 3 customers during all of FY 2012 and only 1 site and 1 customer in each of FY 2011 and FY2010.

- The Company's order backlog as at May 31, 2014 was approximately $1.8 million. As at September 23, 2014, the Company had an order backlog of approximately $3.9 million, of which approximately $0.5 million is related to long term contracts and is not expected to be reflected in revenue within the next 12 months.

5. Summary of Outstanding Shares and Dilutive Instruments

The Company currently has the following shares and dilutive instruments outstanding:

Shares

161,276,616 class A common shares.

Options

Number of Options outstanding	Number of Options Exercisable	Exercise Price Per Share $	Expiry Date
2,450,000	**2,450,000**	**0.10**	**04-May-2015**
2,281,250	**2,281,250**	**0.10**	**10-May-2016**
250,000	**166,667**	**0.10**	**12-Jul-2016**
4,400,000	**2,933,333**	**0.10**	**01-Dec-2016**
4,820,000	**1,606,667**	**0.10**	**22-Nov-2017**
3,538,000	**-**	**0.05**	**18-Nov-2018**
3,763,360	**-**	**0.10**	**28-May-2019**
21,502,610	**9,437,917**		

6. Critical Accounting Estimates and Changes in Accounting Standards

Critical Accounting Estimates

The preparation of financial statements in accordance with IFRS necessitates the use of management estimates, assumptions and judgment that affect reported amounts of assets, liabilities, revenues and expenses and disclosure of contingent assets and liabilities at the date of the financial statements. Although management reviews its estimates on an ongoing basis, actual results may differ from these estimates as confirming events occur. The following components of the financial statements depend most heavily on such management estimates, assumptions and judgment, any changes in which may have a material impact on the Company's financial condition or results of operations. For more information about certain assumptions and risks that may affect these estimates, assumptions and judgments, please see the "Forward Looking Information" section of this MD&A.

Valuation of goodwill and intangible assets and asset impairment

Goodwill and intangible assets are tested annually for impairment, or earlier if circumstances indicate an impairment.

An impairment loss is recognized for the amount by which an asset's or cash-generating unit's carrying amount exceeds its recoverable amount. To determine the recoverable amount, management estimates expected future cash flows from each asset or cash-generating unit and determines a suitable interest rate in order to calculate the present value of those cash flows. In the process of measuring expected future cash flows management makes assumptions about future operating results. These assumptions relate to future events and circumstances. The actual results may vary, and may cause significant adjustments to the Company's assets within the next financial year.

In most cases, determining the applicable discount rate involves estimating the appropriate adjustment to market risk and the appropriate adjustment to asset-specific risk factors.

Future production outputs relating to the finance lease

When a new finance lease or amendment is signed, in determining minimum lease payments receivable, management makes estimates regarding monthly energy outputs of the leased asset based on assumptions regarding the efficiency of the asset, the operations of the plant in which it is located, penalty payments resulting from temporary plant shut-downs and residual value of the equipment. These assumptions relate to future events and circumstances.

Assumptions used in the Black-Scholes fair value calculations

The estimation of share-based payment expense requires the selection of an appropriate valuation model and consideration as to the inputs necessary for the valuation model chosen. In calculating the share-based payment expense, key estimates such as the rate of forfeiture of options granted, the expected life of the option, the volatility of the Company's stock price and the risk free interest rate are used.

Allowance for Doubtful Accounts

The valuation of allowances for uncollectible trade receivables requires assumptions including estimated credit losses based on customer and industry concentrations and the Company's knowledge of the financial conditions of its customers.

Revenue Recognition relating to contracts for heat recovery solutions

The stage of completion of any heat recovery solutions contract is assessed by management by taking into consideration all information available at the reporting date. In this process, management exercises significant estimate about milestones, actual work performed and the estimated costs to complete work.

Deferred tax assets

Deferred tax assets are recognized for unused tax losses, tax credits and deductible temporary differences, to the extent that it is probable that future taxable income will be available against which they can be utilized. These estimates are reviewed at every reporting date. Significant management judgment is required to determine the amount of deferred tax assets that can be recognized, based upon the likely timing and the level of the reversal of existing differences, future taxable income and future tax planning strategies.

Changes in Accounting Standards

The Company has adopted the following new or amended accounting standards.

Amendments to IAS 1, "Presentation of Financial Statements"
Effective June 1, 2013, the Company adopted the amendments to International Accounting Standards ("IAS") 1, Presentation of Financial Statements, issued in June 2011, which requires an entity to group items presented in other comprehensive income on the basis of whether they might be reclassified to profit or loss in subsequent periods and items that will not be reclassified to profit or loss. The amendments to IAS 1 were applied retrospectively and did not have a material impact on the financial position, cash flows or profit or loss of the Company.

