MANAGEMENT'S DISCUSSION & ANALYSIS

For the Fiscal Year Ended May 31, 2016

Introduction

This Management Discussion and Analysis (MD&A) explains the material changes in Thermal Energy International Inc.'s ("Thermal Energy" or the "Company") financial position and results of operations for the fiscal year ended May 31, 2016 (or "FY 2016"), and compares the FY 2016 financial results to the previous year ended May 31, 2015 (or "FY 2015"). The consolidated financial statements and notes to the consolidated financial statements constitute an integral part of the discussion and should be read in conjunction with this MD&A. Unless otherwise indicated, all comparisons to the fourth quarter of FY 2016 are against the fourth quarter of FY 2015. Additional information relating to the Company is available on SEDAR at www.sedar.com.

Currency

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

Review and Approval by the Board of Directors

The Board of Directors, on recommendation of the Audit Committee, approved the content of this MD&A on September 15, 2016. Disclosure contained in this document is current to this date, unless otherwise stated.

Forward-Looking Statements

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

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1. Our Business

1.1 Company Overview

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

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

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

1.2 Core Businesses

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

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

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

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

1.3 Strategy

The Company's mission is to be a best-in-class provider of return on investment-driven thermal energy efficiency technology and solutions to the industrial, institutional, and commercial sectors, helping our clients around the world improve their bottom line, move towards sustainable operations and reduce their environmental and carbon 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 but our current focus is on the key markets of North America, Europe and the Middle East. Despite significant growth over the last few years, Thermal Energy's penetration in these markets remains low and therefore the Company plans to continue growing our sales and distribution capabilities in these markets while at the same time begin to build our business in other energy-intensive markets around the world.

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

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

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

2. Performance Measures

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

2.1 Adjusted Operating Cash Flow

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

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

2.2 EBITDAS

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

2.3 Order Backlog

Order backlog is a useful performance measure that Management uses as an indicator of the short term future revenue of our Company resulting from already recognized orders. 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 generally accepted accounting principles or International Financial Reporting Standards and therefore may not be comparable to similar measures presented by other companies.

3. Performance

3.1 Summary of Fourth Quarter Results

	Q4 2016	Q4 2015
	$	$
Revenue	**4,123,246**	2,525,061
Cost of Sales	**(2,075,533)**	(1,331,240)
Gross Profit	**2,047,713**	1,193,821
Administration, selling, marketing and business development expenses	**(1,840,498)**	(1,508,900)
Research and development expenses	**112,270**	(7,996)
Operating income (loss) before impairment	**319,485**	(323,075)
Impairment	**-**	-
Operating income (loss)	**319,485**	(323,075)
Finance Revenue	**4,911**	6,574
Income (loss) before income taxes	**324,396**	(316,501)
Income taxes (expense) recovery	**(56,283)**	(21,141)
Net income (loss) for the period	**268,113**	(337,642)
Exchange differences on translation of overseas operations	**40,763**	(18,464)
Total comprehensive income (loss) for the period	**308,876**	(356,106)

Revenues and Gross Profits

Revenues were $4,123,246 in the quarter ended May 31, 2016, representing an increase of $1,598,185, or 63%, compared to $2,525,061 in the quarter ended May 31, 2015. Sales of heat recovery systems increased by $1,251,995 (81.9%) over the same period in the previous year, while sales of GEM™ condensate return systems increased by $346,190 (34.7%).

Revenues from sales of heat recovery systems in the current quarter included the substantial completion of installations at two major hospitals, as announced October 29, 2015 and November 23, 2015, as well as the second half of a project at another hospital, as announced November 5, 2015 and the substantial completion of the project at an animal feed supplier, as announced November 11, 2015. In comparison, the same period of the previous year saw the substantial conversion at a site of a food manufacturer, as announced January 26, 2015, and one at a manufacturer of interior lining products, as announced January 5, 2015, plus the first half of a hospital conversion, as announced January 29, 2015, as well as the initial engineering stages of a project at a packaged food company, as announced December 1, 2014.

The increase in GEM™ condensate return system sales in the final quarter of FY 2016 over the same period of the prior year was due mainly to sales to a leading chemical producer as well as partial fulfilment of an order from another site of the Fortune 500 food and beverage company, which has already had a number of site conversions to GEM™. The final quarter of FY 2015 saw no significant individual sales.

The gross profit of $2,047,713 in the quarter ended May 31, 2016 represented an increase of $853,892, or 71.5%, from the $1,193,821 achieved in the quarter ended May 31, 2015. The increase was the result of increased revenues, as well as increased margins on heat recovery projects. Gross profit expressed as a percentage of sales was 49.7% in the final quarter of FY 2016 compared with 47.3% in the final quarter of FY 2015, which included two projects that were specifically costed to encourage customers to agree to trials with the aim of proving the technology and as a result ultimately receiving further orders for their other sites.

Expenses

Administration, selling, marketing and business development expenses in the quarter ended May 31, 2016 totaled $1,840,498 compared to $1,508,900 in the quarter ended May 31, 2015, an increase of $331,598. This increase was predominantly the result of higher commissions associated with the revenues, plus a staff incentive in the current year, as well as foreign exchange gains resulting from the strengthening of the U.S. dollar against the Canadian dollar in the final quarter of FY 2015 not being replicated in the current period.

