

Consolidated Financial Statements of

**THERMAL ENERGY
INTERNATIONAL INC.**

Years ended May 31, 2020 and 2019



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INDEPENDENT AUDITORS' REPORT

To the Shareholders of Thermal Energy International Inc.

Opinion

We have audited the consolidated financial statements of Thermal Energy International Inc. (the Entity), which comprise:

- the consolidated statements of financial position as at May 31, 2020 and May 31, 2019
- the consolidated statements of comprehensive loss for the years then ended
- the consolidated statements of changes in equity for the years then ended
- the consolidated statements of cash flows for the years then ended
- and notes to the consolidated financial statements, including a summary of significant accounting policies

(Hereinafter referred to as the “financial statements”).

In our opinion, the accompanying financial statements present fairly, in all material respects, the consolidated financial position of the Entity as at May 31, 2020 and May 31, 2019, and its consolidated financial performance and its consolidated cash flows for the years then ended in accordance with International Financial Reporting Standards (IFRS).

Basis for Opinion

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the “***Auditors' Responsibilities for the Audit of the Financial Statements***” section of our auditors' report.

We are independent of the Entity in accordance with the ethical requirements that are relevant to our audit of the financial statements in Canada and we have fulfilled our other ethical responsibilities in accordance with these requirements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other Information

Management is responsible for the other information. Other information comprises:

- the information included in Management's Discussion and Analysis filed with the relevant Canadian Securities Commissions.



- the information, other than the financial statements and the auditors' report thereon, included in a document likely to be entitled "Annual Report".

Our opinion on the financial statements does not cover the other information and we do not and will not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit and remain alert for indications that the other information appears to be materially misstated.

We obtained the information included in Management's Discussion and Analysis filed with the relevant Canadian Securities Commissions as at the date of this auditors' report. If, based on the work we have performed on this other information, we conclude that there is a material misstatement of this other information, we are required to report that fact in the auditors' report.

We have nothing to report in this regard.

The information, other than the financial statements and the auditors' report thereon, included in a document likely to be entitled "Annual Report" is expected to be made available to us after the date of this auditors' report. If, based on the work we will perform on this other information, we conclude that there is a material misstatement of this other information, we are required to report that fact to those charged with governance.

Responsibilities of Management and Those Charged with Governance for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with International Financial Reporting Standards (IFRS), and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Entity's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Entity or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Entity's financial reporting process.

Auditors' Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion.



Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists.

Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit.

We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion.

The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Entity's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Entity's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Entity to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.



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- Provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group Entity to express an opinion on the financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

A handwritten signature in black ink that reads 'KPMG LLP' in a cursive, slanted font. A horizontal line is drawn underneath the signature.

Chartered Professional Accountants, Licensed Public Accountants

The engagement partner on the audit resulting in this auditors' report is
Mahesh Mani

Ottawa, Canada

September 22, 2020

THERMAL ENERGY INTERNATIONAL INC.

Consolidated Statements of Financial Position

May 31, 2020 and 2019

(Expressed in Canadian dollars)

	2020	2019 ¹
	\$	\$
Assets		
Current assets:		
Cash and cash equivalents (note 6)	4,774,580	4,177,260
Trade and other receivables (note 7)	2,211,381	3,017,209
Current tax receivable	232,904	42,697
Inventory (note 8)	844,685	653,944
Finance lease receivable (note 9)	-	93,257
	8,063,550	7,984,367
Non-current assets:		
Property, plant and equipment (note 10)	431,597	260,202
Right-of-use assets (note 13)	421,338	-
Intangible assets (note 11)	1,415,756	2,175,262
Goodwill (note 12)	-	2,520,555
Deferred tax assets (note 26)	111,439	105,406
	2,380,130	5,061,425
Total assets	10,443,680	13,045,792
Liabilities		
Current liabilities:		
Trade payables and other liabilities (note 14)	3,437,927	2,549,570
Current tax liabilities	18,710	2,965
Pensions and other employer obligations	139,359	143,948
Current portion of long-term debt (note 15)	269,886	371,993
Deferred revenue (note 16)	937,228	2,604,590
Provisions (note 17)	283,635	283,478
Lease obligations (note 18)	105,269	-
	5,192,014	5,956,544
Non-current liabilities:		
Contingent payable (note 28)	-	110,148
Long-term debt (note 15)	2,489,786	2,633,867
Lease obligations (note 18)	431,976	-
Deferred tax liabilities (note 26)	323,564	450,681
	3,245,326	3,194,696
Total liabilities	8,437,340	9,151,240
Equity		
Capital stock (note 19)	32,117,242	32,464,780
Contributed surplus	4,426,697	4,002,683
Accumulated other comprehensive income	217,342	267,889
Deficit	(34,658,665)	(32,760,222)
Equity attributable to owners of the parent	2,102,616	3,975,130
Non-controlling interest (note 21)	(96,276)	(80,578)
Total equity	2,006,340	3,894,552
Subsequent events (note 30)		
Total liabilities and equity	10,443,680	13,045,792

1. The Company adopted IFRS 16 effective June 1, 2019 as described in note 3(x). Under this adoption, the comparative information is not restated.

The accompanying notes are an integral part of these consolidated financial statements.

On behalf of the Board:

"William Crossland"
Director

"William Ollerhead"
Director

THERMAL ENERGY INTERNATIONAL INC.

Consolidated Statements of Comprehensive Loss

Years ended May 31, 2020 and 2019

(Expressed in Canadian dollars)

	2020	2019 ¹
	\$	\$
Revenue (note 23)	21,416,175	21,083,256
Cost of sales ²	12,462,122	13,042,050
Gross profit	8,954,053	8,041,206
Expenses (note 25):		
Administration	4,616,442	4,711,270
Selling, marketing and business development ²	3,231,569	3,536,058
Research and development	(35,840)	71,703
	7,812,171	8,319,031
Other income (note 28)	133,826	-
Operating income (loss) before impairment	1,275,708	(277,825)
Impairment of intangible assets (note 11)	(499,718)	-
Impairment of goodwill (note 12)	(2,561,482)	-
Operating loss	(1,785,492)	(277,825)
Finance costs	(420,220)	(302,394)
Finance revenue	5,144	20,413
Loss before income taxes	(2,200,568)	(559,806)
Income taxes recovery (note 26)	303,611	108,703
Loss for the year	(1,896,957)	(451,103)
Items that may be reclassified subsequently to profit or loss:		
Exchange differences arising on translation of overseas operations	(50,973)	(8,423)
Total comprehensive loss for the year	(1,947,930)	(459,526)
Net (loss) income for the year attributable to:		
Owners of the parent	(1,898,443)	(424,286)
Non-controlling interest	1,486	(26,817)
Net loss for the year	(1,896,957)	(451,103)
Total comprehensive (loss) income for the year attributable to:		
Owners of the parent	(1,948,990)	(438,689)
Non-controlling interest (note 21)	1,060	(20,837)
Total comprehensive loss for the year	(1,947,930)	(459,526)
Net loss per share - basic and diluted (note 27)	(0.012)	(0.003)

1. The Company adopted IFRS 16 effective June 1, 2019 as described in note 3(x). Under this adoption, the comparative information is not restated.

2. Effective June 1, 2019, the Company changed its accounting policy to reclassify commission expense from selling, marketing and business development expense to cost of sales as described in note 3(b).

The accompanying notes are an integral part of these consolidated financial statements.

THERMAL ENERGY INTERNATIONAL INC.

Consolidated Statements of Changes in Equity

Years ended May 31, 2020 and 2019

(Expressed in Canadian dollars)

	Capital stock \$	Contributed surplus \$	Deficit \$	Accumulated other comprehensive income \$	Total attributable to owners of the parent \$	Non- controlling interest \$	Total equity \$
Balance at June 1, 2018	32,231,329	3,978,830	(32,335,936)	282,292	4,156,515	(51,162)	4,105,353
Share-based compensation (note 22)	-	115,346	-	-	115,346	-	115,346
Stock options exercised (note 19)	233,451	(91,493)	-	-	141,958	-	141,958
Dividends paid	-	-	-	-	-	(8,579)	(8,579)
Transactions with owners	233,451	23,853	-	-	257,304	(8,579)	248,725
Net loss for the year	-	-	(424,286)	-	(424,286)	(26,817)	(451,103)
Other comprehensive (loss) income: exchange differences arising on translation of overseas operations	-	-	-	(14,403)	(14,403)	5,980	(8,423)
Total comprehensive loss for the year	-	-	(424,286)	(14,403)	(438,689)	(20,837)	(459,526)
Balance at May 31, 2019 ¹	32,464,780	4,002,683	(32,760,222)	267,889	3,975,130	(80,578)	3,894,552
Balance at June 1, 2019	32,464,780	4,002,683	(32,760,222)	267,889	3,975,130	(80,578)	3,894,552
Share-based compensation (note 22)	-	203,793	-	-	203,793	-	203,793
Repurchase of Class A common shares (note 19)	(347,538)	220,221	-	-	(127,317)	-	(127,317)
Dividends paid	-	-	-	-	-	(16,758)	(16,758)
Transactions with owners	(347,538)	424,014	-	-	76,476	(16,758)	59,718
Net (loss) income for the year	-	-	(1,898,443)	-	(1,898,443)	1,486	(1,896,957)
Other comprehensive loss: exchange differences arising on translation of overseas operations	-	-	-	(50,547)	(50,547)	(426)	(50,973)
Total comprehensive (loss) income for the year	-	-	(1,898,443)	(50,547)	(1,948,990)	1,060	(1,947,930)
Balance at May 31, 2020	32,117,242	4,426,697	(34,658,665)	217,342	2,102,616	(96,276)	2,006,340

1. The Company adopted IFRS 16 effective June 1, 2019 as described in note 3(x). Under this adoption, the comparative information is not restated. The accompanying notes are an integral part of these consolidated financial statements.

THERMAL ENERGY INTERNATIONAL INC.

Consolidated Statements of Cash Flows

Years ended May 31, 2020 and 2019

(Expressed in Canadian dollars)

	2020	2019
	\$	\$
Operating activities:		
Net loss for the year	(1,896,957)	(451,103)
Add items not involving cash:		
Depreciation of property, plant and equipment (note 10)	110,422	84,509
Depreciation of right-of-use assets (note 13)	125,899	-
Loss (gain) on disposal of assets (note 10)	1,004	(321)
Amortization of intangible assets (note 11)	280,580	253,976
Impairment of intangible assets (note 11)	499,718	-
Impairment of goodwill (note 12)	2,561,482	-
Write-down of finance lease receivable (note 9)	45,848	-
Finance revenue	(5,144)	(20,413)
Other income (note 28)	(133,826)	-
Finance costs	420,220	302,394
Share-based compensation (note 22)	203,793	115,346
Income taxes recovery (note 26)	(303,611)	(108,703)
Unrealized foreign exchange and translation adjustments	(18,467)	69,233
Changes in working capital:		
Trade and other receivables	858,381	203,296
Inventory	(190,741)	8,106
Trade payables and other liabilities	820,039	(1,368,102)
Deferred revenue	(1,730,532)	1,717,634
Income taxes paid	(11,800)	(4,598)
Interest received on finance lease	-	11,711
Interest paid	(326,695)	(242,660)
Net cash provided by operating activities	1,309,613	570,305
Investing activities:		
Finance lease principal payments received	-	45,289
Acquisition of subsidiary, net of cash (note 4)	-	(2,672,894)
Proceeds from disposal of property, plant and equipment (note 10)	-	6,833
Additions to property, plant and equipment (note 10)	(280,548)	(73,498)
Net cash used in investing activities	(280,548)	(2,694,270)
Financing activities:		
Issuance of long-term debt (note 15)	-	2,893,959
Repayment of long-term debt (note 15)	(297,179)	-
Lease incentive received (note 18)	90,000	-
Repayment of lease obligations (note 18)	(99,832)	-
Stock options exercised (note 19)	-	141,958
Repurchase of Class A common shares (note 19)	(127,317)	-
Dividends paid	(16,758)	(8,579)
Net cash (used in) provided by financing activities	(451,086)	3,027,338
Increase in cash and cash equivalents for the year	577,979	903,373
Cash and cash equivalents, beginning of year	4,177,260	3,282,208
Exchange differences on cash and cash equivalents	19,341	(8,321)
Cash and cash equivalents, end of year	4,774,580	4,177,260

1. The Company adopted IFRS 16 effective June 1, 2019 as described in note 3(x). Under this adoption, the comparative information is not restated.

The accompanying notes are an integral part of these consolidated financial statements.

THERMAL ENERGY INTERNATIONAL INC.

Notes to the Consolidated Financial Statements

Years ended May 31, 2020 and 2019

(Expressed in Canadian dollars except share amounts)

1. Nature of operations:

Thermal Energy International Inc. (the “parent”) was incorporated under the Ontario Business Corporations Act on May 22, 1991 and is primarily engaged in the development, engineering and supply of pollution control, heat recovery systems, and condensate return solutions. The parent company’s common shares are listed on the TSX Venture Exchange (“TSX.V”) under the symbol TMG. The primary office is located at Suite 850, 36 Antares Drive, Ottawa, Ontario, K2E 7W5.

These consolidated financial statements were approved and authorized for issue by the Board of Directors on September 22, 2020. The consolidated financial statements comprise the financial results of the parent and its subsidiaries (collectively known as the “Company”) for the years ended May 31, 2020 and 2019.

2. Basis of presentation:

(a) Statement of compliance:

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board (“IASB”).

The policies applied in these consolidated financial statements are based on IFRS issued and effective as of September 22, 2020, the date the Board of Directors approved the consolidated financial statements

(b) Measurement basis:

The financial statements have been prepared on a historical cost basis except as permitted by IFRS and as otherwise indicated within these notes.

(c) Significant accounting judgements and estimates:

The preparation of these consolidated financial statements requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities, income and expenses. The judgements, estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of the valuation of assets and liabilities that are not readily apparent from other sources. The judgements, estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates and assumptions are recognized in the year in which they are revised and in any future periods affected. Actual results may differ from these estimates, judgements and assumptions.

THERMAL ENERGY INTERNATIONAL INC.

Notes to the Consolidated Financial Statements

Years ended May 31, 2020 and 2019

(Expressed in Canadian dollars except share amounts)

2. Basis of presentation (continued):

(c) Significant accounting judgements and estimates (continued):

On March 11, 2020, the World Health Organization designated COVID-19 as a global pandemic. The outbreak began to impact the Company's operations in the latter half of March 2020. Management believes the extent of the COVID-19 pandemic's adverse impact on the Company's operating results and financial condition will be driven by many factors, most of which are beyond management's control and ability to forecast. Such factors include, but are not limited to, the scope and duration of past and potential future stay-at-home policies and business closures, travel restrictions, and the willingness of customers to allow outside contractors onsite. Because of these and other uncertainties, management cannot estimate the length or severity of the impact of the pandemic on the business. Decreases in cash flows and results of operations may have an impact on the inputs and assumptions used in significant accounting estimates, including management's assessment of future compliance with financial covenants and potential impairments of goodwill, intangible and long-lived assets.

The critical estimates include:

- Business combinations:

The identifiable assets acquired and liabilities assumed as part of a business combination are measured at the date of acquisition at their fair values. In estimating fair value, the Company uses market observable data to the extent it is available. In cases when Level 1 inputs are not available, the measurement of fair value involves the selection of an appropriate valuation model and consideration as to the inputs necessary for the valuation model chosen.

- 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 and, in the case of other intangible assets, determines an applicable royalty rate. 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. Further information on the estimates used in determining the recoverable amount of other intangible assets and goodwill is provided in notes 11 and 12 respectively.

THERMAL ENERGY INTERNATIONAL INC.

Notes to the Consolidated Financial Statements

Years ended May 31, 2020 and 2019

(Expressed in Canadian dollars except share amounts)

2. Basis of presentation (continued):

(c) Significant accounting judgements and estimates (continued):

The critical estimates include (continued):

- Future production outputs related 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. Actual results may vary from estimate.

- 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 share price and the risk-free interest rate are used. Further details of inputs used in the measurement of fair values at grant date are provided in note 22.

- Expected credit loss:

The valuation of allowances for uncollectable trade receivables requires assumptions including estimated credit losses based on the Company's knowledge of the financial conditions of its customers, historical experience and general economic conditions.

- Heat recovery solutions contract revenue:

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, significant estimates are made about milestones 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 judgement 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 temporary differences, future taxable income and future tax planning strategies.

THERMAL ENERGY INTERNATIONAL INC.

Notes to the Consolidated Financial Statements

Years ended May 31, 2020 and 2019

(Expressed in Canadian dollars except share amounts)

2. Basis of presentation (continued):

(c) Significant accounting judgements and estimates (continued):

The critical judgements include:

- Business combinations:

Judgement is applied in determining whether an acquisition is a business combination or an assets acquisition. Judgement is also required to assess whether the amounts payable on achievement of certain milestones represent contingent consideration or remuneration for post-acquisition services. When such amounts represent contingent consideration, judgement is applied on classification of such contingent consideration as equity or liability. Contingent consideration that is classified as equity is not remeasured at subsequent reporting dates and its subsequent settlement is accounted for within equity. Contingent consideration that is classified as a liability is remeasured at fair value at each reporting date and subsequent changes in the fair value are recognized in profit or loss.

- Revenue recognition:

Contracts with customers often include promises to deliver multiple goods and services. Judgement is applied in determining whether the goods and services are distinct, and should be accounted for as separate performance obligations, or together as a combined performance obligation. In allocating the consideration received among the multiple elements of a revenue arrangement, management must make estimates in determining the standalone selling prices ("SSP") for distinct performance obligations. The Company uses specific parameters as detailed in note 3(o) to estimate SSP for distinct sales of goods and rendering of services. For contracts for heat recovery solutions, the Company exercises judgement in determining the appropriate method for measuring progress over time. Various inputs as detailed in note 3(o) are used to determine progress for recognizing revenue over time. Changes to these inputs may result in different estimates of completion of performance obligations and timing of revenue recognition. When a percentage of completion estimate is used, estimates related to cost to complete are routinely revised based on changes of the facts relating to each contract.

(d) Functional currency and foreign currency translation:

These consolidated financial statements are presented in Canadian dollars, which is the functional currency of the parent. The functional currency of each entity consolidated with the Company is determined by the currency of the primary economic environment in which it operates along with consideration of other relevant factors.

THERMAL ENERGY INTERNATIONAL INC.

Notes to the Consolidated Financial Statements

Years ended May 31, 2020 and 2019

(Expressed in Canadian dollars except share amounts)

2. Basis of presentation (continued):

(d) Functional currency and foreign currency translation (continued):

In preparing the financial statements of the individual entities, transactions in currencies other than the entity's functional currency are recognized at the rates of exchange prevailing at the dates of the transactions. At the end of each reporting period: monetary assets and liabilities denominated in foreign currencies are translated at the rates of exchange prevailing at that date; non-monetary assets and liabilities carried at fair value that are denominated in foreign currencies are retranslated at the rates of exchange prevailing at the date when fair value was determined; and non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are not retranslated. Such exchange differences arising from translation at year-end are recognized in profit or loss.

Foreign operations are translated from their functional currencies into Canadian dollars on consolidation by applying the exchange rates prevailing at the end of the reporting year for assets and liabilities and the average exchange rate for the year for consolidated statements of comprehensive income items. Such exchange differences, including differences that arise relating to long-term inter-company balances that form part of the net investment in the foreign operation, are recognized in other comprehensive income or loss. On disposal of a foreign entity, the related cumulative translation differences recognized in equity are reclassified to profit or loss and are recognized as part of the gain or loss on disposal.

Goodwill and fair value adjustments arising on the acquisition of a foreign operation are treated as assets and liabilities of the foreign operation and translated at the end of each reporting year. These exchange differences are recognized in accumulated other comprehensive income.

