

Condensed Consolidated Interim Financial Statements

**THERMAL ENERGY
INTERNATIONAL INC.**

Quarters ended August 31, 2018 and 2017

THERMAL ENERGY INTERNATIONAL INC.

UNAUDITED CONDENSED CONSOLIDATED INTERIM STATEMENTS
OF FINANCIAL POSITION
(EXPRESSED IN CANADIAN DOLLARS)

As at	August 31, 2018 \$	May 31, 2018 \$
ASSETS		
Current assets		
Cash and cash equivalents (Note 6)	2,254,613	3,282,208
Trade and other receivables (Note 7)	5,156,091	2,749,640
Current tax receivable	152,096	52,344
Inventory (Note 8)	655,444	439,792
Finance lease receivable (Note 9)	92,365	89,141
	8,310,609	6,613,125
Non-current assets		
Finance lease receivable (Note 9)	67,790	93,257
Property, plant and equipment (Note 10)	270,459	77,395
Intangible assets (Note 11)	2,328,077	640,238
Goodwill (Note 12)	1,908,118	1,216,501
Deferred tax assets	57,444	51,632
	4,631,888	2,079,023
Total assets	12,942,497	8,692,148
LIABILITIES		
Current liabilities		
Trade payables (Note 14)	2,916,480	1,808,139
Current tax liabilities	2,753	-
Pensions and other employer obligations	92,545	95,441
Other liabilities (Note 15)	1,732,445	1,765,697
Current portion of long-term debt (Note 16)	65,275	-
Deferred revenue (Note 17)	931,932	684,623
Provisions (Note 18)	242,845	232,222
	5,984,275	4,586,122
Non-current liabilities		
Contingent payable (Note 25)	94,110	-
Long term debt (Note 16)	2,829,721	-
Deferred tax liabilities	662	673
	2,924,493	673
Total liabilities	8,908,768	4,586,795
EQUITY		
Capital stock (Note 19)	32,231,329	32,231,329
Contributed surplus	3,982,955	3,978,830
Accumulated other comprehensive income	250,593	282,292
Deficit	(32,391,340)	(32,335,936)
Equity attributable to owners of the parent	4,073,537	4,156,515
Non-controlling interest	(39,808)	(51,162)
Total equity	4,033,729	4,105,353
Commitments (Note 24)		
Subsequent events (Note 27)		
Total liabilities and equity	12,942,497	8,692,148

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

On behalf of the Board:

"William Ollerhead"

Director

"Michael Williams"

Director

THERMAL ENERGY INTERNATIONAL INC.

**UNAUDITED CONDENSED CONSOLIDATED INTERIM
STATEMENTS OF COMPREHENSIVE INCOME
(EXPRESSED IN CANADIAN DOLLARS)**

Three months ended August 31	2018 \$	2017 \$
Revenue	6,800,861	3,097,584
Cost of sales	4,590,976	1,579,787
Gross profit	2,209,885	1,517,797
Expenses:		
Administration	1,067,376	697,625
Selling, marketing and business development	1,228,367	1,006,394
Research and development	29,958	33,727
	2,325,701	1,737,746
Operating loss	(115,816)	(219,949)
Finance costs	(36,440)	-
Finance revenue	6,258	9,054
Loss before income taxes	(145,998)	(210,895)
Income taxes recovery	96,540	30,115
Net loss for the period	(49,458)	(180,780)
Other comprehensive loss for the period		
Items that may be reclassified subsequently to profit or loss:		
Exchange differences arising on translation of overseas operations	(26,291)	(241,314)
Total comprehensive loss for the period	(75,749)	(422,094)
Net loss for the period attributable to:		
Owners of the parent	(55,404)	(176,385)
Non-controlling interest	5,946	(4,395)
Net loss for the period	(49,458)	(180,780)
Total comprehensive loss for the period attributable to:		
Owners of the parent	(87,103)	(415,777)
Non-controlling interest	11,354	(6,317)
Total comprehensive loss for the period	(75,749)	(422,094)
Net loss per share - basic and diluted (Note 23)	(0.00)	(0.001)

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

TERMAL ENERGY INTERNATIONAL INC.