IFRS 10, "Consolidated Financial Statements"
In May 2011, the International Accounting Standards Board ("IASB") issued IFRS 10 to replace IAS 27 "Consolidated and Separate Financial Statements" and SIC 12 "Consolidation – Special Purpose Entities". The new consolidation standards result in a revised definition of control applicable to all entities. Under IFRS 10, control is identified as the single basis of consolidation for all types of entities. IFRS 10 is effective for annual periods beginning on or after January 1, 2013, which was June 1, 2013 for the Company, and have

been applied retrospectively to the consolidated financial statements. On June 1, 2013, the adoption of IFRS 10 did not result in any change in the consolidation status of any of our subsidiaries.

IFRS 12, “Disclosure of Interests in Other Entities”
In May 2011, the IASB issued IFRS 12 which integrates and enhances the disclosure requirements for entities that have an interest in a subsidiary, a joint arrangement, an associated or an unconsolidated structured entity. IFRS 12 is effective for annual periods beginning on or after January 1, 2013, which was June 1, 2013 for the Company, and have been applied retrospectively. The adoption of IFRS 12 did not result in any change to the consolidated financial statements. However, the standard results in additional and enhanced disclosures which have been included in our annual consolidated financial statements for the year ended May 31, 2014.

IFRS 13, “Fair Value Measurement”
In May 2011, the IASB issued IFRS 13 which establishes a single source of guidance for fair value measurement under IFRS. IFRS 13 defines fair value, provides guidance on measurement and introduces certain disclosure requirements. It does not affect which items are required to be fair-valued. IFRS 13 is effective for annual periods beginning on or after January 1, 2013, which was June 1, 2013 for the Company. The Company has adopted IFRS 13 prospectively effective June 1, 2013. As the Company currently has no financial instruments measured at fair value on the statement of financial positions, the adoption of IFRS 13 did not result in any measurement adjustments or additional disclosures on its consolidated financial statements.

Amendments to IAS 36 “Recoverable Amount Disclosures for Non-Financial Assets”
In May 2013, the IASB issued Recoverable Amount Disclosures for Non-Financial Assets (Amendments to IAS 36). The IASB has issued amendments to reverse the unintended requirement in IFRS 13, Fair Value Measurement, to disclose the recoverable amount of every CGU to which significant goodwill or indefinite-lived intangible assets have been allocated. Under the amendments, recoverable amount is required to be disclosed only when an impairment loss has been recognized or reversed. The amendments impact certain disclosure requirements only, and the amendments did not have a material impact on the Consolidated Financial Statements.

Amendments to IFRS 7, “Financial Instruments: Disclosure”
In December 2011, the IASB issued the amendments to IFRS 7 which provides common disclosure requirements intended to help investors and other users to better assess the effect or potential effect of offsetting arrangements on a company’s financial position. The amendments to IFRS 7 are effective for annual periods beginning on or after January 1, 2013, which was June 1, 2013 for the Company, and have been applied retrospectively. As the Company currently has no financial instruments measured at fair value on the statement of financial positions, the adoption of the amendments to IFRS 7 did not result in any additional disclosures on its consolidated financial statements.

At the date of approval of these consolidated financial statements, certain new standards, amendments and interpretations to existing standards have been published but are not yet effective, and have not been adopted early by the Company. These standards will be adopted at the effective date.

Management anticipates that all of the pronouncements will be adopted in the Company’s accounting policy for the first period beginning after the effective date of the pronouncement. Information on new standards, amendments and interpretations that are expected to be relevant to the Company’s consolidated financial statements is provided below. Certain other new standards and interpretations have been issued, but are not expected to have an impact on the Company’s consolidated financial statements.

Amendments to IAS 32, “Financial Instruments: Presentation”
In December 2011, the IASB issued amendments to IAS 32, which clarifies the existing requirements for offsetting financial assets and financial liabilities. These amendments are effective for annual periods beginning on or after January 1, 2014, which will be June 1, 2014 for the Company. The adoption of the amendments to IAS 32 is not expected to have a material impact on the consolidated financial statements.

IFRS 9, “Financial Instruments”
In November 2009 the IASB issued IFRS 9, Financial Instruments (IFRS 9 (2009)), and in October 2010, the IASB published amendments to IFRS 9 (IFRS 9 (2010)).
In November 2013, the IASB issued a new general hedge accounting standard, which forms part of IFRS 9 Financial Instruments (2013). The new standard removes the January 1, 2015 effective date of IFRS 9.
In July 2014, the IASB determined that IFRS 9 would be mandatorily effective for annual periods beginning on or after January 1, 2018.

IFRS 15, "Revenue from Contracts with Customers"
In May 2014, the IASB issued IFRS 15, "Revenue from Contracts with Customers", which provides a single, principles-based five-step model for revenue recognition to be applied to all customer contracts, and requires enhanced disclosures. This standard is effective January 1, 2017 and allows early adoption. The Company does not intend to adopt this standard early and is currently evaluating the impact of adopting this standard on the consolidated financial statements.