3. Significant accounting policies

(a) Basis of consolidation:

The consolidated financial statements incorporate the financial statements of the parent, which is the ultimate parent, and its subsidiaries. Subsidiaries are consolidated from the date on which the parent company obtains control and continue to be consolidated until control ceases. Control is established when the parent company is exposed to, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the entity. The financial statements of the subsidiaries are prepared using consistent accounting policies and all material inter-company transactions are eliminated in full upon consolidation.

THERMAL ENERGY INTERNATIONAL INC.

Notes to the Consolidated Financial Statements

Years ended May 31, 2020 and 2019

(Expressed in Canadian dollars except share amounts)

3. Significant accounting policies (continued):

(a) Basis of consolidation (continued):

Where the ownership of a subsidiary is less than 100% and a non-controlling interest thus exists, any losses of that subsidiary are attributed to the owners of the parent and to the non-controlling interest even if that results in the non-controlling interest having a deficit balance. Non-controlling interest presented as part of equity represents the portion of a subsidiary's net income or loss and net assets that are not held by the Company. The Company attributes total comprehensive income of subsidiaries between the owners of the parent and the non-controlling interests based on their respective ownership interests. A change in the ownership interest of a subsidiary, without a loss of control, is accounted for as an equity transaction.

The following subsidiaries have been consolidated within the consolidated financial statements:

Name of subsidiary	Place of incorporation	Ownership interest	Functional currency	Principal activity
Thermal Energy International (UK) Ltd. ⁽¹⁾	United Kingdom	100%	GBP	Manufacture and sale of condensate return solutions and sale of heat recovery solutions
Thermal Energy International Corporation ⁽²⁾	Delaware, U.S.	100%	USD	Sale of heat recovery and condensate return solutions
Boilerroom Equipment Inc. ⁽²⁾⁽³⁾	Pennsylvania, U.S.	100%	USD	Sale of indirect contact heat recovery units
2003356 Ontario Inc.	Ontario, Canada	100%	CAD	Non-operating
2153639 Ontario Inc. ⁽⁴⁾	Ontario, Canada	100%	CAD	Holding company
GEMchem Ltd. ⁽¹⁾	United Kingdom	67%	GBP	Sale of water treatment products and services
Thermal Energy International (Guangzhou) Ltd. ⁽⁴⁾	Guangzhou, China	55%	CAD	Sale of heat recovery and condensate return solutions

⁽¹⁾ Thermal Energy International (UK) Ltd owns 67% of GEMchem Ltd., a company incorporated in the United Kingdom.

⁽²⁾ Thermal Energy International Corporation owns 100% of Boilerroom Equipment Inc., a company incorporated in the United States.

⁽³⁾ Thermal Energy International Corporation acquired Boilerroom Equipment Inc. on June 29, 2018. Further information is provided in note 4.

⁽⁴⁾ 2153639 Ontario Inc. owns 55% of Thermal Energy International (Guangzhou) Ltd., a company incorporated in China.

All subsidiaries have a reporting date of May 31.

Information relating to each of the Company's subsidiaries that have non-controlling interest can be found in note 21.

THERMAL ENERGY INTERNATIONAL INC.

Notes to the Consolidated Financial Statements

Years ended May 31, 2020 and 2019

(Expressed in Canadian dollars except share amounts)

3. Significant accounting policies (continued):

(b) Reclassification of Commission Expense:

Effective June 1, 2019, the Company changed its accounting policy with respect to commissions and reclassified commission expense from selling, marketing and business development expense to cost of sales. The Company believes that the revised policy and presentation provides more reliable and relevant information to users of the consolidated financial statements. The change in accounting policy has been applied retrospectively. The Company has restated the comparative figures in the consolidated statements of operation resulting in reclassification of commission expense in the amount of \$1,192,170 for the year ended May 31, 2019 from selling, marketing and business development expense to cost of sales.

(c) Business combinations:

The Company measures goodwill as the fair value of the consideration transferred including any contingent consideration to be transferred and the recognized amount of any non-controlling interest in the acquired entity, less the net recognized amount of the fair value of the identifiable assets acquired and liabilities assumed, all measured as of the acquisition date. When the excess is negative, a bargain purchase gain is recognized immediately in profit or loss. The Company elects on a transaction-by-transaction basis whether to measure non-controlling interest at fair value or at their proportionate share of the recognized amount of the identifiable net assets at the acquisition date. If the business combination is achieved in stages, the acquisition date fair value of the previously held interest in the acquired entity is re-measured to fair value as at the acquisition date through profit or loss. Transaction costs, other than those associated with the issue of debt or equity securities that the Company incurs in connection with a business combination, are expensed as incurred.

(d) Cash and cash equivalents:

Cash and cash equivalents in the consolidated statements of financial position comprise cash at banks and on hand, and highly liquid investments with an original maturity of three months or less, and which are readily convertible into a known amount of cash and which are subject to an insignificant risk of change in value.

(e) Inventories:

Inventories are valued at the lower of cost and net realizable value. Cost is determined by the first in, first out method and includes all direct costs and an appropriate proportion of fixed and variable overheads where applicable. Net realizable value is the estimated selling price in the ordinary course of business, less the estimated selling costs.

THERMAL ENERGY INTERNATIONAL INC.

Notes to the Consolidated Financial Statements

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3. Significant accounting policies (continued):

(f) Leases:

(i) The Company as a lessor - finance leases:

Finance leases are those where substantially all of the benefits and risks of ownership of the equipment are transferred to the customer. Sales revenue recognized at the inception of the lease represents the fair value of the asset or, if lower, the present value of the minimum lease payments, net of any executory costs and related profit included therein, computed at the market rate of interest. The cost of sale recognized at the commencement of the lease term is the cost, or carrying amount if different, of the leased property less the present value of the unguaranteed residual value. Unearned finance income, effectively the difference between the total minimum lease payments adjusted for executory costs and the aggregate present value, is deferred and presented as finance lease receivable in the consolidated statements of financial position.

Finance lease income is allocated to accounting years over the lease term so as to reflect a constant periodic rate of return on the Company's net investment in the lease.

Finance leases receivable are measured at total estimated minimum lease payments receivable, net of estimated expected finance revenue. Finance leases receivable are assessed for recoverability at each year end. Any indication of impairment of the net investment in lease will result in a write-down to the revised estimated recoverable amount. Indications that a finance lease receivable may be impaired include customers experiencing significant financial difficulties, the increasing possibility of a customer going bankrupt or undergoing a financial restructuring and payment default or delays.

(ii) The Company as a lessee:

Lessee accounting policy is described in note 3(x) *Accounting policy under IFRS 16*.

(g) Property, plant and equipment:

Property, plant and equipment are initially recognized at acquisition cost and are subsequently carried at cost less accumulated depreciation and accumulated impairment losses. Subsequent costs of replacing components are recognized only if it is probable that future economic benefits embodied within the component will flow to the Company, and its cost can be measured reliably. The carrying amount of the replaced component is derecognized. The cost of other replacement parts and general servicing of property, plant and equipment is recognized immediately in profit or loss.

THERMAL ENERGY INTERNATIONAL INC.

Notes to the Consolidated Financial Statements

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3. Significant accounting policies (continued):

(g) Property, plant and equipment (continued):

Depreciation is computed using the following annual rates and methods which reflect the estimated useful life of the assets less estimated residual value:

Asset	Method
Plant and equipment	5 years straight-line
Furniture and fixtures	5 years straight-line
Laboratory equipment	5 years straight-line
Computers	3 years straight-line
Leasehold improvements	3 years straight-line
Motor vehicles	4 years straight-line

Depreciation methods, useful lives and residual values are reviewed at each reporting year and adjusted if appropriate. In the case of assets held under finance leases, expected useful lives are determined by reference to comparable owned assets or over the term of the lease, if shorter. Depreciation and impairment charges are included within administrative expenses.

(h) Intangible assets:

Intangible assets were acquired with the acquisition of Gardner Energy Management on July 1, 2008, and Boilerroom Equipment Inc. on June 29, 2018. Intangible assets are reported at cost less accumulated amortization and accumulated impairment losses, if any. Amortization is computed using the following rates and methods which reflect the estimated useful life of the assets:

Asset	Method
Trade names and trademarks	indefinite life
Non-compete agreements	2 years straight-line
Industrial know-how	5 years straight-line
Designs and drawings	5 years straight-line
Customer relationships	5 - 6 years straight-line
Existing technology	7 years straight line
Proprietary software	4 years straight line
Brand portfolio	indefinite life

Amortization methods, useful lives and residual values are reviewed at each reporting year and adjusted if appropriate. Intangible assets with indefinite lives are subject to annual impairment testing. See note 3(j) for a description of impairment testing procedures.

THERMAL ENERGY INTERNATIONAL INC.

Notes to the Consolidated Financial Statements

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3. Significant accounting policies (continued):

(h) Intangible assets (continued):

The indefinite life intangible assets represent the GEM™ Trade Name and Trademark and the Brand portfolio of Boilerroom Equipment Inc., which are used to set the product apart from those of competitors producing traditional mechanical steam traps or indirect contact heat recovery units. Management considers the reputation of the GEM™ product and the Brand portfolio as continuing to strengthen and cannot be assigned a finite life after which it will have no value.

Amortization is included within administrative expenses.

(i) Goodwill:

Goodwill represents the future economic benefits arising from a business combination that are not individually identified and separately recognized. See note 3(c) for information on how goodwill is initially determined. Goodwill is carried at cost less accumulated impairment losses. See note 3(j) for a description of impairment testing procedures. Impairment losses on goodwill are not reversed.

(j) Impairment:

The carrying values of all property and equipment and intangible assets with a finite useful-life are reviewed for impairment whenever events or changes in circumstances indicate that their carrying amounts may not be recoverable. The carrying values of goodwill and intangible assets with an indefinite useful life are reviewed for impairment on an annual basis.

For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are largely independent cash inflows (cash-generating units). As a result, some assets are tested individually for impairment and some are tested at cash-generating unit level. Goodwill is allocated to those cash-generating units that are expected to benefit from synergies of the related business combination and represent the lowest level within the Company at which management monitors goodwill.

An impairment loss is recognized for the amount by which the asset's or cash-generating unit's carrying amount exceeds its recoverable amount, which is the higher of fair value less costs to sell and value-in-use. To determine the value-in-use, management estimates expected future cash flows from each cash-generating unit and determines a suitable interest rate in order to calculate the present value of those cash flows. The data used for impairment testing procedures are directly linked to the Company's latest approved budget. Discount factors are determined individually for each cash-generating unit and reflect their respective risk profiles as assessed by management.

THERMAL ENERGY INTERNATIONAL INC.

Notes to the Consolidated Financial Statements

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(Expressed in Canadian dollars except share amounts)

3. Significant accounting policies (continued):

(j) Impairment (continued):

Impairment losses for cash-generating units reduce first the carrying amount of any goodwill allocated to that cash-generating unit. Any remaining impairment loss is charged pro rata to the other assets in the cash-generating unit. With the exception of goodwill, all assets are subsequently reassessed for indications that an impairment loss previously recognized may no longer exist. An impairment charge is reversed if the cash-generating unit's recoverable amount exceeds its carrying amount.

Impairment testing of indefinite-lived intangible assets is performed using the relief from royalty method, which requires management to estimate expected future revenue from sales of the product to which the indefinite-lived intangible assets relate and determine an appropriate royalty rate to apply to the future revenue. The royalty rate is subject to estimation uncertainty and reflects company and product specific factors as assessed by management.

(k) Provisions, contingent liabilities and contingent assets:

A provision is recognized if, as a result of a past event, the Company has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation.

Provisions are measured at the estimated expenditure required to settle the present obligation, based on the most reliable evidence available at the reporting date, including the risks and uncertainties associated with the present obligation. Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. Provisions are discounted to their present values, where the time value of money is material.

Any reimbursement that the Company can be virtually certain to collect from a third party with respect to the obligation is recognized as a separate asset. However, this asset may not exceed the amount of the related provision.

All provisions are reviewed at each reporting date and adjusted to reflect the current best estimate.

In those cases where the possible outflow of economic resources as a result of present obligations is considered improbable or remote, no liability is recognized, unless it was assumed in the course of a business combination.

THERMAL ENERGY INTERNATIONAL INC.

Notes to the Consolidated Financial Statements

Years ended May 31, 2020 and 2019

(Expressed in Canadian dollars except share amounts)

3. Significant accounting policies (continued):

(l) Warranties:

The Company warrants its condensate return solution product against defects for 10 years and does not offer extended warranties beyond 10 years. A provision for warranty expense is recorded when the revenue for the related product is recognized. The provision is based upon the terms of the warranty, the Company's historical experience and management estimates of future expense for replacement or repairs. The provision is charged to cost of sales.

(m) Equity:

Capital stock represents the amount received on the issue of shares, less share issue expenses, net of any underlying income tax benefit from the issuance costs.

Contributed surplus includes charges related to stock options and warrants. When stock options and warrants are exercised, the related compensation cost is transferred to capital stock.

Deficit includes all current and prior year retained losses.

Accumulated other comprehensive income represents foreign currency translation differences arising on the translation of the Company's foreign subsidiaries, net of income taxes. All transactions with owners of the parent are recorded separately in equity.

(n) Equity-settled share-based compensation:

The Company offers an equity-settled share-based compensation plan for its directors, employees and certain contractors. None of the Company's plans feature any options for a cash settlement.

All goods and services received in exchange for the grant of any share-based payments are measured at their fair values, unless that fair value cannot be estimated reliably. If the entity cannot estimate reliably the fair value of the goods or services received, the entity shall measure their value indirectly by reference to the fair value of the equity instruments granted. For the transactions with employees and others providing similar services, the Company measures the fair value of the services received by reference to the fair value of the equity instruments granted.

All equity-settled share-based payments (except warrants to brokers) are ultimately recognized as an expense in profit or loss with a corresponding credit to contributed surplus. Equity-settled share-based payments to brokers, in respect of an equity financing are recognized as issuance cost of the equity instruments with a corresponding credit to contributed surplus.

THERMAL ENERGY INTERNATIONAL INC.

Notes to the Consolidated Financial Statements

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(Expressed in Canadian dollars except share amounts)

3. Significant accounting policies (continued):

(n) Equity-settled share-based compensation (continued):

If vesting years or other vesting conditions apply, the expense is allocated over the vesting year, based on the best available estimate of the number of awards expected to vest. Non-market vesting conditions are included in assumptions about the number of awards that are expected to become exercisable. Estimates are subsequently revised if there is any indication that the number expected to vest differs from previous estimates. Any cumulative adjustment prior to vesting is recognized in the current year. No adjustment is made to any expense recognized in prior years if awards ultimately exercised are different to that estimated on vesting.

Each tranche of an award with different vesting dates is considered a separate grant for the calculation of fair value and the resulting fair value is amortized over the vesting year of the respective tranches.

When stock options are exercised, any consideration paid by employees is credited to capital stock in addition to the amount previously recorded in contributed surplus relating to those options.

(o) Revenue recognition:

Revenue is recognized when the Company transfers control of goods or services to customers at an amount that reflects the consideration expected to be received in exchange for transferring those goods or services. Some of the Company's contracts include multiple products and services. Products and services that are generally capable of being distinct are accounted for as separate performance obligations. When a contract includes a series of goods and services that are substantially the same and have the same pattern of transfer to the customer, these are accounted for as a single performance obligation.

Revenue comprises revenue from the sale of goods and rendering of services, as described below.

Nature of products and services

Sale of goods

Revenue is recognized upon transfer of control of promised goods to the customers in an amount that reflects the consideration the Company expects to receive in exchange for those goods. The Company's goods are generally distinct and accounted for as separate performance obligations. A good is distinct if the customer can benefit from it on its own or together with other readily available resources, and the Company's promise to transfer the good is separately identifiable from other promises in the contractual arrangement with the customer. Amounts received in advance of meeting the revenue recognition criteria is recorded as deferred revenue on the consolidated statements of financial position. Products shipped prior to agreed billing terms are included in unbilled product revenue.

THERMAL ENERGY INTERNATIONAL INC.

Notes to the Consolidated Financial Statements

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(Expressed in Canadian dollars except share amounts)

3. Significant accounting policies (continued):

(o) Revenue recognition (continued):

Rendering of services

Services comprise surveys, installation of goods, project development and after-sales service and maintenance. Revenue is recognized when the services are provided by reference to the stage of completion of the contract at the reporting date.

Amounts received in advance of meeting the revenue recognition criteria is recorded as deferred revenue on the consolidated statements of financial position. Services rendered prior to agreed billing terms are included in unbilled product revenue.

Contracts for heat recovery solutions

The Company provides heat recovery solutions specifically customized to each customer. Revenue is recognized over time when the customer simultaneously receives and consumes the benefits provided through the entity's performance as the Company performs or when the Company creates or enhances an asset that the customer controls as the asset is created and enhanced, or when the Company's performance does not create an asset with an alternative use to the Company and the Company has an enforceable right to payment for performance completed to date.

The stage of completion is determined by reference to the costs incurred relative to total estimated costs to determine the extent of progress towards completion ("input" method). Only those contract costs that reflect work performed are included in costs incurred to date.

The timing of revenue recognition often differs from contract payment schedules, resulting in revenue that has been earned but not billed. These amounts are included in unbilled receivables. Amounts billed in accordance with customer contracts, but not yet earned, are recorded and presented as part of deferred revenue.

Multi-element arrangements

The Company provides its heat recovery solutions, GEM™ product, installation and servicing on a standalone basis or as part of a multiple element arrangement. Stand-alone sales include sales of heat recovery solution systems or GEM™ steam traps. When sold in a multiple element arrangement, the heat recovery solution systems or GEM™ steam traps are considered separate performance obligations as they are separately identifiable from other promises in the contract. The total consideration for the arrangement is allocated to the separate performance obligations based on their stand alone selling price ("SSP") and the revenue is recognized for each unit when the requirements for revenue recognition have been met. The Company determines the SSP of each performance obligation based on the specific parameters and model used in determining the contract price, price lists and historical pricing for stand-alone sales of the same goods or services.

THERMAL ENERGY INTERNATIONAL INC.

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3. Significant accounting policies (continued):

(o) Revenue recognition (continued):

Practical expedients

The Company has applied the following practical expedients:

- The Company expenses sales commission costs when incurred if the amortization period is less than 12 months.
- The Company is not adjusting the transaction price for the effects of financing component when the period between customer payment and the transfer of goods and services to the customer is less than 12 months.

Interest revenue and expenses

Interest revenue and expenses are reported on an accrual basis using the effective interest method.

(p) Post employee benefits and short-term employee benefits:

Certain subsidiaries of the Company provide post-employment benefits through defined contribution plans. A defined contribution plan is a pension plan under which the Company pays fixed contributions into an independent entity. The Company has no legal or constructive obligations to pay further contributions after its payment of the fixed contribution.

The cost of the Company's pension benefits for defined contribution plans are expensed when employees have rendered services entitling them to contributions.

Short-term employee benefits, including vacation entitlement, are current liabilities included in "pensions and other employee obligations", measured at the undiscounted amount that the Company expects to pay as a result of the unused entitlement.

(q) Research costs and government assistance:

The Company carries on various research programs, and from time to time these are funded by the Government of Canada. Funding received is accounted for using the cost reduction approach and is netted against research costs. Research costs are expensed as incurred.

(r) Government grants:

The Company received funding from various government bodies as COVID-19 wage subsidy. The grants are accounted for using the cost reduction approach and are netted against related costs for which they are intended to compensate.

THERMAL ENERGY INTERNATIONAL INC.

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3. Significant accounting policies (continued):

(s) Investment tax credits:

Credits claimed in connection with research and development activities are accounted for using the cost reduction method. Under this method, assistance and credits relating to the acquisition of equipment is deducted from the cost of the related assets, and those relating to current expenditures, which are primarily salaries and related benefits, are included in the determination of profit or loss as a reduction of the research and development expenses.

(t) Income taxes:

Tax expense recognized in profit or loss comprises the sum of deferred tax and current tax not recognized in other comprehensive income or directly in equity.