Research and development credits relating to SR&ED claims accrued in the final quarter of FY 2016 gave rise to a net credit of $112,270, compared to an expense of $7,996 in the final quarter of FY 2015.

Finance revenue in the fourth quarter of FY 2016 of $4,911 compared to $6,574 recognized in the fourth quarter of FY 2015. The interest rate implicit in the lease of 14.3% is applied against the reducing finance lease receivable balance, hence lower finance revenues as the term of the agreement progresses.

Income (loss) before income taxes for the quarter ended May 31, 2016 was $324,396 compared to a loss of $316 501 in the same quarter of the previous year.

Income tax charge in the fourth quarter of FY 2016 was $56,283, compared to a charge of $21,141 in the fourth quarter of FY 2015. Taxes are payable on profits made in subsidiaries in both the U.S. and the U.K.

Net income for the fourth quarter of FY 2016 was $268,113 compared to a net loss of $337,642 in the same quarter of the previous year.

Comprehensive income was $308,876 for the final quarter of FY 2016 compared to a loss of $356,106 for the final quarter of FY 2015. The current quarter saw a slight weakening of the Canadian dollar against the U.K. pound sterling from the end of the February quarter, hence the higher comprehensive income arising from the translation of assets recorded in sterling. The final quarter of FY 2015 saw the opposite effect due to a strengthening of the Canadian dollar during that quarter.

3.2 Review of Year End Results

	2016	2015
	$	$
Revenue	**12,402,076**	6,800,192
Cost of Sales	**(5,608,071)**	(3,172,087)
Gross Profit	**6,794,005**	3,628,105
Administration, selling, marketing and business development expenses	**(6,421,215)**	(5,879,062)
Research and development expenses	**(41,846)**	(127,377)
Operating income (loss)	**330,944**	(2,378,334)
Finance Revenue	**25,530**	60,063
Income (loss) before income taxes	**356,474**	(2,318,271)
Income taxes (expense) recovery	**(97,606)**	163,454
Net income (loss) for the period	**258,868**	(2,154,817)
Exchange differences on translation of overseas operations	**(4,031)**	48,373
Total comprehensive income (loss) for the period	**254,837**	(2,106,444)

Revenues and Gross Profits

Revenues were $12,402,076 in FY 2016 compared to $6,800,192 in FY 2015, an increase of $5,601,884, or 82.4%. Sales of heat recovery systems increased by $3,598,411 (108.0%), while sales of GEM™ condensate return systems increased by $2,003,473 (57.7%).

In addition to the extra work performed at a major hospital trust, as announced October 29, 2015, which followed the successful installation of a heat recovery system at one of its sites during the last quarter of FY 2015 and first quarter of FY 2016, and two other hospital substantial completions, as announced November 5 and November 23, 2015, heat recovery sales of $6,929,152 in FY 2016 included installations at another site of the major Fortune 500 food and beverage company, as announced April 29, 2015, a creamery, as announced March 4, 2015, an animal feed supplier, as announced November 11, 2015 and two equipment sales, as announced July 15, 2015 and October 26, 2015. Other than one further site conversion of the same major Fortune 500 food and beverage company, as announced August 27, 2014, plus the substantial completion of an installation at a site of another food producer, as announced January 26, 2015, and the first half of a hospital conversion, as mentioned above, there were no significant projects similar to those mentioned above in the previous year.

GEM™ condensate return systems sales in FY 2016 were $5,472,924 compared to $3,469,451 in FY 2015. FY 2016 saw $428 thousand more revenue than FY 2015 in orders from the Fortune 500 food and beverage company, and FY 2015 revenues from a leading performance materials and chemicals company, as announced October 15, 2014, were replaced by orders in the current year from another leading performance materials and chemicals company. In addition, in FY 2016, the company received its largest GEM™ order to date, from a leading pharmaceutical company, as announced August 17, 2015, revenues from which in the current year totaled approximately $467 thousand. Sales of GEM™ product increased generally in North America.

The gross profit of $6,794,005 in FY 2016 represents an increase of $3,165,900, or 87.3%, over the $3,628,105 achieved in FY 2015. The gross profit expressed as a percentage of sales was 54.8% in FY 2016 compared with 53.4% in FY 2015.

Expenses

Administration, selling, marketing and business development expenses in FY 2016 totaled $6,421,215, compared to $5,879,062 in FY 2015, an increase of $542,153, or 9.2%. The increased commissions on the higher revenues plus a staff incentive provision were the main contributors to the increase, plus foreign exchange losses predominantly from the strengthening of the Canadian dollar against the U.S. dollar. These increases were partially offset by decreases in stock based compensation and training costs, which were higher in FY 2015 due to the bi-annual global sales conference.

Research and development costs in FY 2016 totaled $41,846 compared to $127,377 in FY 2015. During the current year, the company recorded SR&ED credits totaling $98,845, compared to $124,019 towards the ISTP project and SR&ED credits totaling $68,288 in the previous year. Although the ISTP project is now complete, research and development relating to heat recovery and GEM product improvements continues.