UNAUDITED CONDENSED CONSOLIDATED INTERIM STATEMENTS OF CHANGES IN EQUITY
(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, 2017	32,231,329	3,929,224	(32,974,934)	343,235	3,528,854	(19,695)	3,509,159
Stock-based compensation (Note 21)	-	13,923	-	-	13,923	-	13,923
Transactions with owners	-	13,923	-	-	13,923	-	13,923
Net loss for the period	-	-	(176,385)	-	(176,385)	(4,395)	(180,780)
Other comprehensive income: exchange differences arising on translation of overseas operations	-	-	-	(239,392)	(239,392)	(1,922)	(241,314)
Total comprehensive loss for the period	-	-	(176,385)	(239,392)	(415,777)	(6,317)	(422,094)
Balance at August 31, 2017	32,231,329	3,943,147	(33,151,319)	103,843	3,127,000	(26,012)	3,100,988
Balance at June 1, 2018	32,231,329	3,978,830	(32,335,936)	282,292	4,156,515	(51,162)	4,105,353
Stock-based compensation (Note 21)	-	4,125	-	-	4,125	-	4,125
Transactions with owners	-	4,125	-	-	4,125	-	4,125
Net income (loss) for the period	-	-	(55,404)	-	(55,404)	5,946	(49,458)
Other comprehensive income: exchange differences arising on translation of overseas operations	-	-	-	(31,699)	(31,699)	5,408	(26,291)
Total comprehensive income (loss) for the period	-	-	(55,404)	(31,699)	(87,103)	11,354	(75,749)
Balance at August 31, 2018	32,231,329	3,982,955	(32,391,340)	250,593	4,073,537	(39,808)	4,033,729

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

THERMAL ENERGY INTERNATIONAL INC.

**UNAUDITED CONDENSED CONSOLIDATED INTERIM
STATEMENTS OF CASH FLOWS
(EXPRESSED IN CANADIAN DOLLARS)**

Three months ended August 31	2018 \$	2017 \$
OPERATING ACTIVITIES:		
Net loss for the period	(49,458)	(180,780)
Add items not involving cash:		
Depreciation of property, plant and equipment (Note 10)	16,969	10,247
Amortization of intangible assets (Note 11)	37,741	-
Gain on disposal of assets (Note 10)	(191)	(5,840)
Finance revenue	(6,271)	(9,054)
Finance costs	36,440	-
Stock-based compensation (Note 21)	4,125	13,923
Income tax recovery	(96,540)	(30,115)
Unrealized foreign exchange and translation adjustments	52,484	(144,698)
Changes in working capital :		
Trade and other receivables	(1,969,964)	408,440
Inventory	30,617	13,155
Trade payables	1,008,842	(807,098)
Deferred revenue	44,976	(796,444)
Other liabilities	(440,904)	(63,855)
Income taxes paid	(1,847)	(75,156)
Interests received on finance lease	6,258	9,054
Other interests received	13	44
Interest paid	(26,274)	(500)
Net cash used in operating activities	(1,352,984)	(1,658,677)
INVESTING ACTIVITIES:		
Finance lease principal payments received	22,243	19,446
Acquisition of subsidiary, net of cash (Note 4)	(2,612,845)	-
Proceeds from disposal of property, plant and equipment (Note 10)	6,396	7,757
Additions to property, plant and equipment (Note 10)	(22,477)	(22,007)
Net cash (used in)/provided by investing activities	(2,606,683)	5,196
FINANCING ACTIVITIES:		
Issuance of long-term debt (Note 16)	2,937,375	-
Net cash provided by financing activities	2,937,375	-
Decrease in cash and cash equivalents for the period	(1,022,292)	(1,653,481)
Cash and cash equivalents, beginning of period	3,282,208	2,950,140
Exchange differences on cash and cash equivalents	(5,303)	32,925
Cash and cash equivalents, end of period	2,254,613	1,329,584

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

THERMAL ENERGY INTERNATIONAL INC.

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

Three months ended August 31, 2018 and 2017

(Expressed in Canadian dollars)

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 36 Bentley Avenue, Ottawa, Ontario, Canada, K2E 6T8.

These unaudited condensed consolidated interim financial statements were approved and authorized for issue by the Board of Directors on October 26, 2018. The unaudited condensed consolidated interim financial statements comprise the financial results of the parent and its subsidiaries (collectively known as the “Company”) for the three months ended August 31, 2018 and 2017.

2. Basis of presentation:

(a) Statement of compliance:

These unaudited condensed consolidated interim financial statements have been prepared in accordance with International Accounting Standard 34 Interim Financial Reporting as issued by the International Accounting Standards Board (“IASB”). These unaudited condensed consolidated interim financial statements do not include all of the information required for a complete set of financial statements prepared in accordance with International Financial Reporting Standards (“IFRS”) and should be read in conjunction with the audited consolidated financial statements of the Company for the year ended May 31, 2018.

However, selected explanatory notes are included to explain events and transactions that are significant to an understanding of the changes in the Company’s financial position and performance since the last annual consolidated financial statements for the year ended May 31, 2018.

As at June 1, 2018, IFRS 2, IFRS 9 and IFRS 15 have been applied. Changes to significant accounting policies are described in note 3.

The policies applied in these unaudited condensed consolidated interim financial statements are based on IFRS issued and effective as of October 26, 2018, the date the Board of Directors approved the unaudited condensed consolidated interim financial statements.