Current income tax assets and/or liabilities comprise those obligations to, or claims from, fiscal authorities relating to the current or prior reporting years, that are unpaid at the reporting date. Current tax is payable on taxable profit, which differs from profit or loss in the financial statements. Calculation of current tax is based on tax rates and tax laws that have been enacted or substantively enacted by the end of the reporting year.

Deferred income taxes are calculated using the liability method on temporary differences between the financial statement carrying amounts and the tax bases of assets and liabilities. Deferred tax liabilities are always recognized for all taxable temporary differences, and deferred tax assets are generally recognized for all deductible temporary differences to the extent that it is probable that future taxable income will be available against which those deductible temporary differences can be utilized. Such assets and liabilities are not recognized if the taxable temporary difference arises from the initial recognition of goodwill or the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable income or loss, nor the income or loss for the year reported in the Company's statements of comprehensive income (loss).

Deferred tax liabilities are recognized for taxable temporary differences associated with investments in subsidiaries, except where the Company is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future. Deferred tax assets arising from deductible temporary differences associated with such investments are only recognized to the extent that it is probable that there will be sufficient taxable income against which to utilize the benefits of the temporary differences and they are expected to reverse in the foreseeable future.

Deferred tax assets and liabilities are measured, without discounting, at the tax rates that have been enacted or substantively enacted by the end of the reporting year and applicable in the year in which the liability is expected to be settled or the asset realized.

THERMAL ENERGY INTERNATIONAL INC.

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3. Significant accounting policies (continued):

(t) Income taxes (continued):

Deferred tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and the Company intends to settle its current tax assets and liabilities on a net basis.

Changes in deferred tax assets or liabilities are recognized as a component of tax income or expense in profit or loss, except where they relate to items that are recognized in other comprehensive income or directly in equity, in which case the related deferred tax is also recognized in other comprehensive income or equity, respectively.

(u) Earnings per share:

The Company presents basic and diluted earnings per share data for its common shares. Basic earnings per share is calculated by dividing the earnings attributable to owners of the parent by the weighted average number of common shares outstanding during the year. The diluted earnings per share is determined by adjusting the earnings attributable to owners of the parent and the weighted average number of common shares outstanding for the effects of all dilutive potential common shares, which comprise options outstanding.

(v) Financial instruments:

Financial assets and financial liabilities are recognized when the Company becomes a party to the contractual provisions of the financial instrument. Financial assets are derecognized when the contractual rights to the cash flows from the financial asset expire, or when the financial asset and all substantial risks and rewards are transferred. A financial liability is derecognized when it is extinguished, discharged, cancelled or expires.

On initial recognition, trade and other receivables without a significant financing component are initially measured at the transaction price. All other financial assets and liabilities are initially measured at their fair value. Transaction costs that directly attributable to the acquisition or issue of financial assets and financial liabilities (other than financial assets and financial liabilities at fair value through profit or loss ("FVTPL")) are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition. Transaction costs directly attributable to the acquisition of financial assets or financial liabilities at fair value through profit or loss are recognized immediately in profit or loss.

Financial assets

All financial assets are recognized and de-recognized on the trade date.

THERMAL ENERGY INTERNATIONAL INC.

Notes to the Consolidated Financial Statements

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3. Significant accounting policies (continued):

(v) Financial instruments (continued):

Financial assets (continued):

The Company determines the classification of its financial assets on the basis of both the business model for managing the financial assets and the contractual cash flow characteristics of the financial asset. Financial assets are not reclassified subsequent to their initial recognition unless the Company changes its business model for managing financial assets.

A financial asset is measured at amortized cost if it is held within a business model whose objective is to hold assets to collect contractual cash flows, and its contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

The Company's financial assets are classified as follows:

Financial asset	Classification under IFRS 9
Cash and cash equivalents	Amortized cost
Trade and other receivables	Amortized cost
Finance lease receivable	Amortized cost

Amortized cost

Subsequent to initial recognition, financial assets at amortized cost are measured using the effective interest method, less any impairment. Interest income is recognized by applying effective interest rate except for short-term receivables where the interest revenue would be immaterial. Interest income, foreign exchange gains and losses, impairment, and any gain or loss on de-recognition are recognized in profit or loss.

Impairment of financial assets

The Company measures a loss allowance based on the lifetime expected credit losses. Lifetime expected credit losses are estimated based on factors such as the Company's past experience of collecting payments, the number of delayed payments in the portfolio past the average credit period, observable changes in national or local economic conditions that correlated with default on receivables, financial difficulty of the borrower, and it becoming probable that the borrower will enter bankruptcy or financial re-organization.

Financial assets are written off when there is no reasonable expectation of recovery.

THERMAL ENERGY INTERNATIONAL INC.

Notes to the Consolidated Financial Statements

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3. Significant accounting policies (continued):

(v) Financial instruments (continued):

Financial liabilities

The Company determines the classification of its financial liabilities at initial recognition. The Company's financial liabilities are classified as follows:

Financial liability	Classification under IFRS 9
Trade payables and other liabilities	Amortized cost
Contingent payable	FVTPL
Long-term debt	Amortized cost

Amortized cost

Financial liabilities at amortized cost are measured using the effective interest rate method. Interest expense is recognized by applying effective interest rate except for short-term payables where the interest expense would be immaterial.

FVTPL

Contingent payable is an acquisition consideration related liability. It is classified as FVTPL. Gains or losses are recognized in profit or loss.

(w) Segment reporting:

In identifying its operating segments, management generally follows the Company's key geographical areas, which reflect the business of the Company's two main operating units in Ottawa, Canada and Bristol, UK. In determining its reportable segments, the Company considers qualitative factors, such as operations which are considered to be significant by management, as well as quantitative factors, so that material revenues and expenses are appropriately disclosed. Management considers assets and liabilities on a global basis and does not assess on a segment basis. The reportable segments' financial results are reviewed quarterly by senior management and the Board. Corporate and other costs which are not easily attributable to any particular operating segment are separately disclosed within reconciling items.

The two main operating units are as follows:

- North America and China, managed from the Ottawa office.
- Europe and rest of world, managed from the Bristol office.

THERMAL ENERGY INTERNATIONAL INC.

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3. Significant accounting policies (continued):

(w) Segment reporting (continued):

Reconciling items comprise corporate administration costs, share-based compensation, professional fees, depreciation of property, plant and equipment, amortization of intangible assets, acquisition costs, bank charges and interest and foreign exchange differences. Corporate administration costs include employment costs of the Chief Executive Officer and Chief Finance Officer, directors' fees, directors' and officers' liability insurance, and shareholder and investor services expenses.

(x) New standards, amendments and interpretations to existing standards:

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

IFRS 16, "Leases" ("IFRS 16"):

Effective June 1, 2019, the Company adopted IFRS 16, which specifies how to recognize, measure, present and disclose leases. The standard provides a single lessee accounting model, requiring lessees to recognize assets and liabilities for all major leases.

Accounting policy under IFRS 16:

At inception of a contract, the Company assesses whether a contract is, or contains, a lease based on whether the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration.

The Company recognizes a right-of-use asset and a lease liability at the lease commencement date. The right-of-use asset is initially measured based on the initial amount of the lease liability adjusted for any lease payments made at or before the commencement date, plus any initial direct costs incurred and an estimate of costs to dismantle and remove the underlying asset or to restore the underlying asset or the site on which it is located, less any lease incentives received. The assets are depreciated to the earlier of the end of the useful life of the right-of-use asset or the lease term using the straight-line method as this most closely reflects the expected pattern of consumption of the future economic benefits. The lease term includes periods covered by an option to extend if the Company is reasonably certain to exercise that option. Lease terms range from 2 to 10 years for vehicles, equipment and offices. In addition, the right-of-use asset is periodically reduced by impairment losses, if any, and adjusted for certain remeasurements of the lease liability.

The lease liability is initially measured at the present value of the lease payments that are not paid at the commencement date, discounted using the interest rate implicit in the lease or, if that rate cannot be readily determined, the Company's incremental borrowing rate. Generally, the Company uses its incremental borrowing rate as the discount rate.

THERMAL ENERGY INTERNATIONAL INC.

Notes to the Consolidated Financial Statements

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(Expressed in Canadian dollars except share amounts)

3. Significant accounting policies (continued):

- (x) New standards, amendments and interpretations to existing standards (continued):

IFRS 16, "Leases" ("IFRS 16") (continued):

Accounting policy under IFRS 16 (continued):

The lease liability is subsequently measured at amortized cost using the effective interest method. It is remeasured when there is a change in future lease payments arising from a change in an index or rate, if there is a change in the Company's estimate of the amount expected to be payable under a residual value guarantee, or if the Company changes its assessment of whether it will exercise a purchase, extension or termination option.

When the lease liability is remeasured in this way, a corresponding adjustment is made to the carrying amount of the right-of-use asset, or is recorded in profit or loss if the carrying amount of the right-of-use asset has been reduced to zero.

The Company has elected to apply the practical expedient not to recognize right-of-use assets and lease liabilities for short-term leases that have a lease term of 12 months or less and leases of low-value assets. The lease payments associated with these leases are recognized as an expense in profit and loss on a straight-line basis over the lease term.

Impact of transition to IFRS 16:

Effective June 1, 2019, the Company adopted IFRS 16 using the modified retrospective approach and accordingly the information presented for the comparative period has not been restated. It remains as previously reported under IAS 17 and related interpretations.

On initial application, the Company has elected to record right-of-use assets based on the corresponding lease liability. Right-of-use assets and lease obligations of \$231,780 were recorded as of June 1, 2019, with no net impact on retained earnings. When measuring lease liabilities, the Company discounted lease payments using its incremental borrowing rate as at June 1, 2019. The weighted-average rate applied is 6.6%.

The Company has elected to apply the practical expedient not to recognize right-of-use assets and lease liabilities for leases for which the lease term ends within 12 months of the date of initial application.

The Company has elected to apply the practical expedient to grandfather the assessment of which transactions are leases on the date of initial application, as previously assessed under IAS 17 and IFRIC 4. The Company applied the definition of a lease under IFRS 16 to contracts entered into or changed on or after June 1, 2019.

THERMAL ENERGY INTERNATIONAL INC.

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3. Significant accounting policies (continued):

(x) New standards, amendments and interpretations to existing standards (continued):

IFRS 16, "Leases" ("IFRS 16") (continued):

Impact of transition to IFRS 16 (continued):

The following table reconciles the Company's operating lease obligations as at May 31, 2019, as previously disclosed in the Company's consolidated financial statements, to the lease obligations recognized on initial application of IFRS 16 at June 1, 2019.

Aggregate lease commitments as disclosed at May 31, 2019	\$1,351,406
*Less: lease committed but not commenced as at June 1, 2019	(1,074,642)
Less: recognition exemption for short-term leases (leases that expire on or prior to May 31, 2020)	(85,955)
Less: recognition exemption for low-value assets	(14,493)
Add: extension options reasonably certain to be exercised	75,994
Less: foreign exchange and other adjustments	16
Adjusted lease commitments	252,326
Less: impact of present value	(20,546)
Opening IFRS 16 lease liability as at June 1, 2019 (note 13)	\$ 231,780

*The Company entered a 10-year lease for an office space before May 31, 2019. The lease was included in the lease commitment note in the consolidated financial statements at May 31, 2019. The lease commencement date was September 1, 2019. On June 1, 2019, the Company did not recognize the lease obligation and the right-of-use asset for this lease because the lease term had not started (see note 18).

4. Business acquisition:

On June 29, 2018, the Company acquired all of the issued and outstanding shares of Boilerroom Equipment Inc., a company based in Pennsylvania, U.S., which engineers and manufactures a brand of indirect contact heat recovery units.

The Company completed the acquisition for cash consideration of \$2,713,449 (including cash acquired in the amount of \$40,555 and the purchase price adjustment paid in the amount of \$60,049 during the year), plus holdback payable of \$264,545 to be released and paid in cash or shares at seller's choice after eighteen months from the acquisition date, and contingent payable with an estimated fair value of \$93,222 (note 28) at date of acquisition, resulting in total consideration of \$3,071,216.

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4. Business acquisition (continued):

The contingent consideration is payable in cash or shares at Company's choice over a three-year post-acquisition period based on Boilerroom Equipment Inc. meeting certain performance targets. The maximum amount of payment is \$473,445 (equivalent to USD\$350,000). The estimated fair value of the contingent consideration payable at the date of acquisition was calculated using the Monte Carlo model. Further information on the fair value of the contingent payable is provided in note 28.

The transaction was accounted for using the acquisition method with the results of operations included in the consolidated financial statements from the date of the acquisition.

The purchase price allocation is as follows:

	Total \$
Assets acquired:	
Cash and cash equivalents	40,555
Trade and other receivables	418,310
Inventory	222,258
Property, plant and equipment (note 10)	197,413
Intangible assets (note 11)	1,765,837
	<u>2,644,373</u>
Liabilities assumed:	
Trade payables	(101,772)
Pensions and other employer obligations	(26,607)
Other liabilities	(263)
Deferred revenue	(202,333)
Provisions (note 17)	(11,193)
Deferred tax liability	(520,854)
	<u>(863,022)</u>
Goodwill (note 12)	1,289,865
	<u>3,071,216</u>
Total Consideration	3,071,216

The goodwill arising on the acquisition is not expected to be deductible for tax purposes. The carrying value of property, plant and equipment and the intangible assets acquired in the business combination was different from their tax base. Therefore, a deferred tax liability of \$520,854 was recognized at the US net effective tax rate of 27% on the difference between the tax base and the carrying value of these assets on the date of the acquisition. During the year ended May 31, 2020, the Company recognized an income tax recovery of \$112,620 (\$76,620 at May 31, 2019) due to the decrease in the difference between the tax base and the carrying value of these assets and a foreign translation loss in the amount of \$6,686 (\$8,501 at May 31, 2019) to accumulated other comprehensive income related to the revaluation of the deferred tax liability with the period-end closing rate. As at May 31, 2020, the carrying value of the deferred tax liability arising from the acquisition was \$346,801 (\$452,735 at May 31, 2019).

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4. Business acquisition (continued):

The acquisition contributed revenue and net income of \$2,112,518 and \$116,586 during the year ended May 31, 2019.

5. Segment reporting:

In fiscal 2020 and 2019, the Company operated in the energy efficiency industry in North America, Europe, China and 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 and Europe.

Management reporting comprises analysis of revenue and gross profit 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 Ottawa, 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.

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5. Segment reporting (continued):

Segment information for the year ended May 31, 2020 and the comparative year are detailed in the table below:

	Thermal Energy Ottawa		Thermal Energy Bristol		Reconciling Items		Total	
	2020	2019	2020	2019	2020	2019	2020	2019
	\$	\$	\$	\$	\$	\$	\$	\$
Total revenue from external customers	13,337,357	16,648,483	8,078,818	4,434,773	-	-	21,416,175	21,083,256
Cost of sales ⁽¹⁾	(8,452,200)	(10,806,725)	(4,009,922)	(2,235,325)	-	-	(12,462,122)	(13,042,050)
Gross profit	4,885,157	5,841,758	4,068,896	2,199,448	-	-	8,954,053	8,041,206
Other expenses ⁽¹⁾	(3,215,008)	(3,585,362)	(3,266,531)	(3,284,294)	(1,330,632)	(1,449,375)	(7,812,171)	(8,319,031)
Other income	133,826	-	-	-	-	-	133,826	-
Impairment of intangible assets	(103,548)	-	(396,170)	-	-	-	(499,718)	-
Impairment of goodwill	(1,360,450)	-	(1,201,032)	-	-	-	(2,561,482)	-
Net finance income (costs)	(19,319)	20,413	(14,179)	-	(381,578)	(302,394)	(415,076)	(281,981)
Income (loss) before taxation	320,658	2,276,809	(809,016)	(1,084,846)	(1,712,210)	(1,751,769)	(2,200,568)	(559,806)
Tax recovery (expense)	208,132	52,969	(8,236)	(113,030)	103,715	168,764	303,611	108,703
Profit (loss) after taxation	528,790	2,329,778	(817,252)	(1,197,876)	(1,608,495)	(1,583,005)	(1,896,957)	(451,103)
Attributable to:								
Owners of the parent	548,847	2,378,592	(838,795)	(1,219,873)	(1,608,495)	(1,583,005)	(1,898,443)	(424,286)
Non-controlling interest	(20,057)	(48,814)	21,543	21,997	-	-	1,486	(26,817)

(1) The Company reclassified commission expenses from other expenses to cost of sales for the year ended May 31, 2020. As a result, commission expenses in the amount of \$1,192,170 for the year ended May 31, 2019 were also reclassified to cost of sales to conform to the current year presentation.

Reconciling items comprise the following:

	2020	2019
Corporate administration costs	\$ 633,600	\$ 696,564
Share-based compensation	203,793	115,346
Professional fees	180,109	138,092
Depreciation of property, plant and equipment	110,422	84,509
Amortization of intangible assets	280,580	253,976
Acquisition costs	33,973	148,849
Bank charges and interest	-	20,467
Foreign exchange differences	(111,845)	(8,428)
Total	1,330,632	\$ 1,449,375

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.

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5. Segment reporting (continued):

Finance costs within the reconciling items include interest and deferred financing charge on the long-term debt and interest accretion on contingent consideration and holdback payable following the acquisition of Boilerroom Equipment Inc.

During the year ended May 31, 2020, the Company had two customers in North America that accounted for 29.4% and 10.9% of total consolidated revenue for the year.

During the year ended May 31, 2019, the Company had two customers in North America that accounted for 33.4% and 13.8% of total consolidated revenue for the year.

Further geographical analysis:

	Sales for the year ended May 31,		Property, plant and equipment as at May 31,		Goodwill and intangibles assets as at May 31,	
	2020	2019	2020	2019	2020	2019
	\$	\$	\$	\$	\$	\$
U.S.A.	9,689,024	7,560,979	135,506	172,640	1,179,829	2,856,004
Canada	3,562,712	9,037,678	229,780	49,136	–	–
U.K.	2,665,328	3,373,480	66,311	38,426	235,927	1,839,813
Norway	1,620,667	19,655	–	–	–	–
Ireland	1,508,915	16,216	–	–	–	–
Germany	902,838	226,504	–	–	–	–
Poland	299,919	147,459	–	–	–	–
France	245,786	1,537	–	–	–	–
Italy	151,917	416,046	–	–	–	–
Spain	108,859	29,494	–	–	–	–
Netherlands	46,419	106,779	–	–	–	–
Rest of Europe	28,843	50,295	–	–	–	–
Kenya	194,561	46,115	–	–	–	–
Mauritius	110,153	–	–	–	–	–
India	83,742	27,125	–	–	–	–
UAE	83,486	–	–	–	–	–
Rest of world	113,006	23,894	–	–	–	–
Total	21,416,175	21,083,256	431,597	260,202	1,415,756	4,695,817

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6. Cash and cash equivalents:

Cash equivalents consist of excess cash invested in money market funds.

	2020	2019
Cash	4,774,080	\$ 4,176,760
Cash equivalents	500	500
Balance, end of year	4,774,580	\$ 4,177,260

7. Trade and other receivables:

	2020	2019
Trade receivables, gross	\$ 1,888,144	\$ 1,981,726
Allowance for doubtful accounts	(67,438)	(22,864)
Trade receivables, net	1,820,706	1,958,862
Unbilled revenue	77	290,420
Work in progress	10,289	97,109
Prepayments	166,144	298,746
Sales tax and other miscellaneous receivables	214,165	372,072
Balance, end of year	\$ 2,211,381	\$ 3,017,209

The net carrying value of trade receivables is considered a reasonable approximation of fair value.

At May 31, 2020, \$189,442 (10%) of the Company's trade receivables balance was over 90 days past due (\$123,223 (6.2%) at May 31, 2019). \$61,120 of the past due balance was impaired at May 31, 2020 (\$22,864 at May 31, 2019). \$6,318 of trade receivables that was not over 90 days past due was also impaired.