Finance revenue in FY 2016 was $25,530, a decrease of $34,533 from the $60,063 received in FY 2015. FY 2015 saw the expiry of the existing lease, which was further extended in May 2015 by an additional 24 months to April 2017 with lower payments than the previous lease, hence lower finance revenue.

Income before income taxes for the fiscal year ended May 31, 2016 was $356,474 compared to a loss of $2,318,271 for the fiscal year ended May 31, 2015. The $2,674,745 difference is the direct result of the increased revenues in the current year.

Income tax charge in FY 2016 was $97,606, compared to a recovery of $163,454 in the previous year. This change is due to improved results of both the U.K. entity and the U.S. entity.

Net income for FY 2016 was $258,868, compared to a net loss in the year ended May 31, 2015 of $2,154,817.

Comprehensive income was $254,837, compared to a comprehensive loss in the year ended May 31, 2015 of $2,106,444. U.K. Sterling strengthened against the Canadian Dollar in FY 2015, giving rise to an exchange gain on translation of overseas operations of $48,373. In comparison, the current year saw less fluctuation, resulting in a loss on translation of $4,031.

Liquidity & Capital Resources

The working capital was $976,374 at May 31, 2016 compared to working capital of $488,389 at May 31, 2015 – an increase of $487,985, with the Company's net cash position (Cash and cash equivalents less Bank loans) increasing by $427,805 from $715,343 as at May 31, 2015 to $1,143,148 as at May 31, 2016.

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

	Aug 31, 2014 $	Nov 30, 2014 $	Feb 28, 2015 $	May 31, 2015 $	Aug 31, 2015 $	Nov 30, 2015 $	Feb 29, 2016 $	May 31, 2016 $
Current Assets	4,533,588	3,722,822	3,768,369	3,650,605	2,641,290	3,747,206	4,018,307	3,834,124
Current Liabilities	2,415,447	2,193,708	2,848,970	3,162,216	2,512,531	3,528,790	3,317,835	2,857,750
Working Capital	2,118,141	1,529,114	919,399	488,389	128,759	218,416	700,472	976,374

FY 2016 Changes

Current assets increased in FY 2016 by $183,519 to $3,834,124, mostly due to in the increase in cash balances of $427,805, which was partly the result of a decrease in trade receivables. Current liabilities meanwhile decreased by $304,466 to $2,857,750. An increase in trade payables of $282,331 relating to heat recovery project costs was more than offset by the decrease in deferred revenue relating to projects in progress at the end of May 2015.

As at May 31, 2016, $1,611 (0.1%) of the Company's trade receivables balance was over 90 days past due, all of which has since been received.

At May 31, 2016, the Company had operating lease commitments as shown below. The Company had no purchase obligations:

	Total $	Less than 1 year $	1-5 years $	More than 5 years $
Operating Leases	199,670	94,360	105,310	nil

Net cash provided by operating activities in the year ended May 31, 2016 was $418,167. Net cash provided by investing activities of $62,235 comprised $111,524 finance lease principal payments received less $49,289 paid for net additions to property, plant and equipment. A total of $51,448 was used in investing activities, for the repurchase of Class A common shares under the Normal Course Issuer Bid, as announced February 17, 2016. After allowing negative $1,149 for the effect of exchange rate fluctuations on cash and cash equivalents, the net result of the above activities was an increase in cash balance of $427,805.

Adjusted operating cash inflow (defined as net income or loss attributable to the owners of the parent, plus items not involving cash, after net tax and interest cash inflows or outflows, plus finance lease payments received) for the year ended May 31, 2016 was $709,797. After adjusting this for $180,106 of negative changes in non-cash working capital items and deducting $49,289 for the net purchase of fixed assets, and $51,448 used for the repurchase of Class A common shares, and deducting $1,149 to allow for the effect of exchange rate fluctuations on cash and cash equivalents, the net cash inflow was $427,805, increasing the net cash balance as at May 31, 2016 to $1,143,148 from $715,343 as at May 31, 2015.

In addition to its net cash balance of $1,143,148 as at May 31, 2016 the Company also had an estimated $156,000 of unused borrowing capacity under its bank loans.

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. No assurance can be given that any such additional funding will be available or that, if available, it can be obtained on terms favorable to the Company.

Management is of the opinion that sufficient working capital will be obtained from future cash flows by achieving profitable operations through continuing to manage expenditures, concentrating on restoring revenue to the level experienced in 2014 and growing revenues at growth rates experienced in the years ended May 31, 2010 through May 31, 2014. The Company cannot be certain that cash generated from its operations will be sufficient to satisfy its liquidity requirements and it may need to raise capital by obtaining financing.

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

	2014 $	2015 $	2016 $
Net cash provided (used) in operating activities	462,690	(1,806,222)	418,167
Changes in working capital	444,872	(322,219)	180,106
Finance lease principal payments received	441,562	724,014	111,524
Adjusted operating cash flow	1,349,124	(1,404,427)	709,797

Net Investment in Lease

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

	May 31, 2016 $	May 31, 2015 $
Total estimated minimum lease payments receivable	125,054	262,108
Less: unearned income	(8,494)	(34,024)
	116,560	228,084
Less: current portion	(116,560)	(111,524)
	-	116,560

Finance lease receivable relates to one arrangement. The estimated minimum lease payments receivable in this lease represent the estimated monthly energy outputs of the leased asset and are based on assumptions regarding the efficiency of the asset, the operations of the plant in which it is located and penalty payments resulting from temporary plant shut-downs. On December 31, 2012, the lease with Fortress Specialty Cellulose, as signed on June 29, 2010, expired. On November 27, 2012, an agreement was signed whereby the customer agreed to purchase the recovered energy for a further two years, after which the customer had the option to renew for an additional 24 months on substantially the same terms or purchase the asset from the Company.