THERMAL ENERGY INTERNATIONAL INC.

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

Three months ended August 31, 2018 and 2017

(Expressed in Canadian dollars)

2. Basis of presentation (continued):

(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 unaudited condensed consolidated interim 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 period in which they are revised and in any future periods affected. Actual results may differ from these estimates, judgements and assumptions.

The critical estimates include:

- 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. 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.

- 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. Further information on the future production outputs related to the finance lease is provided in note 9.

THERMAL ENERGY INTERNATIONAL INC.

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

Three months ended August 31, 2018 and 2017

(Expressed in Canadian dollars)

2. Basis of presentation (continued):

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

The critical estimates include (continued):

- 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. Further details of inputs used in the measurement of fair values at grant date are provided in note 21.

- 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.

The critical judgements include:

- Multi-element arrangements

Judgement is applied in determining the components of a multiple element revenue arrangement. In allocating the consideration received among the multiple elements of a revenue arrangement, management must make estimates as to the fair value of each individual element. The selling price of the element on a stand-alone basis is used to determine the fair value. Where stand-alone sales do not exist, various inputs as detailed in note 3(n) are used to determine the fair value. Changes to these inputs may result in different estimates of fair value for an element and impact the allocation of consideration and timing of revenue recognition.

(d) Functional currency and foreign currency translation:

These unaudited condensed consolidated interim 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.

THERMAL ENERGY INTERNATIONAL INC.

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

Three months ended August 31, 2018 and 2017

(Expressed in Canadian dollars)

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 period-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 period for assets and liabilities and the average exchange rate for the period 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 period. These exchange differences are recognized in accumulated other comprehensive income or loss.

3. Significant accounting policies

(a) Basis of consolidation:

The unaudited condensed consolidated interim 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 Unaudited Condensed Consolidated Interim Financial Statements

Three months ended August 31, 2018 and 2017

(Expressed in Canadian dollars)

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 (loss) 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 unaudited condensed consolidated interim 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	Delaware, U.S.	100%	USD	Sale of heat recovery and condensate return solutions
Boilerroom Equipment Inc. ⁽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. ⁽²⁾	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. ⁽²⁾	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⁾2153639 Ontario Inc. owns 55% of Thermal Energy International (Guangzhou) Ltd., a company incorporated in China.

⁽³⁾ The Company acquired Boilerroom Equipment Inc. on June 29, 2018. Further information is provided in note 4.

All subsidiaries have a reporting date of August 31.

THERMAL ENERGY INTERNATIONAL INC.

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

Three months ended August 31, 2018 and 2017

(Expressed in Canadian dollars)

3. Significant accounting policies (continued):

b) 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.

(c) 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.

(d) 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.

(e) 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.

THERMAL ENERGY INTERNATIONAL INC.

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

Three months ended August 31, 2018 and 2017

(Expressed in Canadian dollars)

3. Significant accounting policies (continued):

(e) Leases (continued):

(i) The Company as a lessor – finance leases (continued)

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 period 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:

The economic ownership of a leased asset is transferred to the lessee whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. The related asset is then recognized at the inception of the lease at the fair value of the leased asset or, if lower, the present value of the lease payments plus incidental payments, if any. A corresponding amount is recognized as a finance leasing liability, irrespective of whether some of these lease payments are payable up-front at the date of inception of the lease. The corresponding finance leasing liability is reduced by lease payments less finance charges, which are expensed as part of administrative expenses. The interest element of leasing payments represents a constant proportion of the capital balance outstanding and is charged to profit or loss over the period of the lease.

All other leases are classified as operating leases. Payments on operating lease agreements are recognized as an expense on a straight line basis over the lease term. Associated costs, such as maintenance and insurance, are expensed as incurred.

(f) 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 Unaudited Condensed Consolidated Interim Financial Statements

Three months ended August 31, 2018 and 2017

(Expressed in Canadian dollars)

3. Significant accounting policies (continued):

(f) 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.

(g) 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(i) for a description of impairment testing procedures.

The indefinite life intangible assets represent the GEM™ 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.

THERMAL ENERGY INTERNATIONAL INC.

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

Three months ended August 31, 2018 and 2017

(Expressed in Canadian dollars)

3. Significant accounting policies (continued):

(h) Goodwill:

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

(i) 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.

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.

THERMAL ENERGY INTERNATIONAL INC.

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

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(Expressed in Canadian dollars)

3. Significant accounting policies (continued):

(j) 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.

(k) 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.

(l) 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.

THERMAL ENERGY INTERNATIONAL INC.

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

Three months ended August 31, 2018 and 2017

(Expressed in Canadian dollars)

3. Significant accounting policies (continued):

(m) Equity-settled stock-based compensation:

The Company offers an equity-settled stock-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.