The change in allowance for doubtful accounts was as follows:

	2020	2019
Balance, beginning of year	\$ 22,864	\$ 23,074
Provisions	217,647	219,445
Release of provisions	(34,962)	-
Amounts written off	(138,024)	(219,445)
Foreign exchange adjustments	(87)	(210)
Balance, end of year	\$ 67,438	\$ 22,864

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7. Trade and other receivables (continued):

The Company's trade and other receivables have been reviewed for indicators of impairment. For the year ended May 31, 2020, provisions of \$195,212 (net of \$22,435 sales tax) were made as expected credit losses and recorded under administrative expenses. \$31,062 of the provisions was subsequently released due to the collection on the doubtful account (net of \$3,900 sales tax). \$106,241 (net of \$15,910 sales tax) of the provisions related to one customer (see note 9). For the year ended May 31, 2019, trade receivables amounting to \$195,075 were provided for and written off as expected credit losses under administrative expenses (net of \$24,370 sales tax).

8. Inventory:

Inventory is comprised of partly finished products purchased from suppliers and held in inventory pending finishing to the customers' requirements.

For the year ended May 31, 2020, a total of \$ 1,070,859 of inventories was expensed to cost of sales (\$911,864 at May 31, 2019). A total of \$9,453 of inventories (\$39,604 at May 31, 2019) were written off as obsolete. No reversal of previous write-downs has been recorded during the years ended May 31, 2020 or May 31, 2019.

9. Finance lease receivable:

The Company's finance lease receivable includes the following:

	2020	2019
Total estimated minimum lease payments receivable	\$ 47,500	\$ 100,053
Less: unearned income	(1,652)	(6,796)
Less: write-down	(45,848)	-
	-	93,257
Less: current portion	-	(93,257)
	-	-

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.

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9. Finance lease receivable (continued):

On December 16, 2019, Fortress Specialty Cellulose sought and obtained a First Day Initial Order under the Companies' Creditors Arrangement Act from the Quebec Superior Court. The Company's finance lease receivable was reviewed for indicators of impairment. For the year ended May 31, 2020, a write-down of \$45,848 was recognized on the remaining finance lease receivable under administrative expenses. Trade receivables from the customer amounting to \$106,241 (net of \$15,910 sales tax) were provided for and written off as expected credit loss under administration expenses (note 7).

10. Property, plant and equipment:

	Plant and Equipment	Furniture and Fixtures	Laboratory Equipment	Computers	Leasehold Improve- ments	Motor Vehicles	Total
	\$	\$	\$	\$	\$	\$	\$
Cost, May 31, 2018	167,282	102,768	52,857	360,948	22,877	7,362	714,094
Additions	31,777	3,868	-	37,853	-	-	73,498
Additions from acquisition (note 4)	192,770	-	-	-	-	4,643	197,413
Disposals	(7,923)	-	-	-	-	(7,456)	(15,379)
Translation adjustments	2,904	(35)	-	(675)	-	185	2,379
Cost, May 31, 2019	386,810	106,601	52,857	398,126	22,877	4,734	972,005
Additions	43,327	35,129	-	32,976	169,116	-	280,548
Disposals	(1,432)	-	-	-	-	-	(1,432)
Translation adjustments	3,834	(30.83)	-	(190)	-	91	3,704
Cost, May 31, 2020	432,539	141,699	52,857	430,912	191,993	4,825	1,254,825
Accumulated depreciation, May 31, 2018	115,747	102,768	52,857	336,931	22,877	5,519	636,699
Depreciation for the year	56,479	777	-	24,717	-	2,536	84,509
Disposals	(1,718)	-	-	-	-	(7,149)	(8,867)
Translation adjustments	39	(33)	-	(506)	-	(38)	(538)
Accumulated depreciation, May 31, 2019	170,547	103,512	52,857	361,142	22,877	868	711,803
Depreciation for the year	62,968	6,013	-	28,121	12,382	938	110,422
Disposals	(428)	-	-	-	-	-	(428)
Translation adjustments	1,590	(9)	-	(193)	-	43	1,431
Accumulated depreciation, May 31, 2020	234,677	109,516	52,857	389,070	35,259	1,849	823,228
Net book value, May 31, 2019	216,263	3,089	-	36,984	-	3,866	260,202
Net book value, May 31, 2020	197,862	32,183	-	41,842	156,734	2,976	431,597

During the year ended May 31, 2020, the Company disposed of depreciated assets with a net book value of \$1,004 for \$nil in proceeds.

During the year ended May 31, 2019, the Company disposed of depreciated assets with a net book value of \$6,512 for \$6,833 in proceeds.

THERMAL ENERGY INTERNATIONAL INC.

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10. Property, plant and equipment (continued):

There are no property, plant and equipment held under finance leases and no items of property, plant or equipment are subject to restrictions of title or pledged as security.

11. Intangible assets:

	Cost, May 31, 2019	Translation adjustments	Cost, May 31, 2020
	\$	\$	\$
Trade names and trademarks	784,990	(2,852)	782,138
Non-compete agreement	102,390	(372)	102,018
Industrial know-how	119,455	(434)	119,021
Designs and drawings	131,400	(477)	130,923
Customer relationships	749,607	7,973	757,580
Existing technology	723,695	13,910	737,605
Proprietary software	407,163	7,826	414,989
Brand portfolio	201,552	3,874	205,426
Total	3,220,252	29,448	3,249,700

	Accumulated amortization and impairment, May 31, 2019	Impairment	Amortization	Translation adjustments	Accumulated amortization and impairment, May 31, 2020
	\$	\$	\$	\$	\$
Trade names and trademarks	150,590	396,170	-	(548)	546,212
Non-compete agreement	102,390	-	-	(372)	102,018
Industrial know-how	119,455	-	-	(434)	119,021
Designs and drawings	131,400	-	-	(477)	130,923
Customer relationships	353,078	-	77,289	2,567	432,934
Existing technology	94,769	-	102,435	4,759	201,963
Proprietary software	93,308	-	100,856	4,685	198,849
Brand portfolio	-	103,548	-	(1,524)	102,024
Total	1,044,990	499,718	280,580	8,656	1,833,944
Net book value	2,175,262				1,415,756

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11. Intangible assets (continued):

	Cost, May 31, 2018	Additions from acquisitions (note 4)	Translation adjustments	Cost, May 31, 2019
	\$	\$	\$	\$
Trade names and trademarks	792,213	-	(7,223)	784,990
Non-compete agreement	103,332	-	(942)	102,390
Industrial know-how	120,554	-	(1,099)	119,455
Designs and drawings	132,609	-	(1,209)	131,400
Customer relationships	284,163	459,038	6,406	749,607
Existing technology	-	709,784	13,911	723,695
Proprietary software	-	399,337	7,826	407,163
Brand portfolio	-	197,678	3,874	201,552
Total	1,432,871	1,765,837	21,544	3,220,252

	Accumulated amortization and impairment, May 31, 2018	Amortization	Translation adjustments	Accumulated amortization and impairment, May 31, 2019
	\$	\$	\$	\$
Trade names and trademarks	151,975	-	(1,385)	150,590
Non-compete agreement	103,332	-	(942)	102,390
Industrial know-how	120,554	-	(1,099)	119,455
Designs and drawings	132,609	-	(1,209)	131,400
Customer relationships	284,163	69,958	(1,043)	353,078
Existing technology	-	92,725	2,044	94,769
Proprietary software	-	91,293	2,015	93,308
Total	792,633	253,976	(1,619)	1,044,990
Net book value	640,238			2,175,262

Trade Names and Trademarks and Brand portfolio are intangible assets with indefinite lives and are not subject to amortization. They are tested for impairment at each year-end.

Trade Names and Trademarks relate specifically to the GEM™ product. An impairment charge of \$396,170 was recognized for the year ended May 31, 2020 (\$nil at May 31, 2019). The impairment is caused by the decline in the internal forecasts of GEM™ product revenues due partly to economic uncertainty arising from the COVID-19 pandemic. The growth rates attributed by Management to the GEM™ product line are -26.1% in 2021, 5.3% in 2022, followed by positive 10% in each of the subsequent three years. This is lower than the compound annual growth rate over the previous four years of 12%. The Company is expecting lower revenues in the next two years than the amount recognized in 2020 due to the COVID-19 pandemic. The Company is expecting higher growth rates after 2022 as the Company will continue to invest in its sales force post pandemic and will have an increased number of experienced sales staff within the UK and North America. The royalty rate applied to the revenues for the purposes of impairment testing is 1%.

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11. Intangible assets (continued):

Brand portfolio relates specifically to Boilerroom Equipment Inc's products. An impairment charge of \$103,548 was recognized for the year ended May 31, 2020 (\$nil at May 31, 2019). The impairment is caused by the decline in the internal forecasts of brand portfolio related revenues due partly to economic uncertainty arising from the COVID-19 pandemic and the lower than expected revenues recognized during the post-acquisition period from June 29, 2018, the acquisition date, to May 31, 2020. The growth rates attributed by Management to the product line are 4.4% in 2021, 0% in 2022, followed by positive 10% in each of the subsequent three years. The Company is expecting lower growth rate in the next two years due to the COVID-19 pandemic, but is expecting the revenue to grow back to the pre-pandemic level by 2023 as Boilerroom Equipment Inc. will continue to expand its sales territories by utilizing the existing sales channels and network that have been established by the group of companies post pandemic. The royalty rate applied to the revenues for the purposes of impairment testing is 1%.

All other assumptions relating to the calculation of the pre-tax discount rate are as detailed in Goodwill (note 12).

12. Goodwill:

Goodwill arose as a result of the acquisition of Gardner Energy Management Limited on July 1, 2008, and the acquisition of Boilerroom Equipment Inc. on June 29, 2018. Goodwill consists of the following amounts:

	2020	2019
Balance, beginning of year	\$ 2,520,555	\$ 1,216,501
Additions (note 4)	-	1,289,865
Translation adjustments	40,927	14,189
Impairment	(2,561,482)	-
Balance, end of year	-	\$ 2,520,555
From acquisition of Gardner Energy Management Limited	-	1,205,412
From acquisition of Boilerroom Equipment Inc.	-	1,315,143
Balance, end of year	-	\$ 2,520,555

Goodwill arose in these acquisitions because the cost of acquisition included a control premium. In addition, the consideration paid for the combination reflected the benefit of expected revenue growth and future market development. These benefits were not recognized separately from goodwill because they do not meet the recognition criteria for identifiable intangible assets.

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12. Goodwill (continued):

The annual impairment test for goodwill arising as a result of the acquisition of Gardner Energy Management Limited:

For the purpose of annual impairment testing, goodwill is allocated to the following cash-generating units, which are the units expected to benefit from the synergies of the business combinations in which the goodwill arises: Thermal Energy International (UK) Limited and GEMChem Limited, a 67% owned subsidiary of Thermal Energy International (UK) Limited.

Goodwill was tested for impairment as at May 31, 2020, resulting in a total impairment charge of \$1,201,032 (\$nil at May 31, 2019) in the Thermal Energy International (UK) Ltd and GEMchem Limited cash-generating units, which were both included in the "Europe and Rest of World" reporting segment.

The carrying amount of goodwill allocated to each cash-generating unit as at May 31 was as follows:

	2020	2019
Thermal Energy International (UK) Limited	-	\$ 1,027,936
GEMchem Limited	-	177,476
Balance, end of year	-	\$ 1,205,412

The recoverable amounts of the cash-generating units were determined based on value-in-use calculations, covering a two-year forecast, followed by an extrapolation over three further years of expected cash flows to be derived from the cash-generating units assuming growth rates as set out below, and applying a pre-tax discount rate of 23% (2019 - 22%) for both cash-generating units. The pre-tax discount rate used represents the weighted average cost of capital ("WACC") of each cash-generating unit, which includes the cost of equity and the cost of debt. The cost of equity was computed as 19% (2019 - 18%) for each cash-generating unit, incorporating the following factors: market risk premium adjusted for the target levered beta, based upon comparable companies, the risk-free rate of return and a size and company specific risk premium. The cost of debt was assumed as the risk-free rate plus a premium of 3%. In computing the WACC, a capital structure comprising 14% (2019 - 13%) debt and 86% (2019 - 87%) equity was assumed, after considering the capital structure of comparable companies.

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12. Goodwill (continued):

The annual impairment test for goodwill arising as a result of the acquisition of Gardner Energy Management Limited (continued):

The carrying amount of Thermal Energy International (UK) Ltd cash-generating unit was determined to be higher than its recoverable amount of \$1,445,000 and an impairment charge of \$1,024,201 was recognized for the year ended May 31, 2020 (\$nil at May 31, 2019). The impairment charge was fully allocated to goodwill. The impairment charge was caused by the decline in the internal forecasts of revenues to be generated by the cash-generating unit for the next year due partly to economic uncertainty arising from the COVID-19 pandemic. For purposes of the May 31, 2020 impairment testing, Thermal Energy International (UK) Limited's growth in the first year was assumed to be negative 31%, the second year to be positive 37%, as per the two-year forecast prepared, with positive 7% growth per annum thereafter. The Company is expecting lower revenues due to the COVID-19 impact in the first year than the revenues recognized in 2020, but is expecting the revenues to recover to its pre-pandemic level by 2022. The Company is expecting steady growth rates of 7% after 2022 based on the fact that the Company had achieved increased sales on long-term contracts pre-pandemic and built an increased level of experience in the existing sales force in both Europe and North America, as well as additional sales representation in Europe.

The carrying amount of GEMchem Limited cash-generating unit was determined to be higher than its recoverable amount of negative \$34,000 and an impairment charge of \$176,831 was recognized for the year ended May 31, 2020 (\$nil at May 31, 2019). The impairment charge was fully allocated to goodwill. The impairment charge was caused by the decline in the internal forecasts of revenues because of the employee turnover in the sales group and because of the slow-down of the sales activities due to the COVID-19 pandemic. GEMChem Limited's growth in the first year was assumed to be negative 13%, the second year to be 0%, with positive 5% growth per annum thereafter. The Company is expecting the revenues to recover to its pre-pandemic level slowly over the next few years.

Summary of rates used:

Cash Generating Unit		Average Revenue Growth rates		Discount rates	
		2020	2019	2020	2019
Thermal Energy International (UK)	Year 1	-31%	137%	23%	22%
	Year 2	37%	7%		
	Year 3	7%	7%		
	Year 4	7%	7%		
	Year 5	7%	7%		
GEMchem	Year 1	-13%	10%	23%	22%
	Year 2	0%	10%		
	Year 3	5%	10%		
	Year 4	5%	10%		
	Year 5	5%	10%		

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12. Goodwill (continued):

The annual impairment test for goodwill arising as a result of the acquisition of Gardner Energy Management Limited (continued):

Management's key assumptions for the above two cash-generating units include stable gross profit margins, based on past experience in the market. The Company's management believes that this is the best available input for forecasting. Cash flow projections reflect stable gross profit margins achieved immediately before the forecasted period. No expected efficiency improvements have been taken into account and prices and wages reflect forecasts of inflation for the industry. There is significant estimation uncertainty involved in the determination of the recoverable amount of the cash generating units.

The annual impairment test for goodwill arising as a result of the acquisition of Boilerroom Equipment Inc.:

For the purpose of annual impairment testing, goodwill is allocated to the Boilerroom Equipment Inc. cash-generating unit. Goodwill was tested for impairment at year end, resulting in an impairment charge of \$1,360,450 as at May 31, 2020 (\$nil at May 31, 2019) in the Boilerroom Equipment Inc. cash-generating unit, which was included in the "North America and China" reporting segment.

The recoverable amounts of the cash-generating unit was determined based on value-in-use calculations, covering a two-year forecast, followed by an extrapolation over three further years of expected cash flows to be derived from the cash-generating unit assuming growth rates as set out below, and applying a pre-tax discount rate of 20% (2019 - 19%) for the cash-generating unit. The pre-tax discount rate used represents the weighted average cost of capital ("WACC") of the cash-generating unit, which includes the cost of equity and the cost of debt. The cost of equity was computed as 17% (2019 - 16%) for the cash-generating unit, incorporating the following factors: market risk premium adjusted for the target levered beta, based upon comparable companies, the risk-free rate of return and a size and company specific risk premium. The cost of debt was assumed as the risk-free rate plus a premium of 3%. In computing the WACC, a capital structure comprising 14% debt (2019 - 13%) and 86% (2019 - 87%) equity was assumed, after considering the capital structure of comparable companies.

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12. Goodwill (continued):

The annual impairment test for goodwill arising as a result of the acquisition of Boilerroom Equipment Inc. (continued):

The carrying amount of Boilerroom Equipment Inc. cash-generating unit was determined to be higher than its recoverable amount of \$839,000 and an impairment charge of \$1,360,450 was recognized for the year ended May 31, 2020 (\$nil at May 31, 2019). The impairment charge was fully allocated to goodwill. The impairment charge was a result of lower revenues forecasted for the next two years because of the fact that Boilerroom's post-acquisition revenues from June 29, 2018, the acquisition date, to May 31, 2020, had been lower than anticipated at the time of acquisition. The lower forecasted revenues were also due to the economic uncertainty arising from the COVID-19 pandemic. Considering the difficulty in predicting the timing of the end of the pandemic, management is predicting slower growth in the next two years. For purposes of the May 31, 2020 impairment testing, Boilerroom Equipment Inc.'s growth in the first year was assumed to be 5%, the second year to be 0%, as per the two-year forecast prepared, with positive 10% growth per annum thereafter. The Company is expecting lower growth in revenues due to the COVID-19 impact for the first two years. The Company is expecting steady growth rates of 10% after 2022 as the Company will continue the sales development in European markets through the existing sales channels established by the Company.

Summary of rates used:

Cash Generating Unit		Average Revenue Growth rates		Discount rates	
		2020	2019	2020	2019
Boilerroom Equipment Inc.	Year 1	5%	14%	20%	19%
	Year 2	0%	11%		
	Year 3	10%	11%		
	Year 4	10%	11%		
	Year 5	10%	11%		

Management's key assumptions include stable gross profit margins, based on past experience in the market. The Company's management believes that this is the best available input for forecasting. Cash flow projections reflect stable gross profit margins achieved immediately before the forecasted period. No expected efficiency improvements have been taken into account and prices and wages reflect forecasts of inflation for the industry. There is significant estimation uncertainty involved in the determination of the recoverable amount of the cash generating unit.

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13. Right-of-use assets:

	Offices	Vehicles	Equipment	Total right-of-use assets
	\$	\$	\$	\$
Balance, May 31, 2019	-	-	-	-
Balance, June 1, 2019, (note 3(x))	123,114	90,666	18,000	231,780
Additions (note 18)	296,519	35,231	-	331,750
Lease modification	(15,258)	-	-	(15,258)
Depreciation	(88,077)	(30,780)	(7,042)	(125,899)
Translation adjustments	(509)	(583)	57	(1,035)
Balance, end of year	315,789	94,534	11,015	421,338

14. Trade payables and other liabilities:

Trade payables and other liabilities recognized in the statements of financial position can be summarized as follows:

	2020	2019
Trade payables	\$ 1,156,736	\$ 914,497
Accruals	1,118,819	1,387,381
Other government remittances payable	891,162	247,692
Government grants	271,210	-
	\$ 3,437,927	\$ 2,549,570

Included in accruals is \$46,580 due to directors (\$26,600 at May 31, 2019).

On May 11 and 12, 2020, the Company obtained financing in the total amount of \$309,423 (equivalent to USD\$221,127) under the Paycheck Protection Program pursuant to the CARES Act in the U.S. The loans can be forgiven for applicants that meet eligible payroll and non-payroll costs over a certain covered period. As at May 31, 2020, management estimated that the Company would meet the forgiveness criteria. For the year ended May 31, 2020, a total amount of \$34,161 was recognized as a reduction to the operating expenses, of which \$15,166 was netted against administration expenses and \$18,995 against selling, marketing and business development expenses, for the portion of the grant earned from origination date to the reporting date. A foreign translation gain in the amount of \$4,052 was recognized to accumulated other comprehensive income related to the revaluation of the liability with the year-end closing rate.

All amounts are short-term. The carrying values of trade payables are considered to be a reasonable approximation of fair value.