On December 22, 2013, the site commenced a market downtime for a period of ten weeks, following the imposition of an interim duty in China on the import of Canadian dissolving pulp, further to which on April 11, 2014, an agreement was made to further extend the existing lease by five months to mid-May 2015.

On May 1, 2015, the customer signed a further extension for 24 months to May 1, 2017. Pursuant to this new extension, the customer has agreed to pay up to $12,000 per month over two years, at the end of which the customer has the option to purchase the asset from the Company.

As part of calculating the impact of the new lease extension, the existing net residual value of the equipment was re-assessed. The estimated value of any re-sale value or scrap value of the equipment less removal and re-sale costs was assessed as $nil and so a write-down of the $139,530 net residual value was taken. This write-down, combined with the write-down of the May 2015 expected payment under the terms of the previous lease, which was expected to expire in mid-May 2015, reduced the net revenue recognized on renewal of the lease to $69,791.

Until the expiry of the new lease on May 1, 2017, finance revenue will be recognized within the income statement at the interest rate implicit in the lease.

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 and the operations of the plant in which it is located.

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

	$
Less than one year	125,054
Between two and five years	-
Residual value of equipment	-
	125,054

Related Party Transactions

Options outstanding for Directors (excluding the CEO) as at May 31, 2016 were 1,500,000 of which 1,333,333 were exercisable. There were no warrants outstanding for Directors.

Options outstanding for Senior Management (including the CEO) as at May 31, 2016 were 9,708,720 of which 6,123,697 were exercisable. There were no warrants outstanding for Senior Management.

Directors and Senior Management Compensation

During the year ended May 31, 2016 compensation arrangements for directors was as follows:

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

During the year ended May 31, 2016, Directors fees paid were $90,000. Fees to the Chairperson of the Audit Committee were $6,000; fees to the Chairperson of the Ethics, Governance and Compliance Committee were $6,000, fees paid to the Chairman were $9,000; and a total of $27,000 was paid for in-person meetings.

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

	Salaries and fees		Incentives		Other short-term benefits		Total	
	2016 $	2015 $	**2016 $**	2015 $	**2016 $**	2015 $	**2016 $**	2015 $
Directors								
M. Williams	**26,000**	25,000	-	-	**-**	-	**26,000**	25,000
J. Kelly	**29,000**	28,000	-	-	**-**	-	**29,000**	28,000
D. Gibbs (resigned November 6, 2014)	**-**	6,500	-	-	**-**	-	**-**	6,500
W. Ollerhead	**20,000**	19,000	-	-	**-**	-	**20,000**	19,000
B. Linton	**20,687**	21,417	-	-	**-**	-	**20,687**	21,417
J. Schoenmakers	**22,313**	19,000	**-**	**-**	**-**	-	**22,313**	19,000
D. Spagnolo (appointed November 6, 2014)	**20,000**	11,541	**-**	**-**	**-**	-	**20,000**	11,541
Total	**138,000**	130,458	-	-	**-**	-	**138,000**	130,458
Senior Management								
W. Crossland	**240,000**	240,000	**28,658**	**-**	**4,440**	3,783	**273,098**	243,783
J. Flynn	**168,373**	156,488	**17,677**	**-**	**28,661**	24,266	**214,711**	180,754
R. Triebe	**153,699**	153,699	**17,677**	**-**	**8,006**	7,426	**179,382**	161,125
S. Mawby	**106,904**	153,650	**17,677**	**-**	**19,704**	23,791	**144,285**	177,441
Total	**668,976**	703,837	**81,689**	-	**60,811**	59,266	**811,476**	763,103
Total Related Party Transactions	**806,976**	834,295	**81,689**	-	**60,811**	59,266	**949,476**	893,561

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) Ms. Flynn and Mr. Mawby are compensated in U.K. Pound sterling. Average exchange rate to Canadian dollar was 1.975 and 1.836 in FY 2016 and FY 2015 respectively.

(2) Mr. Mawby was on parental leave between June 15, 2015 and November 8, 2015.

(3) Mr. Gibbs resigned and Mr. Spagnolo was appointed on November 6, 2014.

Normal Course Issuer Bid

On February 17, 2016, 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 February 12, 2016. During the 12-month period commencing February 15, 2016 and ending February 15, 2017, the Company is able to purchase on the TSX up to 12,758,701 common shares, representing approximately 8% 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 of the Class A common shares purchased were purchased and cancelled directly under the NCIB for the year ended May 31, 2016 and 2015.

The previously announced NCIB was approved by TSX Venture Exchange on November 3, 2014 and expired on November 3, 2015.

In the year ended May 31, 2016 the Company purchased 1,180,000 common shares for a total purchase price of $51,488 (2015: 2,012,000 shares purchased for a total purchase price of $195,366).