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.

THERMAL ENERGY INTERNATIONAL INC.

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

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3. Significant accounting policies (continued):

(n) Revenue recognition:

The Company adopted IFRS 15 “Revenue from Contracts with Customers” on June 1, 2018. Further information is provided in note 3(v) on the impact of adopting the new accounting policy.

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.

Rendering of services

Services comprise surveys, installation of goods, project development and after-sales service and maintenance and are separate performance obligations. Revenue is recognized over the term of the service. 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 or when the Company creates or enhances an asset, that the customer controls.

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

Contract costs relating to work not yet performed on the contract create an asset related to future contract activity. The gross amount due to customers for contract work is presented as deferred revenue for all contracts in progress for which progress billings exceed costs incurred plus recognized profits (less losses). Costs incurred to date in excess of progress billings are recorded as unbilled revenue.

THERMAL ENERGY INTERNATIONAL INC.

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

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(Expressed in Canadian dollars)

3. Significant accounting policies (continued):

(n) Revenue recognition (continued):

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 units of accounting as they have stand-alone value to the customer. The total consideration for the arrangement is allocated to the separate units of accounting based on their relative fair value and the revenue is recognized for each unit when the requirements for revenue recognition have been met. The Company determines the fair value of each unit of accounting based on the selling price when they are sold separately. When the fair value cannot be determined based on when it was sold separately, the Company determines a value that most reasonably reflects the selling price that might be achieved in a stand-alone transaction. Inputs considered in making this determination include 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.

Interest revenue and expenses

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

(o) 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 "pension and other employee obligations", measured at the undiscounted amount that the Company expects to pay as a result of the unused entitlement.

(p) 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.

THERMAL ENERGY INTERNATIONAL INC.

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

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3. Significant accounting policies (continued):

(q) 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.

(r) 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 period.

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 period 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 period and applicable in the year in which the liability is expected to be settled or the asset realized.

THERMAL ENERGY INTERNATIONAL INC.

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

Three months ended August 31, 2018 and 2017

(Expressed in Canadian dollars)

3. Significant accounting policies (continued):

(r) 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.

(s) Earnings (loss) per share:

The Company presents basic and diluted earnings (loss) per share data for its common shares. Basic earnings (loss) per share is calculated by dividing the earnings (loss) attributable to owners of the parent by the weighted average number of common shares outstanding during the period. The diluted earnings (loss) per share is determined by adjusting the earnings (loss) 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.

(t) 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, a financial asset or a financial liability is measured and recognized at its fair value, plus or minus, in the case of a financial asset or a financial liability not at fair value through profit or loss, transaction costs, that are directly attributable to the acquisition or issue of the financial asset or financial liability.

The Company adopted IFRS 9 "Financial Instruments" on June 1, 2018. Further information is provided in note 3(v) on the impact of adopting the new accounting policy.

The Company has classified the majority of its financial assets and financial liabilities as subsequently measured under amortized cost.

Fair value hierarchy

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

THERMAL ENERGY INTERNATIONAL INC.

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3. Significant accounting policies (continued):

(t) Financial instruments (continued):

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).

The Company has financial instruments measured at fair value on the statement of financial position. Further information is provided in note 25.

(u) 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.

Reconciling items comprise corporate administration costs, stock-based compensation, professional fees, depreciation of property, plant and equipment, 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.

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

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

Amendments to IFRS 2: Share Based Payments ("IFRS 2")

In June 2016, the IASB issued amendments to IFRS 2. The amendments, which were developed through the IFRS Interpretations Committee, provide requirements for accounting for the effects of vesting and non-vesting conditions on the measurement of cash-settled share-based payments. They also provide guidance on the accounting for share-based payment transactions with a net settlement feature for withholding tax obligations; and a modification to the terms and conditions of a share-based payment that changes the classification of the transaction from cash-settled to equity-settled. The company adopted the amendments on June 1, 2018. The adoption of these amendments did not have a material impact on the consolidated financial statements.

THERMAL ENERGY INTERNATIONAL INC.

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

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(Expressed in Canadian dollars)

3. Significant accounting policies (continued):

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

IFRS 9, "Financial Instruments"

Effective June 1, 2018, the Company adopted IFRS 9, which sets out requirements for recognition and measurement, impairment, derecognition and general hedge accounting. 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.

Trade and other receivables that were classified as loans and receivables under IAS 39 are classified as financial assets measured at amortized cost. There is no change to the initial measurement of the Company's financial assets. Impairment of financial assets is based on an expected credit loss ("ECL") model under IFRS 9, rather than the incurred loss model under IAS 39. ECLs are a probability-weighted estimate of credit losses. The Company calculated ECLs based on consideration of customer-specific factors and actual credit loss experience over the past five years. As a percentage of revenue, the Company's actual credit loss experience has not been material.