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15. Long-term debt:

	2020	2019
Term loan (equivalent to USD\$2,001,648), net of deferred financing costs of \$32,196 (equivalent to USD\$23,352), bearing interest at US dollar floating base rate plus a variance of between 1.50% to 8.00%, repayable in monthly principal instalments of \$34,468 (equivalent to USD\$25,000) starting July 1, 2019 and continuing up to the maturity date, with a balloon payment of \$654,883 (equivalent to USD\$475,000) payable on the maturity date, December 1, 2025	\$2,759,672	\$ 3,005,860
Less: current portion	(269,886)	(371,993)
Long term portion	2,489,786	2,633,867

The Company entered into an agreement with a lending institution on June 12, 2018 for a secured seven-year term loan in the amount of \$2,893,959 (equivalent to USD\$2,216,250) net of deferred financing costs of \$43,416 (equivalent to USD\$33,750). On March 19, 2020, the lender agreed to postpone the next 3 payments of principal to the end of the payment schedule. On May 13, 2020, the lender agreed to further postpone another 3 payments to the end of the payment schedule. Consequently, the maturity date of the loan was extended by 6 months from June 1, 2025 to December 1, 2025.

This loan bears interest at the institution's US dollar floating base rate, plus a variance. The US dollar floating base rate was at 4.70% on May 31, 2020 (7.00% on May 31, 2019). Interest is payable monthly in arrears on the 1st day of the month commencing on the August 1st, 2018.

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15. Long-term debt (continued):

As at May 31, 2020, the variance was 8.00% (1.50% at May 31, 2019). The variance is reset annually based on the Company's consolidated total funded debt to EBITDA ratio:

Consolidated total funded debt /EBITDA ⁽¹⁾	Variance
Less than 2.50	1.50%
Between 2.50 and 3.00	2.00%
Between 3.00 and 3.50	2.50%
Between 3.50 and 3.75	4.50%
Between 3.75 and 4.00	5.50%
More than 4.00	8.00%

(1) EBITDA, per the agreement, means, for any fiscal period, the net income from continuing operations (excluding any extraordinary gains or losses) plus, to the extent deducted in determining net income, interest expense, taxes paid and accrued, depreciation, depleting and amortization expenses, plus share-based compensation deducted, for the period. EBITDA is also before the acquisition costs related to the acquisition of Boilerroom Equipment Inc. to a cumulative maximum of USD\$400,000.

The Company has certain covenants in accordance with this term loan. As at May 31, 2020, the Company was in compliance with its covenants under the term loan agreement.

16. Deferred revenue:

The change in deferred revenue was as follows:

	Deferred revenue relating to heat recovery solutions	Deferred revenue relating to sales of goods and rendering of services	Total deferred revenue
Balance, beginning of year	\$ 2,530,047	\$ 74,543	\$ 2,604,590
Increase from payments received	13,409,301	408,327	13,817,628
Decrease from revenue recognized	(15,229,727)	(318,433)	(15,548,160)
Translation adjustments	61,468	1,702	63,170
Balance, end of year	\$ 771,089	\$ 166,139	\$ 937,228

All amounts are short-term and will be settled within the next reporting year.

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17. Provisions:

The change in provisions was as follows:

	Legal provision	Warranty provision	Total provisions
Balance, beginning of year	\$ 190,000	\$ 93,478	\$ 283,478
Translation adjustments	-	157	157
Balance, end of year	\$ 190,000	\$ 93,635	\$ 283,635

On October 25, 2005, the Company was served with a statement of claim from its past President. Among other things, the lawsuit alleges that the former president was wrongfully dismissed from his employment. In November 2009, the Company recorded a provision of \$190,000 in its financial statements. In May, 2010, the plaintiff brought a motion for summary judgment. On October 18, 2011, a decision was rendered. In its decision on the motion for summary judgment the court: i) Allowed the plaintiff's claim for wrongful dismissal assessing the damages for the plaintiff's wrongful dismissal at the equivalent of 18 months of pay in lieu of notice of termination; ii) Dismissed the plaintiff's claim for alleged unpaid loans and advances in the amount of \$618,810; iii) Permitted the remainder of the parties' claims and counterclaims to proceed to trial. As such, the remainder of the parties' claims and counterclaims will proceed to trial. In the event the past President and the Company cannot agree on the damages for his wrongful dismissal claim, the matter will be determined by the court. However, there has been no progress since October 18, 2011. Until the remaining issues are determined, it is unclear what the net balance payable will be. While the Company is confident in the merits of its own case, there is much that is still unknown about the past President's case and the basis for his damages claim. This provision remains unchanged as at May 31, 2020 and is intended to account for future net liabilities resulting from the claim and the counterclaim.

Other than the legal provision of \$190,000, the Company has another provision of \$93,635 for warranty.

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18. Lease obligations:

The following table presents the contractual undiscounted cash flows for lease obligations as of May 31, 2020:

Less than one year	\$ 141,157
One to five years	293,827
Six to ten years	286,500
Total undiscounted lease obligations	721,484
Less: impact of present value	(184,239)
Less: current portion	(105,269)
Long term portion	\$ 431,976

For the year ended May 31, 2020, interest expense on lease obligations was \$34,101; total cash outflow for leases was \$250,993, including \$117,060 for short-term leases. Expenses for leases of low-dollar value items are not material. Extension options are included in the measurement of lease obligations when the Company is reasonably certain to exercise that option.

The Company entered a 10-year lease for an office space before May 31, 2019. The lease was included in the lease commitment note in the consolidated financial statements at May 31, 2019 in the amount of \$1,074,642 (note 3(x)), which included variable lease payments of \$579,642. On September 1, 2019, the lease commencement date, the Company recognized the lease obligation and the right-of-use asset of \$296,519 for this lease (note 13) under IFRS 16. Variable lease payments were not included in the measurement of the lease obligation. For the year ended May 31, 2020, the Company received a lease incentive of \$90,000.

19. Capital stock:

Authorized:

Unlimited number of Class A common shares, no par value.

Unlimited number of Series 1 preferred shares, voting only in the case of dissolution of the Company, redeemable at the option of the Company, at \$0.01 per share and convertible to common shares on a 1 to 1 basis at the rate of 20% of the number originally issued per year.

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19. Capital stock (continued):

Outstanding:

	Year ended May 31, 2020		Year ended May 31, 2019	
	# Shares	\$	# Shares	\$
Class A Common shares issued				
Balance, beginning of year	161,885,616	32,464,780	159,088,950	32,231,329
Stock options exercised ⁽¹⁾	-	-	2,796,666	233,451
Shares purchased and cancelled ⁽²⁾	(1,733,000)	(347,538)	-	-
Balance, end of year	160,152,616	32,117,242	161,885,616	32,464,780

(1) For the year ended May 31, 2020, no share options were exercised. For the year ended May 31, 2019, 2,796,666 shares were issued for \$141,958 following the exercise of stock options, resulting in an increase to capital stock of \$233,451 and a reduction in contributed surplus of \$91,493.

(2) For the year ended May 31, 2020, 1,733,000 shares were purchased for cancellation by the Company for a total purchase price of \$127,317, resulting in a reduction to capital stock of \$347,538 and an increase in contributed surplus of \$220,221. For the year ended May 31, 2019, no shares were purchased for cancellation.

Normal Course Issuer Bid:

On November 19, 2019, the Company announced its intent to re-launch the Normal Course Issuer Bid ("NCIB") for a further period of twelve months. The NCIB was approved by the TSX Venture Exchange on November 18, 2019. During the 12-month period commencing November 22, 2019 and ending November 21, 2020, the Company may purchase on the TSX up to 8,094,280 common shares, representing approximately 5% 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. All the purchased Class A common shares were purchased and cancelled directly under the NCIB for the year ended May 31, 2020.

20. Capital management:

The Company's objectives when managing capital is to ensure financial stability and sufficient liquidity to increase shareholder value through strategic acquisitions and organic growth by investing in sales, marketing and production development. The Company's senior management is responsible for managing the capital through regular review of financial information to ensure sufficient resources are available to meet operating requirements and investments to support its growth strategy. The Board of Directors is responsible for overseeing this process.

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20. Capital management (continued):

The capital structure of the Company consists of long-term debt and components of equity including capital stock, contributed surplus and deficit, which at May 31, 2020 totalled \$1,885,274 (\$3,707,241 at May 31, 2019). The Company manages the capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of the underlying assets. To maintain or adjust the capital structure, the Company may issue new shares, repurchase shares, or issue debt. Management reviews the capital structure on a regular basis to ensure that objectives are met.

The Company is subject to two debt covenants on its long-term debt (see note 15 for details). The Company monitors the ratios on a quarterly basis. The Company's share capital is not subject to external restrictions.

21. Non-controlling interest in subsidiaries:

The following table summarizes the information relating to each of the Company's subsidiaries that has non-controlling interests (NCI), before any intra-group eliminations.

There are no significant restrictions on the ability to access or use assets and settle liabilities of the group. There are no contractual arrangements that could require the parent or its subsidiaries to provide financial support to a consolidated structured entity.

	Year ended May 31, 2020			Year ended May 31, 2019		
	GEMchem	TEI	Total	GEMchem	TEI	Total
	Ltd.	(Guangzhou)		Ltd.	(Guangzhou)	
	\$	\$	\$	\$	\$	\$
NCI percentage	33%	45%		33%	45%	
Non-current assets	2,523	-	2,523	918	-	918
Current assets	458,061	6,159	464,220	379,788	14,347	394,135
Non-current liabilities	362	-	362	667	-	667
Current liabilities	190,894	417,613	608,507	123,917	381,231	505,148
Net assets (liabilities)	269,328	(411,454)	(142,126)	256,122	(366,884)	(110,762)
Carrying amount of NCI	88,878	(185,154)	(96,276)	84,520	(165,098)	(80,578)
Revenue	1,051,603	-	1,051,603	992,560	4,812	997,372
Profit (loss) after tax	65,283	(44,571)	20,712	66,657	(108,475)	(41,818)
Total comprehensive income (loss)	63,990	(44,571)	19,419	64,262	(93,430)	(29,168)
Profit (loss) allocated to NCI	21,543	(20,057)	1,486	21,997	(48,814)	(26,817)
Comprehensive income (loss) allocated to NCI	21,117	(20,057)	1,060	21,206	(42,043)	(20,837)
Cash flows from operating activities	190,774	(43,506)	147,268	(1,034)	(33,638)	(34,672)
Cash flows from investing activities	(1,583)	-	(1,583)	-	-	-
Cash flows from financing activities	(50,783)	36,515	(14,268)	(25,831)	38,914	13,083
Net increase (decrease) in cash and cash equivalents	138,408	(6,991)	131,417	(26,865)	5,276	(21,589)

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22. Share-based payments:

The Company established the Company's Share Option Plan applicable to directors, officers and full-time and part-time employees of the Company. In the plan, the aggregate number of options may not exceed 20% of the outstanding shares and the total number of shares to be optioned to any optionee may not exceed 5% of the number of issued and outstanding shares as at the option granting date. The options are granted with an exercise price equal to the market value of the common shares of the Company at the date of grant, less any permissible discounts, and may be exercised at any time after the vesting date, not to exceed five years from the date of granting. The vesting term for options granted is at the discretion of the Board of Directors.

Activity in stock options was as follows:

	Year ended May 31, 2020		Year ended May 31, 2019	
	# Options	Weighted Average Exercise Price \$	# Options	Weighted Average Exercise Price \$
Outstanding, beginning of year	14,259,193	0.07	20,495,531	0.08
Granted	4,085,000	0.08	7,725,000	0.08
Expired	(250,000)	0.09	(9,678,671)	0.10
Forfeited	(272,917)	0.08	(1,486,000)	0.08
Exercised	-	-	(2,796,667)	0.05
Outstanding, end of year	17,821,276	0.07	14,259,193	0.07
Options exercisable, end of year	8,827,943	0.07	6,500,859	0.07

The following tables summarize information about stock options outstanding:

At May 31, 2020:

	Options outstanding			Options exercisable		
Range of exercise prices	Number outstanding May 31, 2020	Weighted average remaining contractual life	Weighted average exercise price	Number exercisable at May 31, 2020	Weighted average exercise price	
0.05-0.07	2,739,583	1.00	0.05	2,739,583	0.05	
0.08-0.10	14,831,693	3.09	0.08	5,838,360	0.08	
0.11-0.12	250,000	1.49	0.12	250,000	0.12	
	17,821,276	2.75	0.07	8,827,943	0.07	

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22. Share-based payments (continued):

At May 31, 2019:

Range of exercise prices	Options outstanding			Options exercisable	
	Number outstanding May 31, 2019	Weighted average remaining contractual life	Weighted average exercise price	Number exercisable at May 31, 2019	Weighted average exercise price
0.05-0.07	2,770,833	2.00	0.05	2,770,833	0.05
0.08-0.09	11,238,360	3.38	0.08	3,563,360	0.08
0.10-0.12	250,000	2.50	0.12	166,666	0.12
	14,259,193	3.10	0.07	6,500,859	0.07

The fair value of services received in return for share options granted is based on the fair value of share options granted, measured using the Black-Scholes model. As at May 31, 2020, there was \$206,502 (\$232,561 at May 31, 2019) of total unrecognized share-based compensation costs related to unvested stock option awards granted under the Plan, which are expected to be recognized over a term of three years.

The following inputs were used in the measurement of the fair values at grant date of the share-based payment plans:

	November 30, 2019
Grant date share price (\$) ⁽¹⁾	0.08
Exercise price (\$)	0.08
Expected volatility (%) ⁽²⁾	84.01
Expected life (years)	4.00
Expected dividend yield (%)	0.00
Risk-free interest rate (%)	1.49
Forfeiture rate (%)	11.00

(1) The closing market price of the shares on the TSX Venture Exchange on the day immediately preceding the date of grant or the last day of trading preceding the date of grant if no shares traded on the day immediately preceding the date of grant.

(2) The expected volatility was based on historical volatility of the Company over a period of time that is commensurate with the expected life of the options.

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22. Share-based payments (continued):

Share-based compensation expense related to the issuance of stock options is included in administration, selling, marketing and business development expenses and is broken down as follows:

	2020	2019
Administration	\$ 164,765	\$ 92,762
Selling, marketing and business development	39,028	22,584
	\$ 203,793	\$ 115,346

23. Revenue:

	2020	2019
Sales of goods	\$ 4,534,203	\$ 4,322,582
Rendering of services	1,625,466	1,874,070
Contracts for heat recovery solutions	15,256,506	14,886,604
	\$21,416,175	\$21,083,256

24. Employee benefits expense:

	2020	2019
Salaries and benefits	\$ 7,237,573	\$ 7,066,054
Share-based compensation (note 22)	203,793	115,346
Pension charge	46,632	40,767
	\$ 7,487,998	\$ 7,222,167

The Company contributes to defined contribution pension plans for permanent employees of two of its subsidiaries. The Company matches employee contributions. The plans and their assets are held by independent managers. The pension charge represents contributions paid by the Company.

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25. Other significant expenses:

Other significant expenses included in administration expense are as follows:

	2020	2019
Depreciation of property, plant and equipment (note 10)	\$ 110,422	\$ 84,509
Depreciation of right-of-use assets (note 13)	125,899	-
Amortization of intangible assets (note 11)	280,580	253,976
Foreign exchange loss (gain)	(111,845)	(8,428)

The Company received funding from various government bodies as COVID-19 wage subsidies. For the year ended May 31, 2020, a total amount of \$258,543 related to COVID-19 wage subsidies was recognized as a reduction to operating expenses, of which \$100,592 was netted against administration expenses and \$157,951 against selling, marketing and business development expenses.

During the year ended May 31, 2020, the Company received funding on various research programs. For the year ended May 31, 2020, a total amount of \$181,498 related to various research funding was recognized as a reduction to research and development expenses.

For the year ended May 31, 2019, an amount of \$50,000 related to research funding was recognized as a reduction to research and development expenses.

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26. Income taxes:

The Company's effective tax rate differs from the combined federal and provincial income tax rate in Canada. This difference comes from the following items:

	2020	2019
Loss before income taxes	\$ (2,200,568)	\$ (559,806)
Income taxes recovery calculated using combined federal and provincial income tax rates in Canada of 26.50% (2019 – 26.50%)	\$ (583,150)	\$ (148,349)
Share-based compensation	54,005	30,567
Impairment of intangible assets	24,778	-
Impairment of goodwill	621,110	-
Difference in tax rate of foreign subsidiaries	(849)	80,980
Tax effect of temporary difference for which no deferred tax asset is recorded	(705,729)	(264,239)
Difference in future tax rates	(18,548)	12,920
Permanent differences and others	304,772	179,418
Current and deferred income tax recovery	\$ (303,611)	\$ (108,703)
Current	\$ (165,930)	\$ 18,414
Deferred	(137,681)	(127,117)
	\$ (303,611)	\$ (108,703)

Major components of the current tax (recovery) expense are as follows:

	2020	2019
Statutory income tax of the year	\$ 18,950	\$ 17,185
Adjustment for prior years	14,261	1,229
Carryback of losses	(199,141)	-
	\$ (165,930)	\$ 18,414

Major components of the deferred tax recovery are as follows:

	2020	2019
Origination of timing differences	\$ (119,133)	\$ (140,037)
Difference in future tax rates	(18,548)	12,920
	\$ (137,681)	\$ (127,117)

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26. Income taxes (continued):

Change in deferred tax balances in 2020:

	June 1, 2019 \$	Recognized in income (loss) \$	Recognized in other comprehensive income \$	May 31, 2020 \$
Provisions	38,939	(10,916)	(197)	27,826
Property, plant and equipment	(34,826)	(5,642)	719	(39,749)
Finance lease receivable	(24,712)	24,712	-	-
Non-capital losses	199,206	(34,806)	(1,222)	163,178
Intangible assets	(523,882)	164,333	(3,831)	(363,380)
	(345,275)	137,681	(4,531)	(212,125)
Recognized as deferred tax assets				111,439
Recognized as deferred tax liabilities				(323,564)
				(212,125)

Change in deferred tax balances in 2019:

	June 1, 2019 \$	Recognized in income (loss) \$	Recognized in other comprehensive income \$	Recognized due to acquisition (note 4) \$	May 31, 2019 \$
Provisions	79,115	(40,979)	803	-	38,939
Property, plant and equipment	318,305	(308,108)	(945)	(44,078)	(34,826)
Finance lease receivable	(48,336)	23,624	-	-	(24,712)
Non-capital losses	(189,284)	383,716	4,774	-	199,206
Intangible assets	(108,841)	68,864	(7,129)	(476,776)	(523,882)
	50,959	127,117	(2,497)	(520,854)	(345,275)
Recognized as deferred tax assets					105,406
Recognized as deferred tax liabilities					(450,681)
					(345,275)

THERMAL ENERGY INTERNATIONAL INC.

Notes to the Consolidated Financial Statements

Years ended May 31, 2020 and 2019

(Expressed in Canadian dollars except share amounts)

26. Income taxes (continued):

At May 31, the Company had the following temporary differences for which no deferred tax asset was recorded:

	2020	2019
Property, plant and equipment	\$ 1,070,546	\$ 932,077
Intangible assets	2,739,157	2,739,157
Provisions	248,854	252,018
Non-capital losses	8,753,252	11,959,631
	\$ 12,811,809	\$ 15,882,883

As at May 31, 2020, the Company had available non-capital income tax loss carry forwards in the following amounts for which no deferred tax asset was recognized. These tax loss carry forwards may be used to reduce federal and provincial taxable income:

Year of expiry	Amount
2029	2,149,238
2030	3,032,173
2031	714,141
2032	43,753
2033	1,537,989
2035	171,250
2037	91,210
Total	\$ 7,739,754

As at May 31, 2020, the Company had non-capital losses in foreign subsidiaries, for which no deferred tax asset was recorded in the amount of \$1,013,499. Losses in the amount of \$289,397 expire between 2021 and 2025 and losses of \$724,102 could be carried forward indefinitely.