Segmented Information

In the years ended May 31, 2016 and May 31, 2015, the Company operated in the energy efficiency industry in North America, Europe, China and the rest of the world. The Company markets, sells, engineers, fabricates, constructs, installs and supports two technology lines – heat recovery solutions and condensate return system solutions. The Company is also developing a third technology line - low temperature biomass drying systems. Assets are located in Canada, Europe and China.

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

Segment information for the year ended May 31, 2016 and the comparative period are detailed in the table below.

	North America and China		Europe and Rest of World		Reconciling Items		Total	
	2016 **$**	2015 $	**2016** **$**	2015 $	**2016** **$**	2015 $	**2016** **$**	2015 $
Total revenue from external customers	**5,603,330**	3,084,773	**6,798,746**	3,715,419	–	–	**12,402,076**	6,800,192
Cost of sales	**(2,520,316)**	(1,906,068)	**(3,087,755)**	(1,266,019)	–	–	**(5,608,071)**	(3,172,087)
Gross profit	**3,083,014**	1,178,705	**3,710,991**	2,449,400	–	–	**6,794,005**	3,628,105
Other expenses	**(2,463,536)**	(2,187,433)	**(2,813,507)**	(2,730,051)	**(1,186,018)**	(1,088,955)	**(6,463,061)**	(6,006,439)
Finance revenue	**25,530**	60,063	–	–	–	–	**25,530**	60,063
Income (loss) before taxation	**645,008**	(948,665)	**897,484**	(280,651)	**(1,186,018)**	(1,088,955)	**356,474**	(2,318,271)
Tax (expense) recovery	**(71,603)**	(7,223)	**(142,428)**	123,364	**116,425**	47,313	**(97,606)**	163,454
Profit (loss) after taxation	**573,405**	(955,888)	**755,056**	(157,287)	**(1,069,593)**	(1,041,642)	**258,868**	(2,154,817)
Attributable to:								
Owners of the parent	**591,272**	(948,484)	**732,170**	(161,259)	**(1,069,593)**	(1,041,642)	**253,849**	(2,151,385)
Non-controlling interest	**(17,867)**	(7,404)	**22,886**	3,972	–	–	**5,019**	(3,432)

Reconciling items comprise the following:

	2016 **$**	2015 $
Corporate administration costs	**849,642**	739,006
Stock-based compensation	**168,074**	229,298
Professional fees	**122,909**	138,091
Depreciation of property, plant and equipment	**38,344**	36,077
Bank charges and interest	**37,419**	39,390
Foreign exchange differences	**(30,370)**	(92,907)
Total	**1,186,018**	1,088,955

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

During the year ended May 31, 2016, the Company had one customer in Europe and the rest of the world that accounted for 13.1% of total revenue for the year.

During the year ended May 31, 2015, the Company had one customer in North America and China that accounted for 14.4% of total 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,		Finance lease receivable (non-current) as at May 31,	
	2016	2015	**2016**	2015	**2016**	2015	**2016**	2015
	$	$	**$**	$	**$**	$	**$**	$
Canada	**326,567**	459,545	**50,380**	46,260	–	–	-	116,560
U.S.A.	**5,270,334**	2,618,679	–	–	–	–	–	–
U.K.	**6,125,908**	2,662,359	**28,057**	16,103	**2,047,246**	2,049,617	–	–
Italy	**121,152**	286,038	–	–	–	–	–	–
Netherlands	**124,629**	107,405	–	–	–	–	–	–
Ireland	**26,939**	54,838	–	–	–	–	–	–
Germany	**132,326**	197,956	–	–	–	–	–	–
Rest of Europe	**31,413**	36,636	–	–	–	–	–	–
India	**44,897**	113,959	–	–	–	–	–	–
Kenya	**109,414**	115,320	–	–	–	–	–	–
China	**6,429**	6,549	–	–	–	–	–	–
Rest of world	**82,068**	140,908	–	–	–	–	–	–
Total	**12,402,076**	6,800,192	**78,437**	62,363	**2,047,246**	2,049,617	-	116,560

Material Segmentation Variances

Revenue

North America and China: revenue for the year ended May 31, 2016 was $5,603,330 compared to $3,084,773 for FY 2015. Heat recovery revenue increased by $401,588. Each year saw the substantial completion of two turnkey projects, but the current year revenue also included an equipment sale. Revenue from sales of GEM™ products meanwhile increased by $2,116,969. Six orders received from a major Fortune 500 food and beverage company during the current year compared to three orders from the same customer in the prior year. In addition, the order from a healthcare company, as announced August 17, 2015, was substantially fulfilled in the year, along with a number of orders from a leading chemical manufacturer. General other sales within the region also contributed to the increase.

Europe and the rest of the world: revenue for the year ended May 31, 2016 was $6,798,746 compared to $3,715,419 for the previous year. Heat recovery revenue increased by $3,196,823 in FY 2016, with projects including a hospital installation, as announced November 5, 2015, plus an extension project at three sites of another hospital, as announced October 29, 2015, an equipment sale to a gypsum company, as announced October 26, 2015, a FLU-ACE® installation at a dairy supplier, as announced March 4, 2015 and another at a leading animal feed supplier, as announced November 11, 2015. In comparison, the previous year's heat recovery revenue included only a hospital extension project and one equipment sale. Revenue from sales of GEM™ products meanwhile decreased by $113,496 from FY 2015, with sales to a leading chemical supplier in FY 2015 being partially replaced in the current year with one site conversion at a hospital.