The adoption of IFRS 9 has not had an effect on the Company's accounting policies related to the financial liabilities.

There was no material impact of transition to IFRS 9 on the Company's statement of financial position at June 1, 2018.

IFRS 15, "Revenue from Contracts with Customers"

Effective June 1, 2018, the Company adopted IFRS 15.

IFRS 15 provides a single, principles based five-step model to be applied to all sales contracts as outlined below. It is based on the transfer of control of goods and services to customers and replaces the separate models for goods, services and construction contracts.

1. Identify the contract(s) with a customer
2. Identify the performance obligations in the contract
3. Determine the transaction price
4. Allocate the transaction price to the performance obligations in the contract
5. Recognise revenue when or as the entity satisfies its performance obligations

The revenue recognition policy under IFRS 15 is set out in note 3(n)

THERMAL ENERGY INTERNATIONAL INC.

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(Expressed in Canadian dollars)

3. Significant accounting policies (continued):

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

IFRS 15, "Revenue from Contracts with Customers" (continued):

The Company adopted IFRS 15 using the cumulative effect method, with the effect of adopting this standard recognized on June 1, 2018, the date of initial application. Accordingly, the information presented for 2018 has not been restated. It remains as previously reported under IAS 18, IAS 11 and related interpretations. Adoption of IFRS 15 has not impacted the accounting for the sale of goods, rendering of services and contracts for heat recovery solutions.

New standards and amendments yet to be adopted:

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 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. The company will adopt the new standard on June 1, 2019.

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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 \$2,653,400 (including cash acquired in the amount of \$40,555), plus purchase price adjustment payable in cash in the amount of \$50,993 within two months from the quarter-end, plus holdback payable of \$264,545 to be released and paid in cash or shares after eighteen months from the acquisition date, and contingent payable with an estimated fair value of \$93,222, resulting in total consideration of \$3,062,160.

The contingent consideration is payable in cash or shares over a three-year post-acquisition period based on Boilerroom Equipment Inc. meeting certain performance targets. The estimated fair value of the contingent consideration payable is calculated using the Monte Carlo model.

The Company is in the process of determining and finalizing the estimated fair value of the net assets acquired.

The transaction was accounted for using the acquisition method with the results of operations included in these unaudited condensed consolidated interim 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	420,397
Inventory	246,269
Property, plant and equipment (note 10)	197,413
Intangible assets (note 11)	1,765,837
	<u>2,670,471</u>
Liabilities assumed:	
Trade payables	(101,772)
Pensions and other employer obligations	(26,607)
Other liabilities	(263)
Deferred revenue	(202,333)
Provisions	(11,193)
	<u>(342,168)</u>
Goodwill	733,857
	<u>3,062,160</u>
Total Consideration	<u>3,062,160</u>

THERMAL ENERGY INTERNATIONAL INC.

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

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5. Segment reporting:

In quarters ended August 31, 2018 and August 31, 2017, 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, Europe and China.

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.

Segment information for the quarter ended August 31, 2018 and the comparative period are detailed in the table below:

	Thermal Energy Ottawa		Thermal Energy Bristol		Reconciling Items		Total	
	2018	2017	2018	2017	2018	2017	2018	2017
	\$	\$	\$	\$	\$	\$	\$	\$
Total revenue from external customers	5,654,400	2,061,529	1,146,461	1,036,055	-	-	6,800,861	3,097,584
Cost of sales	(3,983,705)	(1,207,180)	(607,271)	(372,607)	-	-	(4,590,976)	(1,579,787)
Gross profit	1,670,695	854,349	539,190	663,448	-	-	2,209,885	1,517,797
Other expenses	(937,166)	(687,965)	(844,779)	(742,866)	(543,756)	(306,915)	(2,325,701)	(1,737,746)
Net finance (costs) income	(30,182)	9,054	-	-	-	-	(30,182)	9,054
Income (loss) before taxation	703,347	175,438	(305,589)	(79,418)	(543,756)	(306,915)	(145,998)	(210,895)
Tax (expense) recovery	-	(18,868)	60,441	29,055	36,099	19,928	96,540	30,115
Profit (loss) after taxation	703,347	156,570	(245,148)	(50,363)	(507,657)	(286,987)	(49,458)	(180,780)
Attributable to:								
Owners of the parent	707,986	165,994	(255,733)	(55,392)	(507,657)	(286,987)	(55,404)	(176,385)
Non-controlling interest	(4,639)	(9,424)	10,585	5,029	-	-	5,946	(4,395)

THERMAL ENERGY INTERNATIONAL INC.