Deferred tax liabilities have not been recognized for temporary differences associated with investments in subsidiaries as the parent is able to control the timing of the reversal of the temporary differences and it is probable that the temporary differences will not reverse in the foreseeable future. The aggregate amount of the temporary differences at May 31, 2020 was \$1,851,673 (\$1,206,125 at May 31, 2019).

THERMAL ENERGY INTERNATIONAL INC.

Notes to the Consolidated Financial Statements

Years ended May 31, 2020 and 2019

(Expressed in Canadian dollars except share amounts)

27. Loss per share:

The calculation of basic and diluted loss per share for the year ended May 31, 2020 was based on the net loss attributable to owners of the parent of \$1,898,443 (2019 – net loss of \$424,286) and a weighted average number of basic common shares outstanding of 161,319,023 (2019 – 160,612,690). Diluted loss per share for the year ended May 31, 2020 did not include the effect of outstanding stock options existing at this date as they would have the effect of decreasing the loss per share. 2,739,583 stock options out of 8,827,943 exercisable options could potentially dilute basic earnings per share in the future, but were not included in the calculation of diluted loss per share because they were anti-dilutive for the year ended May 31, 2020. For the year ended May 31, 2019, 1,289,131 stock options out of 6,500,859 exercisable options could potentially dilute basic earnings per share in the future, but were not included in the calculation of diluted loss per share because they were anti-dilutive.

The average market value of the Company's shares for purposes of calculating the dilutive effect of stock options was based on quoted market prices for the year during which options were outstanding.

The following tables summarize the calculation of the weighted average number of basic and diluted common shares:

	2020	2019
Issued common shares at beginning of year	161,885,616	159,088,950
Effect of shares purchased and cancelled	(566,593)	-
Effect of shares issued	-	1,523,740
Weighted average number of basic and diluted common shares at end of year	161,319,023	160,612,690

28. Financial instruments:

Financial risk management:

In the normal course of business, the Company is exposed to financial risks that have the potential to negatively impact its financial performance. The Company does not use derivative financial instruments to manage these risks, as management believes the risks arising from the Company's financial instruments to be at an already acceptably low level. The Company has exposure to the following risks from its use of financial instruments: credit risk, market risk, and liquidity risk. These risks are discussed in more detail below.

- (a) Market risk is the risk that changes in market prices, such as interest rates and foreign exchange, will affect the Company's net earnings or loss or the value of its financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable limits, while maximizing returns.

THERMAL ENERGY INTERNATIONAL INC.

Notes to the Consolidated Financial Statements

Years ended May 31, 2020 and 2019

(Expressed in Canadian dollars except share amounts)

28. Financial instruments (continued):

Financial risk management (continued):

a) Market risk (continued):

(i) Foreign currency risk:

Foreign currency exchange risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.

The following table shows the foreign currency exchange risk on the financial assets and liabilities of the Company's operations denominated in currencies other than the functional currency of the different Company entities.

Functional currency of Company entity	Net financial assets/(liabilities) in CAD\$			Total CAD \$
	US \$	EUR	NOK	
May 31, 2020				
Canadian Dollar	1,617,576	-	-	1,617,576
British Pound	-	1,587,337	(13,079)	1,574,258
	1,617,576	1,587,337	(13,079)	3,191,834
May 31, 2019				
Canadian Dollar	1,468,558	-	-	1,468,558
British Pound	-	652,113	-	652,113
	1,468,558	652,113	-	2,120,671

A 10% strengthening of the following currencies against the Canadian dollar would have had the following effect on operations and equity:

	May 31, 2020				May 31, 2019			
	US\$	EUR	NOK	Total	US\$	EUR	NOK	Total
Net income (loss)	161,758	158,734	(1,308)	319,184	146,856	65,211	-	212,067
Equity	161,758	158,734	(1,308)	319,184	146,856	65,211	-	212,067

The Company operates internationally with subsidiaries in the United Kingdom, China and the United States. The Company earns revenues and incurs cost of sales, administration, selling, marketing and business development expenses in U.S. dollars, Euros, Norwegian Krone and Chinese Renminbi. The majority of the foreign denominated transactions are in U.S. dollars, GBP and Euros.

THERMAL ENERGY INTERNATIONAL INC.

Notes to the Consolidated Financial Statements

Years ended May 31, 2020 and 2019

(Expressed in Canadian dollars except share amounts)

28. Financial instruments (continued):

Financial risk management (continued):

(a) Market risk (continued):

(i) Foreign currency risk (continued):

The Company does not enter into arrangements to hedge its foreign exchange risk. The Company's policy is to ensure that its net exposure is kept to an acceptable level by buying or selling foreign currencies at spot rates when necessary to address short-term imbalances.

(ii) Interest rate risk:

Interest rate risk is defined as the risk that the fair value or future cash flows of a financial instrument will fluctuate because of a change in market interest rates. The Company minimizes risk by investing only with credit worthy banking institutions or draws on its available facility with floating rate borrowings, as mentioned in liquidity risk above.

The Company currently does not use interest rate hedges or fixed interest rate contracts to manage the Company's exposure to interest rate fluctuations. The Company is exposed to interest rate risk on its long-term debt. For the year ended May 31, 2020, a 1% increase or decrease in interest rate applied to the Company's long-term debt would result in an increase/decrease in loss before tax of \$27,919.

(b) Credit risk:

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its obligations. The financial instruments that potentially expose the Company to credit risk are trade and other receivables and finance lease receivable.

The Company's management considers that all of the above financial assets that are not impaired or past due at each of the reporting dates under review are of good credit quality.

Trade and other receivables

Each new customer is assessed individually for creditworthiness before standard payment and delivery terms and conditions are offered. Consideration is given to the country and industry in which the customer operates, as well as maturity of the customer, existence of previous financial difficulties and general reputation. For GEM and Boilerroom Equipment Inc. products, a significant percentage of revenue is attributable to a small number of country-wide distributors with whom the Company has a trading history of at least two years. Goods are sold subject to retention of title clauses, so that in the event of non-payment, the Company may have a secured claim.

THERMAL ENERGY INTERNATIONAL INC.

Notes to the Consolidated Financial Statements

Years ended May 31, 2020 and 2019

(Expressed in Canadian dollars except share amounts)

28. Financial instruments (continued):

Financial risk management (continued):

(b) Credit risk (continued):

Contracts for heat recovery solutions are planned to help achieve positive cash flows throughout the life of the project. A project may be halted pending payment by a customer, thus preventing further commitments under the contract.

The amounts reported for trade and other receivables in the statement of financial position are net of expected credit loss. The Company's maximum exposure to credit risk at the reporting date is the carrying value of its cash and cash equivalents (see note 6), trade receivables, other miscellaneous receivables (see note 7) and finance lease receivable (see note 9). In determining the fair value of the finance lease, the Company uses the discounted cash future cash flows of the asset, being the minimum lease payments, discounted using a rate of 14.3% - rate implicit in the lease. The fair value of the finance lease receivable at May 31, 2020 was \$nil (\$100,053 at May 31, 2019).

The credit risk for cash and cash equivalents is considered negligible, since the counterparties are reputable banks with high quality external credit ratings.

(c) Liquidity risk:

Liquidity risk is the risk that the Company will encounter difficulty in meeting the obligations of its financial liabilities that are settled by cash or another financial asset. Liquidity risk management serves to maintain a sufficient amount of cash and cash equivalents and to ensure that the Company has financing sources such as bank loans for an authorized amount. The Company continues to actively seek external financing to ensure it has the necessary funds to fulfill its obligations.

In addition to the lease obligations disclosed in note 18, the Company is obligated to the following contractual maturities of undiscounted cash flows:

	Carrying amount	Contractual cash flows	Year 1	Year 2-3	Year 4 and onwards
	\$	\$	\$	\$	\$
Trade payables and other liabilities	3,437,927	3,437,927	3,437,927	-	-
Long-term debt	2,759,672	3,480,188	506,914	1,093,677	1,879,597
	6,197,599	6,918,115	3,944,841	1,093,677	1,879,597

THERMAL ENERGY INTERNATIONAL INC.

Notes to the Consolidated Financial Statements

Years ended May 31, 2020 and 2019

(Expressed in Canadian dollars except share amounts)

28. Financial instruments (continued):

Fair value of financial instrument assets and liabilities that are measured at fair value on a recurring basis:

Financial instruments measured at fair value on the statement of financial position are classified using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. The fair value hierarchy has the following levels: Level 1 - valuation based on quoted prices unadjusted in active markets for identical assets or liabilities; Level 2 - valuation techniques based on inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (i.e., as prices) or indirectly (i.e., derived from prices); Level 3 - valuation techniques using inputs for the asset or liability that are not based on observable market data (unobservable inputs).

In the table below, the Company has segregated all financial assets and liabilities that are measured at fair value into the most appropriate level within the fair value hierarchy based on the inputs used to determine the fair value at the measurement date.

As at May 31, 2020:	Level 1	Level 2	Level 3
Contingent payable	\$ -	\$ -	\$ -
As at May 31, 2019:	Level 1	Level 2	Level 3
Contingent payable	\$ -	\$ -	\$110,148

The Company has no other financial assets or financial liabilities measured at fair value after initial recognition other than contingent payable recognized in connection with business acquisition.

There were no transfers of fair value measurement between level 1, 2 and 3 of the fair value hierarchy in the year ended May 31, 2020 and 2019.

The following table shows a reconciliation from the beginning balance to the ending balance for fair value measurements in level 3 of the fair value hierarchy.

Contingent payable	2020	2019
Balance, beginning of year	\$ 110,148	\$ -
Increase from business acquisition (note 4)	-	93,222
Charges through profit or loss under finance costs	19,061	14,780
Write-down through profit or loss under other income	(133,826)	-
Foreign exchange	4,617	2,146
Classified as current liabilities, end of year	-	-
Classified as non-current liabilities, end of year	-	110,148

THERMAL ENERGY INTERNATIONAL INC.

Notes to the Consolidated Financial Statements

Years ended May 31, 2020 and 2019

(Expressed in Canadian dollars except share amounts)

28. Financial instruments (continued):

Fair value of financial instrument assets and liabilities that are measured at fair value on a recurring basis (continued):

The contingent consideration is payable in cash or shares at Company's choice over a three-year post-acquisition period based on Boilerroom Equipment Inc. meeting certain performance targets. Estimates of the fair value of contingent payable is performed by the Company on a quarterly basis. Key unobservable inputs include revenue growth rates over the post-acquisition period and discount rate applied (16%). The estimated fair value increases as the annual revenue growth rate increases and decreases as the discount rate increases, and vice versa.

Boilerroom Equipment Inc's post-acquisition growth rate for the twenty-three months ended May 31, 2020 has been lower than the rate anticipated at the date of acquisition. The growth rate for the remaining thirteen months based on the forecasts is also expected to be lower due to the COVID-19 pandemic. As a result, it is highly unlikely that the performance targets will be met. As the Company do not expect to make any contingent payment at the end of the three-year post-acquisition period based on this assessment, the fair value of contingent payable was written down to \$nil as at May 31, 2020.

Fair value of financial instrument assets and liabilities that are not measured at fair value but fair value disclosures are required:

The carrying value of cash and cash equivalents, trade and other receivables, trade payables and other liabilities approximate their fair values due to their short-term to maturity. Long-term debt is subject to the market interest rate.

29. Related party transactions:

Related parties include the members of the Board of Directors and key management personnel, as well as close family members and enterprises that are controlled by these individuals and shareholders.

Transactions with key management personnel

Key management personnel of the Company include members of the Company's Board of Directors as well as members of the Company's senior management team. Key management personnel remuneration includes the following expenses:

	2020	2019
Salaries and other short-term employee benefits	\$ 914,914	\$ 886,768
Share-based payments	80,773	58,226
	\$ 995,687	\$ 944,994

THERMAL ENERGY INTERNATIONAL INC.

Notes to the Consolidated Financial Statements

Years ended May 31, 2020 and 2019

(Expressed in Canadian dollars except share amounts)

29. Related party transactions (continued):

Salaries and other short-term employee benefits include cash payments for base salaries and related social security costs and employee benefits, as well as payments made into defined contribution pension plans of the Company's UK based subsidiary, amounts expensed in the year as due to key management personnel under the Company's employee incentive plan, and Directors' fees including meeting fees, committee chairman fees and retainers. Share-based payments include the fair value of equity settled share-based payment arrangements expensed during the year.

30. Subsequent events:

On June 9, 2020, the Company entered into a Working Capital – COVID-19 loan with a lending institution for a total amount of \$2,300,000. The amounts advanced under the financing will be expected to support internal working capital needs related to operations and to assist with a degree of continuity of operations of the Company during the current economic environment. This loan bears interest at the institution's floating base rate less a variance of 1.10% and is repayable over the next 3 years. The institution's floating base rate was at 4.55% on June 9, 2020. \$1,000,000 was advanced under this loan as of the date these consolidated financial statements were approved and authorized for issue.



MANAGEMENT'S DISCUSSION & ANALYSIS

For the Fiscal Year Ended May 31, 2020

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 financial performance for the fiscal year ended May 31, 2020 (or "FY 2020"), and compares the FY 2020 financial results to the previous year ended May 31, 2019 (or "FY 2019"). The consolidated financial statements and accompanying notes 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 2020 are against the fourth quarter of FY 2019. 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 36% our operations, assets and liabilities are denominated in British Pound Sterling and 26% in US Dollar. 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 22, 2020. Disclosure contained in this document is current to September 22, 2020, 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 9 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 10 entitled "Forward-Looking Information".

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1. Our Business

1.1 Company Overview

Thermal Energy, established in 1991, is 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, Germany, and U.S.

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; lowered 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 primarily in North America and Europe but also sells its products and services through representative agents throughout the rest of the world. The Company markets, sells, engineers, fabricates, constructs, installs and supports two technology lines – heat recovery solutions, including direct contact heat recovery solutions (e.g. **FLU-ACE®**), indirect contact heat recovery solutions (**HEATSPONGE** and **SIDEKICK**), and condensate return system solutions (**GEM™** steam traps). The Company is also developing several other technology lines, including low temperature biomass drying systems (**DRY-REX™**).

Management Discussion and Analysis for the Fiscal Year Ended May 31, 2020

In 2008, the Company acquired Gardner Energy Management Limited, which owns, manufactures and sells the GEM™ steam traps 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. On June 29, 2018, the Company acquired Boilerroom Equipment Inc., a company based in the U.S., which owns, manufactures and sells HEATSPONGE and SIDEKICK indirect contact heat recovery units.

The Company has two primary operational bases of operation, one in Ottawa, Canada covering North America (“Thermal Energy Ottawa”), and the other in Bristol, United Kingdom, covering Europe and the rest of the world (“Thermal Energy Bristol”). Although the Thermal Energy Ottawa is considered to be the center of excellence for heat recovery engineering and technical support, and Thermal Energy Bristol the center of excellence for GEM™ steam traps and condensate return systems engineering and technical support, continuous cross-training means that both Ottawa and Bristol have expertise across both major product lines.

Although the Company markets its products throughout the world, most sales are from within North America and Europe where the Company has direct sales and engineering staff. While North American and European markets continue to be the Company’s strategic focus, the Company also continues to look for new agents and distributors in other 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 footprint. 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 with a current focus on the key markets of North America and Europe. Thermal Energy’s penetration in these markets remains low and therefore the Company plans to continue growing its sales and distribution capabilities in these markets, while at the same time, build its 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 companies in the pharmaceutical, food and beverage, pulp and paper, chemical and petrochemical sectors.

With an established global sales and distribution network, the Company is looking to develop and/or acquire additional complementary products and services that can be distributed through its existing network.

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 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 impairment of goodwill and other intangible assets, and net write-down of lease. 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 International Financial Reporting Standards (“IFRS”) and therefore may not be comparable to similar measures presented by other companies. There is no direct comparable IFRS measure for EBITDAS. A reconciliation of net income (loss) to EBITDAS is shown in section 3.5 Selected Annual Information.

Management Discussion and Analysis for the Fiscal Year Ended May 31, 2020

2.2 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. 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 financial statements. It is important to note that once an order or partial order is recorded as revenue, the order backlog is reduced by the amount of the newly reported revenue. Order backlog does not have a standardized meaning prescribed by 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 2020	Q4 2019
	\$	\$
Revenue	2,790,664	5,974,546
Cost of sales ¹	(1,362,936)	(2,857,249)
Gross profit	1,427,728	3,117,297
Expenses:		
Administration, selling, marketing and business development ¹	1,631,126	2,280,099
Research and development	(38,560)	(60,608)
	1,592,566	2,219,491
Other income	133,826	-
Operating income (loss) before impairment	(31,012)	897,806
Impairment of intangible assets	(499,718)	-
Impairment of goodwill	(2,561,482)	-
Operating income (loss)	(3,092,212)	897,806
Finance costs	(112,767)	(102,787)
Finance revenue	-	3,922
Income (loss) before income taxes	(3,204,979)	798,941
Income taxes recovery (expense)	251,793	(198,983)
Net income (loss) for the period	(2,953,186)	599,958
Exchange differences on translation of overseas operations	(50,695)	(45,100)
Total comprehensive income (loss) for the period	(3,003,881)	554,858
EBITDAS for the quarter ²	31,412	1,029,103
Order backlog as at May 31	3.6 million	14.0 million
Order backlog as at reporting date	9.3 million	18.2 million

1. The Company reclassified commission expense from selling, marketing and business development expense to cost of sales effective June 1, 2019. As a result, commission expense in the amount of \$356,079 for the comparative period was reclassified from selling, marketing and business development expense to cost of sales.
2. A reconciliation of net income (loss) to EBITDAS is shown in section 3.5 Selected Annual Information.

Management Discussion and Analysis for the Fiscal Year Ended May 31, 2020

Revenues and Gross Profits

Revenues were \$2,790,664 in the quarter ended May 31, 2020, representing a decrease of \$3,183,882, or -53.3%, compared to \$5,974,546 in the quarter ended May 31, 2019. The decrease of revenue in the fourth quarter of FY 2020 was mainly due to the delay in the delivery of heat recovery systems. The COVID-19 pandemic caused significant delays on heat recovery projects because customers' sites were either closed or our technical team and the subcontractors could not travel to site due to the travel restrictions. The revenues of condensate return systems also decreased in the fourth of FY 2020 compared to the same quarter last year. The Company received less orders in the condensate return systems in the fourth quarter due to the COVID-19 pandemic.

The gross profit of \$1,427,728 in the quarter ended May 31, 2020 represented a decrease of \$1,689,569, or -54.2%, from the \$3,117,297 in the quarter ended May 31, 2019 due to the decrease in the sales of heat recovery systems and condensate return systems. Gross profit expressed as a percentage of sales was 51.2% in the fourth quarter of FY 2020 compared with 52.2% in the same quarter of FY 2019.

Expenses

Administration, selling, marketing and business development expenses ("Operating Expenses") in the quarter ended May 31, 2020 totaled \$1,631,126 compared to \$2,280,099 in the quarter ended May 31, 2019, a decrease of \$648,973, or 28.5%. During the fourth quarter of FY 2020, the company received COVID-19 related wage subsidies from various government bodies in the amount of \$258,543. Since March 2020, the Company's business activities significantly slowed down due to the travel restrictions and temporary lock-down caused by COVID-19. To reduce the costs, the Company implemented new cost control measures including postponement of discretionary expenditures. The slow-down in the business activities also resulted in the reduced operating costs, including general administration cost, marketing, selling and business development cost. As a result, the operating expenses decreased significantly in the fourth quarter of FY 2020.

Research and development ("R&D") related to expenditures on various research and development programs. The Company receives tax credits and government funding on various research programs related to product development. The tax credits and government funding are accounted as a reduction of research and development expenses. The Company recorded the estimated R&D tax credits related to FY 2020 in the fourth quarter of F2020. Hence, the Company recognized a R&D expense recovery of \$38,560 in the fourth quarter of FY 2020.