Segment Income (loss) Before Tax

North America and China: Gross profit increased by $1,904,309 in FY 2016 over the previous year. As a percentage of revenue, gross profit was 55.0% in FY 2016, compared to 38.2% achieved in FY 2015. The previous year included two projects which were specifically costed to encourage customers to agree to trials with the aim of proving the technology and as a result ultimately receiving further orders for their other sites. FY 2016 gross profit was also higher due to the increase in GEM™ sales, which attract a higher margin than heat recovery sales. Other expenses in the region increased by $276,103 (12.6%), due mainly to increased commissions payable and profit related incentive, which were partially offset by increased SR&ED credits. With finance revenue decreasing by $34,533 as the finance lease progresses, the resulting segment income before tax of $645,008 represented an improvement of $1,593,673 over the previous year.

Europe and the rest of the world: gross profit increased in the year ended May 31, 2016 over the previous year by $1,261,591, as a result of the increased revenues, with gross profit as a percentage of revenue decreasing from 65.9% to 54.6% due to the increase in revenue being all heat recovery. The increase in other expenses of $83,456 is due to the exchange rate. Actual costs in U.K. pounds were lower than in FY 2015 with higher commissions payable and profit related incentive being offset by lower staff costs, due to parental leave of management. The resulting pre-tax income of $897,484 compared to a loss of $280,651 in the prior year, an improvement of $1,178,135.

Other expenses within Reconciling items, which incorporates all costs not specifically attributable to either regional operational center, increased in FY 2016 over the prior year by $97,063. A decrease in stock based compensation expense was more than offset by profit related incentive and a lesser net gain on foreign currency translation, due to the strengthening of U.K. Sterling against the Canadian dollar.

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, 2014, 2015 and 2016

	2014 $	2015 $	2016 $
Revenue	13,150,810	6,800,192	12,402,076
Gross Profit	6,973,620	3,628,105	6,794,005
Gross Profit Percentage	53.0%	53.4%	54.8%
EBITDAS[(1)]	879,244	(2,048,552)	564,179
Total net income (loss) attributable to owners of the parent	626,996	(2,151,385)	253,849
Net profit (loss) per share – basic and diluted	0.004	(0.013)	0.002
Total assets	7,445,964	5,896,865	5,980,709
Total long term financial liabilities	0	0	0
Cash dividends declared per share	0.00	0.00	0.00
Adjusted operating cash flow[(2)]	1,349,123	(1,404,427)	709,797

(1) EBITDAS represents earnings before interest, taxation, depreciation, amortization, impairment of goodwill and other intangible assets, share-based compensation expense and net write down of lease.
(2) Adjusted operating cash flow represents net income (loss) plus items not involving cash, plus lease payments received.

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

	2014 $	2015 $	2016 $
Total net income (loss) attributable to owners of the parent	626,996	(2,151,385)	253,849
Total net income (loss) attributable to non-controlling interest	7,027	(3,432)	5,019
Interest paid	4,750	4,473	4,692
Interest received	(1,453)	(129)	(3,405)
Taxation	74,396	(163,454)	97,606
Depreciation	38,401	36,077	38,344
Amortization	8,303	-	-
Share based compensation	120,824	229,298	168,074
Net investment in finance lease	-	-	-
EBITDAS	879,244	(2,048,552)	564,179

FY 2016 provided $5,601,884 more revenue than FY 2015 – an increase of 82%. Whereas the previous year saw just one heat recovery order from a hospital, which was partially completed that year, the current year included the completion of that project as well as two other hospital conversions and a significant extension project at the first site. In addition, FY 2016 included three FLU-ACE® projects from other markets as well as two equipment sales, compared to two conversions and one smaller equipment sale in the prior year. Revenue from the sale of GEM™ products in North America increased by $2,116,969 in the current year, much of which was due to orders from three customers, but also some resulting from a general increase in orders from that region. This increase in revenue contributed directly to the increase in gross profit, with the main increases in other expenses also being the result of the increased activity, as commissions payable and incentive payable being higher than in FY 2015. Total assets grew by $83,844 in the current year, with an increase in cash balances of $427,805 being partially offset by a decrease in finance lease receivable and current tax assets, due to the profits realized in the U.K. entity this year.

FY 2015 saw a 48% drop in revenue, with a corresponding 48% decrease in gross profit to $3,628,105. Sales to hospitals fell drastically in FY 2015, with no entire heat recovery conversions or GEM™ installations being recorded. In the U.K., a number of expected projects were delayed due to the increased use of third parties to review and often manage energy reduction programs on behalf of the estates departments. This was a major contributory factor in the drop in both heat recovery and GEM sales, and consequently gross profit, in FY 2015. Despite lower commissions payable and no staff incentive due in FY 2015, other expenses were just 5% less than in FY 2014 due to increased costs relating to the extra sales and marketing staff added towards the end of FY 2014. Total assets fell in FY 2015 by $1,549,099, predominantly as a result of the decreased cash balance due to the performance in the year. The decrease in finance lease receivable was partially offset by increases in trade receivables and deferred tax assets.