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5. Segment reporting (continued):

Reconciling items comprise the following:

	2018	2017
Corporate administration costs	\$ 247,884	\$ 236,270
Stock-based compensation	4,125	13,922
Professional fees	75,446	80,120
Depreciation of property, plant and equipment	16,969	10,247
Amortization of intangible assets	37,741	-
Acquisition costs	107,342	-
Bank charges and interest	41,990	8,741
Foreign exchange differences	12,259	(42,385)
Total	\$ 543,756	\$ 306,915

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 and strategic planning.

During the quarter ended August 31, 2018 the company had one customer in North America that accounted for 63% of total group revenue for the period.

During the quarter ended August 31, 2017 the company had one customer in North America that accounted for 28% of total group revenue for the period.

Further geographical analysis:

	Sales for the three months ended		Property, Plant and Equipment as at		Goodwill and other Intangible assets as at		Finance lease receivable (non current) as at	
	August 31, 2018	August 31, 2017	August 31, 2018	May 31, 2018	August 31, 2018	May 31, 2018	August 31, 2018	May 31, 2018
	\$	\$	\$	\$	\$	\$	\$	\$
Canada	4,475,421	601,515	44,686	41,789	-	-	67,790	93,257
U.S.A.	1,178,979	1,460,014	190,597	-	2,422,103	-	-	-
U.K.	1,034,168	759,206	35,176	35,606	1,814,092	1,856,739	-	-
Italy	43,335	51,845	-	-	-	-	-	-
Netherlands	37,947	17,847	-	-	-	-	-	-
Germany	19,770	78,671	-	-	-	-	-	-
Norway	-	44,196	-	-	-	-	-	-
Slovenia	-	30,965	-	-	-	-	-	-
Rest of Europe	4,531	6,082	-	-	-	-	-	-
U.A.E	-	43,790	-	-	-	-	-	-
Rest of world	6,710	3,453	-	-	-	-	-	-
Total	6,800,861	3,097,584	270,459	77,395	4,236,195	1,856,739	67,790	93,257

THERMAL ENERGY INTERNATIONAL INC.

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6. Cash and cash equivalents:

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

	August 31, 2018	May 31, 2018
Cash	\$ 2,254,113	\$ 3,281,708
Cash equivalents	500	500
Cash and cash equivalents	\$ 2,254,613	\$ 3,282,208

7. Trade and other receivables:

	August 31, 2018	May 31, 2018
Trade receivables, gross	\$ 3,693,359	1,765,479
Allowance for doubtful accounts	(46,836)	(23,074)
Trade receivables, net	3,646,523	1,742,405
Contracts for heat recovery solutions (see note 7(a))	112,166	95,372
Unbilled product and service revenue (see note 7(b))	12,115	55,476
Prepayments	228,033	293,500
Sales tax and other miscellaneous receivables	1,157,254	562,887
	\$ 5,156,091	\$ 2,749,640

The net carrying value of trade receivables is considered a reasonable approximation of fair value. Other miscellaneous receivables include \$35,836 (\$37,922 at May 31, 2018) due from a Chinese distributor receiving payments on the Company's behalf from a Chinese customer, which is net of a provision of \$65,726 (\$69,778 at May 31, 2018).

At August 31, 2018, \$343,339 (9.2%) of the Company's trade receivables balance was over 90 days past due, but not impaired (\$165,420 (9.3%) at May 31, 2018).

The change in allowance for doubtful accounts was as follows:

	August 31, 2018	May 31, 2018
Balance, beginning of period	\$ 23,074	\$ 15,617
Provisions	24,152	7,605
Foreign exchange adjustments	(390)	(148)
Balance, end of period	\$ 46,836	\$ 23,074

The Company's trade and other receivables have been reviewed for indicators of impairment. For the quarter ended August 31, 2018 a provision was made for \$24,152 and for the quarter ended August 31, 2017, no provisions were made.

THERMAL ENERGY INTERNATIONAL INC.

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7. Trade and other receivables (continued):

(a) Contracts for heat recovery solutions:

Certain amounts recognized in the statements of financial position relate to contracts in progress at the end of the reporting period. The amounts are calculated as the net amounts of costs incurred plus recognized profits, less recognized losses and progress billings. The carrying amounts of assets and liabilities are analyzed as follows:

	August 31, 2018	May 31, 2018
Aggregate amount of costs incurred and recognized profits and losses for all contracts in progress	\$ 2,683,059	\$ 2,246,577
Less progress billings	(3,420,272)	(2,734,831)
	\$ (737,213)	\$ (488,254)

Recognized as:

	August 31, 2018	May 31, 2018
Due from customers for contract work, recognized in trade and other receivables	\$ 112,166	\$ 95,372
Due to customers for contract work, recognized in deferred revenue (note 17)	(849,379)	(583,626)
	\$ (737,213)	\$ (488,254)

(b) Unbilled product and service revenue:

The amounts included within unbilled product and services revenue are calculated as the net amounts of costs incurred plus recognized profits, less recognized losses and progress billings. The carrying amounts of assets and liabilities are analyzed as follows:

	August 31, 2018	May 31, 2018
Aggregate amount of costs incurred and recognized profits and losses for all contracts in progress	\$ 252,863	\$ 1,237,965
Less progress billings	(323,301)	(1,283,487)
	\$ (70,438)	\$ (45,522)

Recognized as:

Due from customer for service performed, recognized in trade and other receivables	\$ 12,115	\$ 55,476
Due to customer for products and services not delivered yet, recognized in deferred revenue (note 17)	(82,553)	(100,998)
	\$ (70,438)	\$ (45,522)

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8. Inventory:

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

For the quarter ended August 31, 2018, a total of \$185,386 of inventories was expensed to cost of sales (2017 - \$159,657). A total of \$Nil of inventories (2017 - \$Nil) were written off or provided for as slow-moving. No reversal of previous write-downs has been recorded during the quarters ended August 31, 2018 and 2017.

9. Finance lease receivable:

The Company's finance lease receivable includes the following:

	August 31, 2018	May 31, 2018
Total estimated minimum lease payments receivable	\$ 181,107	\$ 209,607
Less: unearned income	(20,952)	(27,209)
	160,155	182,398
Less: current portion	(92,365)	(89,141)
	\$ 67,790	\$ 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 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.

On May 1, 2017, a final extension agreement was signed for 36 months to May 1, 2020. Pursuant to this new extension, the customer has agreed to pay up to \$9,500 per month over three years, at the end of which the customer assumes full ownership of the equipment.

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9. Finance lease receivable (continued):

Until the expiry of the new lease on May 1, 2020, finance revenue will be recognized within the consolidated statements of comprehensive income 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	\$ 109,554
Between two and three years	71,553
Residual value	-
	\$ 181,107

The finance lease receivable at the end of the reporting period is neither past due nor impaired.

10. Property, plant and equipment:

	Plant and Equipment	Furniture and Fixtures	Laboratory Equipment	Computers	Leasehold Improve- ments	Motor Vehicles	Total
	\$	\$	\$	\$	\$	\$	\$
Cost, May 31, 2017	151,011	102,797	52,857	337,642	22,877	7,433	674,617
Additions	22,577	-	-	26,973	-	-	49,550
Disposals	(5,475)	-	-	(3,134)	-	-	(8,609)
Translation adjustments	(831)	(29)	-	(533)	-	(71)	(1,464)
Cost, May 31, 2018	167,282	102,768	52,857	360,948	22,877	7,362	714,094
Additions	10,324	405	-	11,748	-	-	22,477
Additions from acquisition	192,770	-	-	-	-	4,643	197,413
Disposals	(7,923)	-	-	-	-	-	(7,923)
Translation adjustments	(4,570)	(57)	-	(1,383)	-	(198)	(6,208)
Cost, August 31, 2018	357,883	103,116	52,857	371,313	22,877	11,807	919,853
Accumulated depreciation, May 31, 2017	99,599	101,760	52,857	317,185	22,877	3,716	597,994
Depreciation for the year	20,498	1,036	-	21,142	-	1,666	44,342
Disposals	(3,558)	-	-	(812)	-	-	(4,370)
Translation adjustments	(792)	(28)	-	(584)	-	137	(1,267)
Accumulated depreciation, May 31, 2018	115,747	102,768	52,857	336,931	22,877	5,519	636,699
Depreciation for the period	11,454	-	-	4,904	-	611	16,969
Disposals	(1,718)	-	-	-	-	-	(1,718)
Translation adjustments	(1,301)	(51)	-	(954)	-	(250)	(2,556)
Accumulated depreciation, August 31, 2018	124,182	102,717	52,857	340,881	22,877	5,880	649,394
Net book value, May 31, 2018	51,535	-	-	24,017	-	1,843	77,395
Net book value, August 31, 2018	233,701	399	-	30,432	-	5,927	270,459

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.

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10. Property, plant and equipment (continued):

During the quarter ended August 31, 2018 the Company disposed of a depreciated asset with a net book value of \$6,205 for \$6,396 in proceeds.

During the quarter ended August 31, 2017, the Company disposed of a depreciated asset with a net book value of \$1,917 for \$7,757 in proceeds.