Other income in the amount of \$133,826 was related to the write-down of the contingent earn-out, which was first recognized as a contingent liability at the time of acquisition of Boilerroom Equipment Inc. The contingent earn-out is payable if certain performance targets are met over the 36 months after the acquisition. As the performance targets are likely not being met, the entire amount was written down.

Impairment of intangible assets and goodwill: The Company recognized impairment charge of \$3,061,200 on intangible assets and goodwill in the fourth quarter of FY 2020. The impairment is caused by the decline in the internal forecasts of revenues for the next 24 months due partly to economic uncertainty arising from the COVID-19 pandemic.

Finance costs and finance revenue: Finance costs include interest expense on the long-term debt, interest accretion on contingent payable and holdback payable related to acquisition, and amortization on financing cost. The fourth quarter of FY 2020 incurred a finance cost of \$112,767. The cost was higher than the fourth quarter of FY 2019 by \$9,980 because the interest rate on the long-term debt was higher for FY 2020 than FY 2019. The interest rate is reassessed annually.

Loss before income taxes for the quarter ended May 31, 2020 was \$3,204,979, compared to an income of \$798,941 in the same quarter of the previous year. Income before income taxes decreased by \$4,003,920 mainly due to the impairment charge of \$3,061,200 on intangible assets and goodwill, the decrease of gross profit of \$1,689,569 offset by the decrease in the operating expenses of \$648,973.

Management Discussion and Analysis for the Fiscal Year Ended May 31, 2020

Income tax recovery in the fourth quarter of FY 2020 was \$251,793, as compared to an expense of \$198,983 in the fourth quarter of FY 2019, an increase of \$450,776. In FY 2019, the Company's subsidiary based in the UK incurred operational losses. Tax losses can be carried forward and used against future income, which gave rise to income tax recovery of \$252,231 relating to the UK subsidiary for the first three quarters of FY 2019. In the fourth quarter of FY 2019, after having a loss for eight consecutive quarters, the Company applied a valuation allowance to the UK subsidiary's deferred tax asset to decrease the income tax recovery recognized from the first three quarters of FY 2019, which resulted in the income tax expense of \$198,983 for the fourth quarter of FY 2019. In the fourth quarter of FY 2020, income tax recovery of \$251,793 was recognized. \$103,230 of the recovery was related to the write-down of deferred tax liabilities because of the impairment write-down on intangible assets of \$499,718. When the intangible assets were first recognized at the date of acquisition, deferred tax liabilities on these assets were also recognized. When these intangible assets were written down through impairment, the deferred taxes associated with these assets were also discharged. \$197,322 of the tax recovery was recognized by the Company's US subsidiary which incurred a taxable loss in F2020. The US tax authority had provided a tax relief measure under COVID-19, under which a business was permitted to carry back taxable loss to apply against taxable income from previous tax years. As a result, the Company expected to receive tax refund of \$197,322 by applying for this tax relief measure.

Net loss for the fourth quarter of FY 2020 was \$2,953,186, compared to a net income of \$599,958 in the same quarter of the previous year, representing a decrease of \$3,553,144. The decrease in net income was mainly due to the impairment charge of \$3,061,200 on intangible assets and goodwill, the decrease of gross profit of \$1,689,569 offset by the decrease in the operating expenses of \$648,973 and the increase in income tax recovery of \$450,776.

Comprehensive loss was \$3,003,881 for the fourth quarter of FY 2020, compared to a comprehensive income of \$554,858 for the fourth quarter of FY 2019. The increased comprehensive loss was due to the increase in the net loss of \$3,553,144.

EBITDAS was \$31,412 for the fourth quarter of FY 2020, compared to a \$1,029,103 for the same quarter of the previous year, representing a decrease of \$997,691. The decrease was mainly due to the decrease in gross profit of \$1,689,569 offset by the reduction of operating expenses of \$648,973.

Management Discussion and Analysis for the Fiscal Year Ended May 31, 2020

3.2 Review of Year End Results

	2020	2019
	\$	\$
Revenue	21,416,175	21,083,256
Cost of sales ¹	(12,462,122)	(13,042,050)
Gross profit	8,954,053	8,041,206
Expenses:		
Administration, selling, marketing and business development expenses	7,848,011	8,247,328
Research and development	(35,840)	71,703
	7,812,171	8,319,031
Other income	133,826	-
Operating income (loss) before impairment	1,275,708	(277,825)
Impairment of intangible assets	(499,718)	-
Impairment of goodwill	(2,561,482)	-
Operating loss	(1,785,492)	(277,825)
Finance costs	(420,220)	(302,394)
Finance revenue	5,144	20,413
Loss before income taxes	(2,200,568)	(559,806)
Income taxes recovery	303,611	108,703
Net loss for the year	(1,896,957)	(451,103)
Exchange differences on translation of overseas operations	(50,973)	(8,423)
Total comprehensive loss for the year	(1,947,930)	(459,526)
EBITDAS ²	1,921,495	176,006
Order backlog as at May 31, 2020	3.6 million	14.0 million
Order backlog as at September reporting date	9.3 million	18.2 million

1. The Company reclassified commission expense from selling, marketing and business development expense to cost of sales effective June 1, 2019. As a result, commission expense in the amount of \$1,192,170 for the comparative period was reclassified from selling, marketing and business development expense to cost of sales.
2. A reconciliation of net income (loss) to EBITDAS is shown in section 3.5 Selected Annual Information.

Revenues and Gross Profits

Revenues were \$21,416,175 in the year ended May 31, 2020, representing an increase of \$332,919, or 1.6%, over the \$21,083,256 recognized in the year ended May 31, 2019. The increase in revenues was due to the increased sales in the European and the Rest of the World market for both heat recovery solutions and the condensate return systems.

The gross profit of \$8,954,053 in the year ended May 31, 2020 represented an increase of \$912,847, or 11.4%, from the \$8,041,206 achieved in the year ended May 31, 2019. The increase was mainly due to increased margins on the heat recovery projects as the revenues are comparable to prior year. In FY 2019, the Company completed a mega heat recovery project with the total contract value of \$11 million. The gross margin on this mega project was lower than average margin because the Company provided a discounted price to the customer in order to win this mega project. In FY 2020, there was no mega project. As a result, the overall gross margin on the heat recovery projects improved in FY 2020. The gross profit expressed as a percentage of sales also increased from 38.1% in FY 2019 to 41.8% in FY 2020.

Management Discussion and Analysis for the Fiscal Year Ended May 31, 2020

Expenses

Administration, selling, marketing and business development expenses (“Operating Expenses”) in the year ended May 31, 2020 totaled \$7,848,011 compared to \$8,247,328 in FY 2019, representing a decrease of \$399,317, or 4.8%. The decrease was mainly due to the increase of foreign exchange gain of \$103,417, the decrease in the acquisition related cost of \$114,876, the receipt of government wage subsidies of \$258,543, offset by the increase in the share based compensation expense of \$88,447. The Operating Expenses as a percent of revenue was 36.6% in FY 2020 compared to 39.1% in FY 2019.

Research and development related to expenditures on various research and development programs. The Company receives tax credits and government funding on various research programs related to product development. The tax credits and government funding are accounted as a reduction of research and development expenses. The Company’s R&D expense was negative \$35,840 in FY 2020, compared to an expense \$71,703 in FY 2019, a decrease of \$107,543 in R&D expense. The decrease was mainly due to the increased amount of R&D tax credits and government funding applied. During the year ended May 31, 2020, the Company applied for R&D tax credits and government funding in the amount of \$181,498. In FY 2019, the Company only claimed \$50,000 related to R&D tax credits and government funding.

Finance costs and finance revenue: In the year ended May 31, 2020, finance costs increased by \$117,826 from \$302,394 to \$420,220. The increase was mainly due to the increased interest rate on the long-term debt.

Loss before income taxes for the year ended May 31, 2020 was \$2,200,568 compared to a loss of \$559,806 in the same period of the previous year, representing an increase of \$1,640,762. The increase was mainly due to impairment charge of \$3,061,200 recorded on intangible assets and goodwill, offset by the increase in gross profits of \$912,847, the decrease in operating expenses of \$399,317, the decrease in research and development expense of \$107,543, and the other income of \$133,826 recognized for the year.

Income tax recovery in FY 2020 was \$303,611, compared to \$108,703 in FY 2019, an increase of \$194,908. Both the U.K. and the U.S. entities are subject to tax charges. Fluctuations in the tax charges are the result of changing profitability in those entities. In FY 2020, income tax recovery of \$197,322 was recorded by the Company’s US subsidiary as the subsidiary incurred taxable losses in FY 2020. The income tax recovery for FY 2020 also included the write-down of deferred tax liabilities of \$103,230 that were associated with certain intangible assets, which were written down through impairment charge in the fourth quarter of FY 2020.

Net loss for the year ended May 31, 2020 was \$1,896,957, compared to a loss of \$451,103 in the year ended May 31, 2019, representing an increase of \$1,445,854. The increase was mainly due to the impairment charge of \$3,061,200 recognized on intangible assets and goodwill offset by the increase in operating income before impairment of \$1,553,533.

Comprehensive loss was \$1,947,930 for the year ended May 31, 2020, compared to a loss of \$459,526 for the year ended May 31, 2019.

EBITDAS was \$1,921,495 for the year ended May 31, 2020 compared to \$176,006 for the previous year, representing an increase of \$1,745,489. The increase was mainly due to the increase in gross profits of \$912,847, the decrease in operating expenses of \$399,317, the decrease in research and development expense of \$107,543, and the other income of \$133,826 recognized for the year.

3.3 Liquidity & Capital Resources

Current assets increased by \$79,184 to \$8,063,550 at May 31, 2020, compared to \$7,984,367 at May 31, 2019. This increase was mainly due to the increase in cash and cash equivalents of \$597,320, the increase in current tax receivable of \$190,207 and the increase in inventory of \$190,741 offset by the reduction in accounts receivable of \$805,828 and finance lease receivable of \$93,257. Current liabilities decreased by \$764,530 to \$5,192,014, mainly due to the decrease in deferred revenue of \$1,667,362 and the decrease in

Management Discussion and Analysis for the Fiscal Year Ended May 31, 2020

the current portion of long-term debt of \$102,107, offset by the increase in trade payable and accrued liabilities of \$888,357 and the increase in short-term lease obligations of \$105,269.

Working capital increased by \$843,713 to \$ 2,871,536 at May 31, 2020, compared to \$2,027,823 at May 31, 2019. The increase was mainly due to the significant decrease in deferred revenue of \$1,667,362 at May 31, 2020, the increase in cash and cash equivalents of \$597,320, offset by the increase of trade payable and other liabilities of \$888,357 and the decrease in trade and other receivables of \$805,828. Deferred revenue is recorded when the Company receives cash deposit before it delivers products or services to a customer. Deferred revenue decreases when the Company delivers the work to the customer and revenue is recognized. As at May 31, 2020, a few heat recovery projects were completed or close to be completed which resulted in the decrease in deferred revenue. When a project is close to the completion, the Company will receive the billings from subcontractors and vendors for the equipment and installation cost, hence, the Company will have a higher amount in the trade payable at the completion or close to completion stage of a heat recovery project.

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

	Aug 31, 2018 \$	Nov 30, 2018 \$	Feb 28, 2019 \$	May 31, 2019 \$	Aug 31, 2019 \$	Nov 30, 2019 \$	Feb 29, 2020 \$	May 31, 2020 \$
Current Assets	8,310,609	7,244,731	7,337,334	7,984,367	9,544,737	9,574,004	8,646,798	8,063,550
Current Liabilities	5,984,275	5,178,449	8,816,994	5,956,544	7,423,040	7,129,049	5,859,669	5,192,014
Working Capital	<u>2,326,334</u>	<u>2,066,282</u>	<u>(1,479,660)</u>	<u>2,027,823</u>	<u>2,121,697</u>	<u>2,444,955</u>	<u>2,787,129</u>	<u>2,871,536</u>

The Company's cash position was \$4,774,580 as at May 31, 2020, compared to \$4,177,260 at May 31, 2019, representing an increase of \$597,320. The increase was mainly due to net cash generated from operating activities of \$1,309,613 as well as foreign exchange gain impact of \$ 19,341 offset by the cash used in investing activities \$280,548 and the financing activities of \$451,086.

The net cash generated from the operating activities included the net loss of \$1,896,957 and the addbacks of non-cash items of \$3,787,918, offset by the negative change in working capital of \$242,853, the interest paid on long-term debt of \$326,695 and the income taxes paid of \$11,800. The Company's cash position normally fluctuates based on the timing of long-term projects. Cash increases at the beginning of a project because the Company receives upfront deposit before a project is started. The cash position decreases when a project is near the end because the Company has collected from its customer and needs to make full payments to the suppliers and subcontractors. A few heat recovery projects were completed or close to the completion as at May 31, 2020, therefore there was a negative change in working capital of \$242,853.

The Company invested \$280,548 in property, plant and equipment during the year ended May 31, 2020, of which \$169,116 related to a leasehold improvement and \$35,129 related to furniture and fixtures for a new rental space. The Company also purchased production equipment of \$43,327 and computers of \$32,976 during the year. The Company made the investment to purchase more laptop computers early in the year so that the technical team could travel easily with a laptop.

The Company's used cash for financing activities, which included repayments to the long-term debt of \$297,179, repayments related to the lease obligations of \$99,832, the purchase of Class A common shares of \$127,317 under the Normal Course Issuer Bid and the dividends paid to a non-controlling interest party of \$16,758. The Company received \$90,000 lease incentive payment from the landlord for the new rental space.

The Company's trade and other receivables have been reviewed for indicators of impairment. May 31, 2020, \$189,442 (10%) of the Company's trade receivables balance was over 90 days past due. \$61,120 of the past due balance was impaired at May 31, 2020. \$6,318 of trade receivables that was not over 90 days past due was also impaired.

Management Discussion and Analysis for the Fiscal Year Ended May 31, 2020

At May 31, 2019, \$123,223 (6.2%) of the Company's trade receivables balance was over 90 days past due. \$22,864 of the past due balance was impaired at May 31, 2019.

The Company's finance lease receivable includes the following:

	2020	2019
Total estimated minimum lease payments receivable	\$ 47,500	\$ 100,053
Less: unearned income	(1,652)	(6,796)
Less: write-down	(45,848)	-
	-	93,257
Less: current portion	-	(93,257)
	-	-

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 16, 2019, Fortress Specialty Cellulose sought and obtained a First Day Initial Order under the Companies' Creditors Arrangement Act from the Quebec Superior Court. The Company's finance lease receivable was reviewed for indicators of impairment. For the year ended May 31, 2020, a write-down of \$45,848 was recognized on the remaining finance lease receivable under administrative expenses. Trade receivables from the customer amounting to \$106,241 (net of \$15,910 sales tax) were provided for and written off as expected credit loss under administration expenses.

The following table presents the contractual undiscounted cash flows for lease obligations as of May 31, 2020:

Less than one year	\$ 141,157
One to five years	293,827
Six to ten years	286,500
Total undiscounted lease obligations	\$ 721,484

The Company's ability to realize its assets and discharge its liabilities depends on its ability to generate sufficient cash from operations or its ability to arrange debt or equity financing.

On June 9, 2020, the Company entered into a Working Capital – COVID-19 loan with a lending institution for a total amount of \$2,300,000. The amounts advanced under the financing will be expected to support internal working capital needs related to operations and to assist with a degree of continuity of operations of the Company during the current economic environment. This loan bears interest at the institution's floating base rate less a variance of 1.10% and is repayable over the next 3 years. The institution's floating base rate was at 4.55% on June 9, 2020. The first tranche of the proceeds in the amount of \$1,000,000 was received by the Company on July 23, 2020. The remaining amount of \$1,300,000 is expected to be received in two separate tranches by March 2021.

Management is of the opinion that there is sufficient cash to support the Company's operations for the next 12 months. Once the COVID-19 pandemic ends, the Company will be generating sufficient cash by achieving profitable operations through continuing to manage expenditures, concentrating on building upon revenue levels experienced from FY 2016 to FY 2020.

Management Discussion and Analysis for the Fiscal Year Ended May 31, 2020

3.4 Segmentation Information

In fiscal 2020 and 2019, the Company operated in the energy efficiency industry in North America, Europe, China and 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 and Europe.

Management reporting comprises analysis of revenue and gross profit 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 Ottawa, Canada covering North America and China, and the other in Bristol, UK, 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, 2020 and the comparative year are detailed in the table below:

	Thermal Energy Ottawa		Thermal Energy Bristol		Reconciling Items		Total	
	2020	2019	2020	2019	2020	2019	2020	2019
	\$	\$	\$	\$	\$	\$	\$	\$
Total revenue from external customers	13,337,357	16,648,483	8,078,818	4,434,773	-	-	21,416,175	21,083,256
Cost of sales ⁽¹⁾	(8,452,200)	(10,806,725)	(4,009,922)	(2,235,325)	-	-	(12,462,122)	(13,042,050)
Gross profit	4,885,157	5,841,758	4,068,896	2,199,448	-	-	8,954,053	8,041,206
Other expenses ⁽¹⁾	(3,215,008)	(3,585,362)	(3,266,531)	(3,284,294)	(1,330,632)	(1,449,375)	(7,812,171)	(8,319,031)
Other income	133,826	-	-	-	-	-	133,826	-
Impairment of intangible assets	(103,548)	-	(396,170)	-	-	-	(499,718)	-
Impairment of goodwill	(1,360,450)	-	(1,201,032)	-	-	-	(2,561,482)	-
Net finance income (costs)	(19,319)	20,413	(14,179)	-	(381,578)	(302,394)	(415,076)	(281,981)
Income (loss) before taxation	320,658	2,276,809	(809,016)	(1,084,846)	(1,712,210)	(1,751,769)	(2,200,568)	(559,806)
Tax recovery (expense)	208,132	52,969	(8,236)	(113,030)	103,715	168,764	303,611	108,703
Profit (loss) after taxation	528,790	2,329,778	(817,252)	(1,197,876)	(1,608,495)	(1,583,005)	(1,896,957)	(451,103)
Attributable to:								
Owners of the parent	548,847	2,378,592	(838,795)	(1,219,873)	(1,608,495)	(1,583,005)	(1,898,443)	(424,286)
Non-controlling interest	(20,057)	(48,814)	21,543	21,997	-	-	1,486	(26,817)

(1) The Company reclassified commission expenses from other expenses to cost of sales for the year ended May 31, 2020. As a result, commission expenses in the amount of \$1,192,170 for the year ended May 31, 2019 were also reclassified to cost of sales to conform to the current period presentation.

Management Discussion and Analysis for the Fiscal Year Ended May 31, 2020

Reconciling items comprise the following:

	2020	2019
Corporate administration costs	\$ 633,600	\$ 696,564
Share-based compensation	203,793	115,346
Professional fees	180,109	138,092
Depreciation of property, plant and equipment	110,422	84,509
Amortization of intangible assets	280,580	253,976
Acquisition costs	33,973	148,849
Bank charges and interest	-	20,467
Foreign exchange differences	(111,845)	(8,428)
Total	1,330,632	\$ 1,449,375

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.

Finance costs within the reconciling items include interest and deferred financing charge on the long-term debt and interest accretion on contingent consideration and holdback payable following the acquisition of Boilerroom Equipment Inc.

Material Segmentation Variances

Thermal Energy Ottawa:

Revenue for the year ended May 31, 2020 of \$13,337,357, represented a decrease of \$3,311,126, or 19.9%, over the \$16,648,483 in the previous year. The decrease was mainly due to the reduced sales in both heat recovery systems and condensate return systems.

Gross profit for the year ended May 31, 2020 decreased by \$956,601 over the last year. The decrease in gross profit was mainly due to the decreased sales. As a percentage of revenue, gross profit was 36.6% for the year ended May 31, 2020, compared to 35.1% achieved in last year.

Other expenses in this segment decreased by \$370,354 (10.3%) for the year ended May 31, 2020 over the last year. The decrease was mainly due to the decrease in operating costs due to the reduced amount of business activities and the \$197,895 government wage subsidies received.