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

Quarterly financial information (unaudited)
For the eight quarters ended May 31, 2016

Quarter ended	31-May-16 $	29-Feb-16 $	30-Nov-15 $	31-Aug-15 $
Revenue	4,123,246	3,220,621	2,501,595	2,556,614
Gross Profit	2,047,713	2,029,240	1,617,282	1,099,770
Gross Profit Percentage	49.7%	63.0%	64.6%	43.0%
EBITDAS[(1)]	376,858	504,654	83,538	(400,871)
Total net income (loss)	268,113	417,722	25,630	(452,597)
Income (loss) per share, basic and diluted	0.001	0.003	0.000	(0.003)

Quarter ended	31-May-15 $	28-Feb-15 $	30-Nov-14 $	31-Aug-14 $
Revenue	2,525,061	1,440,985	1,662,805	1,171,341
Gross Profit	1,193,821	711,906	1,019,426	702,952
Gross Profit Percentage	47.3%	49.4%	61.3%	60.0%
EBITDAS(1)	(256,642)	(647,245)	(486,557)	(658,108)
Total net income (loss)	(337,642)	(657,592)	(491,164)	(668,419)
Income (loss) per share, basic and diluted	(0.002)	(0.004)	(0.003)	(0.004)

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

4. Business Outlook

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

- In May 2016, the Company announced that it had received an order for approximately $1,015,000 from a leading food products business for the supply and installation of a FLU-ACE® heat recovery solution at one of its sites. This order was less than 2% complete as at May 31, 2016, with the balance expected to be fulfilled and revenue earned over the next six months.

- In July 2016, the Company announced that it had received an order for approximately $840,000 from a multi-site hospital group for the extension of a heat recovery system previously installed by Thermal Energy. This order is expected to be fulfilled and revenue earned over the next six months.

- In August 2016, the Company announced that it had received two orders from a hospital trust: the first valued at approximately $868,000 for the supply and installation of a heat recovery system at one of its sites; and the second for the supply and installation of GEM™ steam traps at another site, worth approximately $280,000. These orders are expected to be fulfilled and revenue earned over the next six months.

- Also in August 2016, the Company announced that it had received an order for approximately $750,000 from a global brewing company for the supply and installation of a FLU-ACE® heat recovery solution at one of its sites. This order is expected to be fulfilled and revenue earned over the next six months.

- The Company's order backlog as at May 31, 2016 was approximately $2.6 million. As at September 15, 2016, the Company had an order backlog of approximately $7.3 million, of which approximately $0.3 million is related to long term contracts and is not expected to be reflected in revenue within the next 12 months.

5. Summary of Outstanding Shares and Dilutive Instruments

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

Shares

159,264,616 class A common shares.

Options

Number of Options outstanding	Number of Options Exercisable	Exercise Price Per Share $	Expiry Date
3,860,000	3,860,000	0.10	01-Dec-2016
4,340,000	4,340,000	0.10	22-Nov-2017
3,072,000	2,048,000	0.05	18-Nov-2018
3,297,360	2,198,240	0.10	28-May-2019
250,000	83,333	0.09	01-Dec-2019
4,224,360	1,408,120	0.08	29-May-2020
3,425,000	-	0.05	30-May-2021
22,468,720	13,937,693		

6. Critical Accounting Estimates and Changes in Accounting Standards

Critical Accounting Estimates

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

Valuation of goodwill and intangible assets and asset impairment

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

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

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

Future production outputs relating to the finance lease

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

Assumptions used in the Black-Scholes fair value calculations

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

Revenue Recognition relating to contracts for heat recovery solutions

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

Deferred tax assets

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

Changes in Accounting Standards

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

Amendments to IFRS 2, "Share-based Payments"

In December 2013, the IASB issued amendments to IFRS 2 Share-based payments, which clarify vesting conditions by separately defining a performance condition and a service condition, both of which were previously incorporated within the definition of a vesting condition. These amendments became effective for annual periods beginning on or after July 1, 2014 and interim periods within those annual periods. The Company adopted the amendments on July 1, 2014. The adoption of the amendments to IFRS 2 did not have a material impact on the consolidated financial statements.

Amendments to IFRS 13, "Fair Value Measurements"

In December 2013, the IASB issued amendments to IFRS 13 Fair Value Measurements, which relate to the measurement of short-term receivables and payables, and the scope of the portfolio exemption. Short-term receivables and payables with no stated interest rate can still be measured at the invoice amount without discounting if the effect of discounting is immaterial. The portfolio exemption permits an entity to measure the fair value of a group of financial assets and financial liabilities on a net basis. The amendment clarifies that the portfolio exemption applies to all contracts within the scope of IAS 39 Financial Instruments: Recognition and Measurement (or IFRS 9 Financial Instruments if this has been adopted early), regardless of whether the meet the definition of financial assets or financial liabilities within IAS 32 Financial Instruments: Presentation. These amendments became effective for annual periods beginning on or after July 1, 2014. The Company adopted the amendments on July 1, 2014. The adoption of the amendments to IFRS 13 did not have a material impact on the consolidated financial statements.