IFRIC 21, "Levies"

In May 2013, the IASB issued IFRIC 21, Levies which provides guidance on accounting for levies in accordance with the requirements of IAS 37, Provisions, Contingent Liabilities and Contingent Assets. The interpretation defines a levy as an outflow from an entity imposed by a government in accordance with legislation. It also notes that levies do not arise from executor contracts of other contractual arrangements. The interpretation also confirms that an entity recognizes a liability for a levy only when the triggering event specified in the legislation occurs. This IFRIC is effective for annual periods beginning on or after January 1, 2014 and is required to be applied retrospectively. The Company does not expect the amendment to have a material impact on the Consolidated Financial Statements.

7. Risk Factors and Risk Management

Management is confident about our long-term prospects, but does recognize that the company is exposed to a number of risks in the normal course of business that could negatively impact the financial condition of the Company.

Operational risks of the company include the ability to continue to secure and implement sales contracts for its GEM® and FLU-ACE® technology solutions.

Financial risks and uncertainties of the Company include:

- The Company's history of operating losses and uncertainty of future profitability;
- The ability to grow sales through the establishment of new cooperative partnerships and strategic alliances;
- The ability to grow sales through the licensing of the corporation's technologies;
- The ability to secure and maintain the required outside working capital financing;
- The ability to achieve profitable operations through increased sales,
- Reliance on third party collaborations and license arrangements;
- Reliance on proprietary technology;
- Competition in the energy conservation and environmental compliance solutions;
- Product liability claims and insurance;
- Reliance on key personnel;
- The ongoing litigation with its former President & CEO;
- The ability to control costs and achieve a positive gross margin on projects; and,
- The effect of a continuing prolonged recession in Canada, USA and Europe to the financial markets in securing project financing and in particular to industrial and commercial customers in committing capital to projects.

Management's addressing of the risks:

FY 2012 saw the Company's first ever net profit, which was the result of increased revenues and strict cost control. FY 2013, however, produced an operating loss of $844,328, resulting from diminished revenues and increasing costs. Despite further cost increases as management continue to build the sales force, FY 2014 produced the company's best ever post-tax income of $634,023 as well as an increase in cash balance of $742,022.

The Company actively protects its proprietary technology through registered trademarks and confidentiality agreements.

The Company maintains adequate forms of general liability insurance including product liability and errors and omission coverage.

Management believes that competition against its core technology of GEM®, FLU-ACE® and DRY-REX™ is limited at this time and believes that the market place is sufficiently large enough to mitigate the risk of stronger competition in the future.

8. Forward-Looking Information

This MD&A contains certain “forward-looking statements.” All statements, other than statements of historical fact, that address activities, events or developments that the Company believes, expects or anticipates will or may occur in the future (including, without limitation, statements regarding financial and business prospects and financial outlook) are forward looking statements. These forward-looking statements reflect the current expectations or beliefs of Management, based on information currently available to the Company. Forward-looking statements are subject to a number of risks, uncertainties and assumptions that may cause the actual results of the Company to differ materially from those discussed in the forward-looking statements and, even if such actual results are realized or substantially realized, there can be no assurance that they will have the expected consequences to, or effects on the Company. Factors that could cause actual results or events to differ materially from current expectations include, among other things, changes in general economic and market conditions, changes to regulations affecting the Company’s activities, and uncertainties relating to the availability and costs of financing needed in the future. Any forward-looking statement speaks only as at the date on which it is made and, except as may be required by applicable securities laws, the Company disclaims any intent or obligation to update any forward-looking statement, whether as a result of new information, future events or results or otherwise. Although Management believes that the assumptions inherent in the forward-looking statements are reasonable, forward-looking statements are not guarantees of future performance and, accordingly, undue reliance should not be put on such statements due to the inherent uncertainty therein.

9. Management’s Responsibility for Financial Reporting

In compliance with the Canadian Securities Administrators’ National Instrument 52-109 (“NI 52-109”), the Company has filed with applicable Canadian securities regulatory authorities, certificates signed by its Chief Executive Officer (“CEO”) and Chief Financial Officer (“CFO”) that, among other things, report on the design and effectiveness of disclosure controls and procedures and the design of internal controls over financial reporting.

Under the supervision of the CEO and CFO, the Company maintains systems of internal accounting and administrative controls to provide reasonable assurance that the financial information is relevant, reliable and accurate and that transactions are authorized, assets are safeguarded and proper records are maintained. Internal controls over financial reporting, no matter how well designed, have inherent limitations and may not prevent or detect all misstatements. There were no changes to the Company’s internal control over financial reporting during the year ended May 31, 2014 that have materially affected, or are reasonably likely to materially affect, the Company’s internal control over financial reporting.

The Board of Directors is responsible for ensuring that management fulfills its responsibility principally through its Audit Committee.

Thermal Energy’s auditors, KPMG LLP, conducted an independent audit of the consolidated financial statements for the year ended May 31, 2014, performing such tests and other procedures as they consider necessary to express an audit opinion. The external auditors have full and unrestricted access to the Audit Committee to discuss their audit and related findings.