For the year ended May 31, 2020, income before tax of \$320,658 was achieved, represented a decrease of \$1,956,151, or 85.9%, from the previous year. The decrease was mainly due to the impairment charge of \$1,463,998 recognized on intangible assets and goodwill related to Boilerroom Equipment Inc. and the decrease of gross profit of \$956,601 because of the decreased revenues, offset by the decrease in other operating expenses of \$370,354 and the other income of \$133,826 related to the write-off of contingent earn-out for Boilerroom Equipment Inc.

Thermal Energy Bristol:

Revenue for the year ended May 31, 2020 of \$8,078,818, represented an increase of \$3,644,045, or 82.2%, over the \$4,434,773 achieved in the previous year. The increase for the year ended May 31, 2020 was due to increased sales in both condensate return systems and heat recovery systems.

Gross profit increased in the year ended of FY 2020 by \$1,869,448, compared to the last year. The increase in gross profit was mainly due to the increased sales in both heat recovery systems and condensate return systems. As a percentage of revenue, gross profit was 50.4% in the FY 2020, compared to 49.6% achieved in the FY 2019.

Management Discussion and Analysis for the Fiscal Year Ended May 31, 2020

Other expenses decreased by \$17,763 or 0.5% for the year ended May 31, 2020, compared to prior year. This segment received the government wage subsidies of \$60,648 during the fourth quarter of FY 2020.

The resulting pre-tax loss was \$809,016 for the year ended May 31, 2020, as compared to a loss of \$1,084,846 for the prior year, a decrease of \$275,830. The improved pre-tax loss was mainly due to the increase of \$1,869,448 in gross profit offset by the impairment charge of \$396,170 on trade names and trademarks and the impairment charge of \$1,201,032 on goodwill related to the Company's UK subsidiaries' cash-generating units.

Reconciling Items:

Other expenses within Reconciling items, which incorporates all costs not specifically attributable to either regional operational center, decreased by \$118,743 to \$1,330,632, compared to the previous year. The decrease in other expenses was mainly due to the increase of the foreign exchange gains of \$103,417, the reduction of corporate admin cost of \$62,964, the decrease of acquisition cost of \$114,876, offset by the increase in professional fees of \$42,017 and share-based compensation expense of \$88,447.

3.5 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, 2018, 2019 and 2020:

	2018 \$	2019 \$	2020 \$
Revenue	17,408,211	21,083,256	21,416,175
Gross Profit ⁽¹⁾	6,929,523	8,041,206	8,954,053
Gross Profit Percentage	39.8%	38.1%	41.8%
EBITDAS ⁽²⁾	616,905	176,006	1,921,495
Total net income (loss) attributable to owners of the parent	638,998	(424,286)	(1,898,443)
Net profit (loss) per share – basic and diluted	0.004	(0.003)	(0.012)

(1) The Company reclassified commission expense from selling, marketing and business development expense to cost of sales effective June 1, 2019. As a result, commission expense in the amount of \$1,192,170 and \$1,404,500 for 2019 and 2018, respectively, was reclassified from selling, marketing and business development expense to cost of sales, which resulted in decreased gross profit for these two comparative years.

(2) 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.

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

	2018 \$	2019 \$	2020 \$
Total net income (loss) attributable to owners of the parent	638,998	(424,286)	(1,898,443)
Total net income (loss) attributable to non-controlling interest	(19,519)	(26,817)	1,486
Interest charge	2,302	302,394	420,220
Interest received	(349)	(20,413)	-
Taxation	(98,475)	(108,703)	(303,611)
Depreciation and amortization	44,342	338,485	391,002
Share based compensation	49,606	115,346	203,793
Impairment – intangible assets	-	-	499,718
Impairment - goodwill	-	-	2,561,482
Net write-down of lease	-	-	45,848
EBITDAS	616,905	176,006	1,921,495

Management Discussion and Analysis for the Fiscal Year Ended May 31, 2020

For the eight quarters ended May 31, 2020:

Quarter ended	31-Aug-19	30-Nov-19	29-Feb-20	31-May-20
	\$	\$	\$	\$
Revenue	4,965,789	7,848,096	5,811,626	2,790,664
Gross Profit ⁽¹⁾	2,190,518	2,918,357	2,417,450	1,427,728
Gross Profit Percentage	44.1%	37.2%	41.6%	51.2%
EBITDAS ⁽²⁾	471,786	709,182	709,115	31,412
Total net income (loss)	241,261	385,181	429,787	(2,953,186)
Income (loss) per share, basic and diluted	0.002	0.002	0.003	(0.019)

Quarter ended	31-Aug-18	30-Nov-18	28-Feb-19	31-May-19
	\$	\$	\$	\$
Revenue	6,800,861	5,193,092	3,114,757	5,974,546
Gross Profit ⁽¹⁾	1,946,035	1,834,770	1,143,104	3,117,297
Gross Profit Percentage	28.6%	35.3%	36.7%	52.2%
EBITDAS ⁽²⁾	(50,736)	(67,995)	(734,366)	1,029,103
Total net income (loss)	(49,458)	(112,122)	(889,481)	599,958
Income (loss) per share, basic and diluted	0.00	(0.001)	(0.006)	0.004

(1) The Company reclassified commission expense from selling, marketing and business development expense to cost of sales effective June 1, 2019. As a result, commission expense for the quarters ended before May 31, 2019 was reclassified from selling, marketing and business development expense to cost of sales to conform to the current year presentation.

(2) 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.

4. Related Party Transactions

Options outstanding for Directors (excluding the CEO) as at May 31, 2020 were 1,000,000, of which 500,000 were exercisable. There were no warrants outstanding for Directors.

Options outstanding for Senior Management (including the CEO) as at May 31, 2020 were 5,758,360, of which 2,800,027 were exercisable. There were no warrants outstanding for Senior Management.

Directors and Senior Management Compensation

During the year ended May 31, 2020 compensation arrangements for directors was as follows:

\$13,500 per annum per Director plus an additional \$8,100 per annum payable to the Chairman of the Board, \$5,400 per annum payable to the chairperson of the Audit Committee, \$5,400 per annum payable to the chairperson of the Ethics Committee, and \$1,000 payable for each in-person meeting.

During the year ended May 31, 2020, Directors fees paid were \$74,881. Fees to the Chairperson of the Audit Committee were \$5,400; fees to the Chairperson of the Ethics, Governance and Compliance Committee were \$5,400; fees paid to the Chairman were \$8,100. Two in-person meetings were held during the year, a total cost of \$10,000.

Management Discussion and Analysis for the Fiscal Year Ended May 31, 2020

Compensation paid to directors and officers during the year ended May 31, 2020 (inclusive of the amounts described above but excluding share-based compensation) was as follows:

	Salaries and fees		Incentives		Other short-term benefits		Total	
	2020 \$	2019 \$	2020 \$	2019 \$	2020 \$	2019 \$	2020 \$	2019 \$
Directors								
M. Williams	16,247	18,500	-	-	-	-	16,247	18,500
J. Kelly	25,195	26,600	-	-	-	-	25,195	26,600
W. Ollerhead	22,546	22,900	-	-	-	-	22,546	22,900
D. Spagnolo	22,546	20,245	-	-	-	-	22,546	20,245
W. White	17,247	18,500	-	-	-	-	17,247	18,500
J. Schoenmakers ⁽³⁾	-	10,293	-	-	-	-	-	10,293
Total	103,781	117,038	-	-	-	-	103,781	117,038
Senior Management								
W. Crossland	235,500	240,000	34,883	-	4,097	3,953	274,480	243,953
R. Triebe	177,606	181,000	26,307	-	7,619	7,333	211,532	188,333
S. Mawby ⁽¹⁾	150,342	157,961	20,243	-	24,534	24,726	195,119	182,687
J. Zhang ⁽²⁾	122,656	104,167	20,242	-	7,347	9,442	150,245	113,609
J. Flynn ^{(2) (4)}	-	35,429	-	-	-	5,619	-	41,048
Total	686,104	718,557	101,675	-	43,597	51,073	831,376	769,630
Total Related Party Transactions	789,885	835,595	101,675	-	43,597	51,073	935,157	886,668

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 U.K. based subsidiaries.

- (1) Mr. Mawby is compensated in UK Pound sterling. Average exchange rate to Canadian dollar was 1.6895 and 1.7184 in FY 2020 and FY 2019, respectively.
- (2) Ms. Flynn stepped down as Chief Financial Officer effective July 31, 2018 and Ms. Zhang was appointed Chief Financial Officer of the Corporation effective the same date.
- (3) Mr. Schoenmakers resigned on November 27, 2018.
- (4) Ms. Flynn was compensated in UK Pound sterling. Average exchange rate to Canadian dollar was 1.7184 in FY 2019.

5. COVID-19 Update

On March 11, 2020, COVID-19 was declared a global pandemic by the World Health Organization. The Company has been closely monitoring the impact of COVID-19 on all aspects of its business. COVID-19 has had disruptive effects in countries in which the Company operates including Canada, US and the UK.

We are conducting business with substantial modifications to employee travel and employee work locations. The travel restrictions have decreased business development and sales activities. While most of our customers are essential businesses and continue to operate, the pandemic also has impacts on many of them, including adapting their operation to include physical distancing, limiting site visits, delays in making purchasing decisions and the temporary suspension of on-going projects.

The Company has taken proactive measures to cope with the impact from COVID-19 including the deployment of video conferencing tools, the development of remote working and file-sharing capabilities, a temporary reduction in non-essential expenditures, and the application of government sponsored emergency loans and salary subsidy programs. Despite the COVID-19 slowdown, the Company has maintained its pre-pandemic staff levels and has maintained its full production and project development capabilities. After three

Management Discussion and Analysis for the Fiscal Year Ended May 31, 2020

years of strong revenue growth and staff additions, the Company is using this time to conduct extensive staff training and product and project development. In short, we are taking advantage of the current slowdown to adapt and strengthen our business and to ensure the Company emerges from the COVID period in as strong a position as possible.

Currently, we are unable to estimate the long-term impact of COVID-19 on our businesses, financial position, results of operations, and cash flows. We expect COVID-19 to continue to affect our results of operations in the next 12 months because of the decline in forecasted revenues.

The Company is working towards a full recovery by continuing developing new sales opportunities through remote work with customers using various technology tools. The Company has received \$5.7 million new orders since May 31, 2020. See section 6 Business Outlook below for a review of orders received and order backlog information. We also have sufficient liquidity available from cash to support the business' operations. As at May 31, 2020, the cash balance was \$4,774,580. In addition, the Company entered a Working Capital COVID-19 loan in the amount of \$2.3 million on June 9, 2020 with a lending institution. We received the first tranche of the proceeds in the amount of \$1,000,000 on July 23, 2020. See section 3.3 Liquidity and Capital Resources for more details about this loan.

6. Business Outlook

Governments around the world are taking unprecedented action, including increasing regulations, to reduce carbon emissions. Energy efficiency can make the transition toward a clean energy economy faster and cheaper than other initiatives, and therefore is an important element in energy policies around the world. As such, the industrial sector has begun to feel the pressing need to adopt measures that can improve the energy efficiency of internal processes and operations, thus contributing to an increased demand for energy efficiency products, solutions and services globally.

Other than our order backlog, we do not provide specific financial performance guidance. However, we believe that we are well positioned to benefit from this increased demand, particularly in our key markets of North America, the United Kingdom, and the European Union. As mentioned in Section 2.2 earlier, Management uses order backlog as an indicator of the short-term future revenue of our Company resulting from already recognized orders.

The Company's order backlog as at May 31, 2020 was approximately \$3.6 million. As at September 22, 2020, the Company had an order backlog of approximately \$9.3 million.

	2018 \$ million	2019 \$ million	2020 \$ million
Order backlog as at May 31	9.9	14.0	3.6
Order backlog as at September reporting date	12.7	18.2	9.3

- On August 18, 2020, the Company announced that it has been commissioned by one of Europe's largest food and drink groups to supply a turnkey heat recovery system designed to reduce fuel use and carbon emissions, while also minimizing particulate matter, and NOx emissions. The project, valued at approximately \$920,000, will be installed at a canning and pouch packaging facility in the UK. At the heart of the system will be Thermal Energy's proprietary direct contact heat recovery technology, FLU-ACE®. Once commissioned, the system is expected to deliver an annual fuel saving of \$383,300 and reduce the site's carbon emissions by 2,868 tonnes a year.
- On June 10, 2020, the company announced that it had been commissioned by a leading consumer protein company to supply energy efficient equipment and engineering for a plant upgrade project. This equipment, valued at approximately \$950,000, will be used to heat process water for the plant operation producing up to 2,700 US gallons per minute of water heated from 85°F to 140°F.

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- On August 7, 2019, the company announced that it had been commissioned by a leading European brewer to install a high-efficiency heat recovery system. The FLU-ACE® heat recovery project, valued at over \$650,000, is designed to optimize efficiency at the UK production facility, helping the site to reach its sustainability goals. Preliminary analysis shows the initiative will provide an expected utility saving of \$400,000 per year. The project was about 40% complete at the year-end.
- On March 27, 2019, the Company announced that it had been commissioned by a leading multinational animal nutrition and agricultural products company to improve energy efficiency at one of its European facilities. The project, valued at approximately \$2.3 million, will see the Company install two of its proprietary FLU-ACE® heat recovery systems to delivery greater fuel efficiency. The project was about 72% complete at the year-end.
- On March 11, 2019, the Company announced that it had been commissioned by a major US dairy group to design and implement an extensive heat recovery project. This project, valued at \$1.8 million, will utilize the Company's recently acquired HEATSPONGE technology to heat boiler feed and process water. It is the first project between the Company and the dairy group. The project was 69% complete at the year-end.

7. Summary of Outstanding Shares and Dilutive Instruments

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

Shares:

160,152,616 class A common shares.

Normal Course Issuer Bid:

On November 19, 2019, the Company announced its intent to re-launch the Normal Course Issuer Bid ("NCIB") for a further period of twelve months. The NCIB was approved by the TSX Venture Exchange on November 18, 2019. During the 12-month period commencing November 22, 2019 and ending November 21, 2020, the Company may purchase on the TSX up to 8,094,280 common shares, representing approximately 5% 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. All the purchased Class A common shares were purchased and cancelled directly under the NCIB for the year ended May 31, 2020.

Options:

Range of exercise prices	Options outstanding		Options exercisable		
	Number outstanding May 31, 2020	Weighted average remaining contractual life	Weighted average exercise price	Number exercisable at May 31, 2020	Weighted average exercise price
0.05-0.07	2,739,583	1.00	0.05	2,739,583	0.05
0.08-0.10	14,831,693	3.09	0.08	5,838,360	0.08
0.11-0.12	250,000	1.49	0.12	250,000	0.12
	17,821,276	2.75	0.07	8,827,943	0.07

8. Critical Accounting Estimates and Changes in Accounting Standards

Critical Accounting Estimates

The preparation of financial statements requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities, income and expenses. The judgements, estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of the valuation of assets and liabilities that are not readily apparent from other sources. The judgements, estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates and assumptions are recognized in the year in which they are revised and in any future periods affected. Actual results may differ from these estimates, judgements and assumptions.

The COVID-19 outbreak began to impact the Company's operations in the latter half of March 2020. Management believes the extent of the COVID-19 pandemic's adverse impact on the Company's operating results and financial condition will be driven by many factors, most of which are beyond management's control and ability to forecast. Such factors include, but are not limited to, the scope and duration of past and potential future stay-at-home policies and business closures, travel restrictions, and the willingness of customers to allow outside contractors onsite. Because of these and other uncertainties, management cannot estimate the length or severity of the impact of the pandemic on the business. Decreases in cash flows and results of operations may have an impact on the inputs and assumptions used in significant accounting estimates, including management's assessment of future compliance with financial covenants and potential impairments of goodwill, intangible and long-lived assets.

The following components of the financial statements depend most heavily on such management estimates, assumptions and judgment, and 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.

Business combinations

The identifiable assets acquired and liabilities assumed as part of a business combination are measured at the date of acquisition at their fair values. In estimating fair value, the Company uses market observable data to the extent it is available. In cases when Level 1 inputs are not available, the measurement of fair value involves the selection of an appropriate valuation model and consideration as to the inputs necessary for the valuation model chosen.

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 and, in the case of other intangible assets, determines an applicable royalty rate. 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 period.

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. Actual results may vary from estimate.

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.

Expected credit loss

The valuation of allowances for uncollectable trade receivables requires assumptions including estimated credit losses based on the Company's knowledge of the financial conditions of its customers, historical experience, and general economic conditions.

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 Policies

Effective June 1, 2019, the Company changed its accounting policy with respect to commissions and reclassified commission expense from selling, marketing and business development expense to cost of sales. The Company believes that the revised policy and presentation provides more reliable and relevant information to users of the consolidated financial statements. The change in accounting policy has been applied retrospectively. The Company has restated the comparative figures in the consolidated statements of operation resulting in reclassification of commission expense in the amount of \$1,192,170 for the year ended May 31, 2019 from selling, marketing and business development expense to cost of sales.

Changes in Accounting Standards

Note 3(x) of the Company's audited consolidated financial statements for the year ended May 31, 2020 discusses IFRS standards and interpretations that became effective for the Company on June 1, 2019.

9. 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 impact of major global pandemics;
- 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;
- The effect of a continuing prolonged recession in Canada, U.S. and Europe to the financial markets in securing project financing and in particular to industrial and commercial customers in committing capital to projects; and
- The impact of the departure from the European Union by the U.K.

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 continued 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. However, this was again followed by a net loss of \$2,154,817, accompanied by a cash decrease of \$1,331,074 in FY 2015. FY 2016 and FY 2017 saw a return to profitability and an increase in cash balances of \$427,805 and \$1,806,992, respectively. This was followed in FY 2018 by another profitable year which saw cash balances increase by \$336,334. In FY 2019, sales increased by 21.1% due to the increased revenue in heat recovery systems and the acquisition of Boilerroom Equipment Inc. In FY 2020, despite of the COVID-19 pandemic, the Company maintained the same sales level as FY 2019 with higher gross margins and recorded operating income before impairment of \$1,275,708. The Company reported a loss for the year because of the impairment write-down of \$3,061,200 on intangible assets and goodwill.

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 still believes that competition against its core technologies is limited at this time and believes that the marketplace is sufficiently large enough to mitigate the risk of stronger competition in the future.

Management Discussion and Analysis for the Fiscal Year Ended May 31, 2020

On June 23, 2016, a referendum was held in the U.K., resulting in the decision to leave the European Union (“EU”). The withdrawal of the UK from the EU is also called “Brexit”. As at January 31, 2020, UK was no longer a member of the European Union. Even though Brexit happened on January 31, 2020, both the UK and the EU still need to work out the specific rules for their new relationship. This includes everything from trade, immigration, aviation, security and access to fishing waters. These rules must be negotiated and signed off by the EU and UK Parliaments during the 11 months transition period ending on December 31, 2020. When the transition period ends, the UK will automatically drop out of the EU's main trading arrangements (i.e. the single market and the customs union). The single market means that countries share the same rules on product standards and access to services, whereas the customs union is an agreement between EU countries not to charge taxes and tariffs on each other's goods. If a new trade deal is not ready by December 31, 2020, then tariffs and border checks would be applied to UK goods travelling to the EU. The UK could also do this to EU goods, if it chose to. Tariffs would make UK goods more expensive and harder to sell in the EU, while full border checks could cause long delays at ports. Even if a trade deal is reached, it would not eliminate all border checks. Negotiations regarding how trade will continue after December 31, 2020 are ongoing, the outcome of which is difficult to predict. In the meantime, business continues as normal and the UK still follows EU rules. Management continues to monitor the situation, and is exploring alternative solutions to minimize the potential negative impact from Brexit on our business.

Management continues to focus on strengthening relationships with key customers, as well as securing new relationships with multi-site organizations, which is anticipated to provide repeat business into the foreseeable future. Management continually monitors costs and cash flow to ensure that the Company has sufficient funds for operations while providing for future growth.

10. 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.

11. 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, 2020 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.