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

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

IFRS 9, "Financial Instruments"

In July 2014, the IASB issued the final version of IFRS 9, bringing together the classification and measurement, impairment and hedge accounting phases of the project to replace IAS 39, "Financial Instruments: Recognition and Measurement. This standard simplifies the classification of a financial asset as either at amortized cost or at fair value as opposed to the multiple classifications which were permitted under IAS 39. This standard also requires the use of a single impairment method as opposed to the multiple methods in IAS 39. The approach in IFRS 9 is based on how an entity manages its financial instruments in the context of its business model and the contractual cash flow characteristics of the financial assets. The standard also adds guidance on the classification and measurement of financial liabilities. IFRS 9 is to be applied retrospectively for annual periods beginning on or after January 1, 2018. Early application is permitted. The Company does not intend to adopt this standard early and is currently evaluating the impact of adopting this standard on the consolidated financial statements.

IFRS 15, "Revenue from Contracts with Customers"

In May 2014, the IASB issued IFRS 15, Revenue from Contracts with Customers, which provides a single, principles-based five-step model for revenue recognition to be applied to all customer contracts, and requires enhanced disclosures. The IASB recently confirmed a one year deferral of the effective date of IFRS 15 to January 1, 2018. Earlier application of IFRS 15 continues to be permitted. The Company does not intend to adopt this standard early and is currently evaluating the impact of adopting this standard on the consolidated financial statements.

IFRS 16, "Leases"

In January 2016, the IASB issued IFRS 16, Leases, which specifies how to recognize, measure present and disclose leases. The standard provides a single lessee accounting model, requiring lessees to recognize all assets and liabilities for all leases unless the lease term is 12 months or less or the underlying asset has a low value. Consistent with its predecessor, IAS 17, the new lease standard continues to require lessors to classify leases as operating or finance. IFRS 16 is to be applied retrospectively for annual periods beginning on or after January 1, 2019. Earlier application is permitted if IFRS 15 Revenue from Contracts with Customers has also been applied. The Company does not intend to adopt this standard early and is currently evaluating the impact of adopting this standard on the consolidated financial statements.

Amendments to IAS 16 "Property, Plant and Equipment" and IAS 38 "Intangible Assets"

In May 2014, the IASB issued amendments to IAS 16 Property, Plant and Equipment and IAS 38 Intangible Assets. These amendments prohibit entities from using a revenue-based depreciation method for items of property, plant and equipment. They also introduce a rebuttable presumption that revenue is not an appropriate basis for amortization of an intangible asset. The amendments explain that an expected future reduction in selling prices could be indicative of a reduction of the future economic benefits embodied in an asset. These amendments are to be applied prospectively for annual periods beginning on or after January 1, 2016. The Company is currently evaluating the impact of adopting these amendments on the consolidated financial statements.

7. Risk Factors and Risk Management

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

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

Financial risks and uncertainties of the Company include:

- The Company's history of operating losses and uncertainty of future profitability;
- The ability to grow sales through the establishment of new cooperative partnerships and strategic alliances;
- The ability to grow sales through the licensing of the corporation's technologies;
- The ability to secure and maintain the required outside working capital financing;
- The ability to achieve profitable operations through increased sales,
- Reliance on third party collaborations and license arrangements;
- Reliance on proprietary technology;
- Competition in the energy conservation and environmental compliance solutions;
- Product liability claims and insurance;
- Reliance on key personnel;
- The ongoing litigation with its former President & CEO;
- The ability to control costs and achieve a positive gross margin on projects; and,
- The effect of a continuing prolonged recession in Canada, U.S.A. and Europe to the financial markets in securing project financing and in particular to industrial and commercial customers in committing capital to projects.
- The impact of the pending 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 continue to build the sales force, FY 2014 produced the company's best ever post-tax income of $634,023 as well as an increase in cash balance of $742,022, but this was again followed by a net loss of $2,154,817, accompanied by a cash decrease of $1,331,074 in FY 2015. The current year saw a return to profitability and an increase in cash balances of $427,805.

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

On June 23, 2016 a referendum was held in the U.K., resulting in the decision to leave the European Union. One immediate effect was a significant fall in the value of U.K. Pound Sterling against most other major currencies, although it has now stabilized. Negotiations regarding how trade will continue after the U.K. leaves are ongoing, the outcome of which is difficult to predict. Management continues to monitor the situation, but at this point cannot comment on how the eventual break will impact the Company. In the meantime, business continues as normal.

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.

8. Forward-Looking Information

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

9. Management's Responsibility for Financial Reporting

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

Under the supervision of the CEO and CFO, the Company maintains systems of internal accounting and administrative controls to provide reasonable assurance that the financial information is relevant, reliable and accurate and that transactions are authorized, assets are safeguarded and proper records are maintained. Internal controls over financial reporting, no matter how well designed, have inherent limitations and may not prevent or detect all misstatements. There were no changes to the Company's internal control over financial reporting during the year ended May 31, 2016 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

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

Thermal Energy's auditors, KPMG LLP, conducted an independent audit of the consolidated financial statements for the year ended May 31, 2016, performing such tests and other procedures as they consider necessary to express an audit opinion. The external auditors have full and unrestricted access to the Audit Committee to discuss their audit and related findings.