11. Intangible assets:

	Cost, May 31, 2018	Additions from acquisitions	Translation adjustments	Cost, August 31, 2018
	\$	\$	\$	\$
Trade names and trademarks	792,213	-	(19,872)	772,341
Non-compete agreement	103,332	-	(2,592)	100,740
Industrial know-how	120,554	-	(3,024)	117,530
Designs and drawings	132,609	-	(3,326)	129,283
Customer relationships	284,163	459,038	(14,442)	728,759
Existing technology	-	709,784	(11,342)	698,442
Proprietary software	-	399,337	(6,382)	392,955
Brand portfolio	-	197,678	(3,159)	194,519
Total	1,432,871	1,765,837	(64,139)	3,134,569

	Accumulated amortization, May 31, 2018	Amortization	Translation adjustments	Accumulated amortization, August 31, 2018
	\$	\$	\$	\$
Trade names and trademarks	151,975	-	(7,739)	144,236
Non-compete agreement	103,332	-	(2,592)	100,740
Industrial know-how	120,554	-	(3,024)	117,530
Designs and drawings	132,609	-	(3,326)	129,283
Customer relationships	284,163	8,185	(7,129)	285,219
Existing technology	-	16,078	(39)	16,039
Proprietary software	-	13,478	(33)	13,445
Total	792,633	37,741	(23,882)	806,492
Net book value	640,238			2,328,077

	Cost, May 31, 2017	Additions from acquisitions	Translation adjustments	Cost, May 31, 2018
	\$	\$	\$	\$
Trade names and trademarks	799,802	-	(7,589)	792,213
Non-compete agreement	104,322	-	(990)	103,332
Industrial know-how	121,709	-	(1,155)	120,554
Designs and drawings	133,880	-	(1,271)	132,609
Customer relationships	286,885	-	(2,722)	284,163
Total	1,446,598	-	(13,727)	1,432,871

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11. Intangible assets (continued):

	Accumulated amortization, May 31, 2017	Amortization	Translation adjustments	Accumulated Amortization, May 31, 2018
	\$	\$	\$	\$
Trade names and trademarks	153,429	-	(1,454)	151,975
Non-compete agreement	104,322	-	(990)	103,332
Industrial know-how	121,709	-	(1,155)	120,554
Designs and drawings	133,880	-	(1,271)	132,609
Customer relationships	286,885	-	(2,722)	284,163
Total	800,225	-	(7,592)	792,633
Net book value	646,373			640,238

Trade Names and Trademarks and Brand portfolio are intangible assets with indefinite lives and are not subject to amortization. Trade Names and Trademarks relate specifically to the GEM™ product. Intangible assets are tested for impairment at each year-end. No impairment was recognized for the year ended May 31, 2018 or May 31, 2017. The growth rates attributed by Management to the GEM™ product line are 10% in 2019, followed by positive 10% in each of the subsequent four years. This is higher than the compound annual growth rate over the previous six years of 5%. The Company continued to invest in its sales force in the year ended May 31, 2018. As a result, the Company is expecting higher growth rates in sales due to the 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 2.5%. 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:

	August 31, 2018	May 31, 2018
Balance, beginning of period	\$ 1,216,501	\$ 1,228,156
Additions	733,857	-
Translation adjustments	(42,240)	(11,655)
Balance, end of period	\$ 1,908,118	\$ 1,216,501
From acquisition of Gardner Energy Management Limited	1,185,987	1,216,501
From acquisition of Boilerroom Equipment Inc.	722,131	-
Balance, end of period	\$ 1,908,118	\$ 1,216,501

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 arose as a result of the acquisition of Gardner Energy Management Limited:

Goodwill was tested for impairment as at each year end, resulting in no impairment charge as at May 31, 2018 or May 31, 2017. 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.

The recoverable amounts of the cash-generating units were determined based on value-in-use calculations, covering a one-year budget, followed by an extrapolation over four 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 19% (2017 - 18%) 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% (2017 - 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 15% (2017 - 15%) debt and 85% (2017 - 85%) equity was assumed, after considering the capital structure of comparable companies.

For purposes of the May 31, 2018 impairment testing, Thermal Energy International (UK) Limited's growth from 2018 to 2019 was assumed to be 58%, as per the detailed budget prepared with 7% per annum thereafter. This growth is the result of a combination of the level of experience of the existing sales force in both Europe and North America, as well as additional sales representation in Europe, while allowing for unknown changes in the global economic climate following the decision of the UK to leave the European Union.

GEMChem Limited's growth from 2018 to 2019 was assumed to be 9%, as per the detailed budget prepared with subsequent growth of 10% in 2020 through to 2023. The future expected growth is the result of additional sales staff in 2019.

Apart from the considerations described above in determining value-in-use of the cash-generating units, management is not currently aware of any other factors that would necessitate changes in its key estimates.

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 budget 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 cash generating units.

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13. Short-term borrowings:

The Company had a credit facility of up to approximately \$431,000 dependent on the level of certain UK accounts receivable balances. The available facility as at May 31, 2018 was in the amount of \$157,000, of which \$nil was utilized as at May 31, 2018. The Company has cancelled the credit facility effective June 29, 2018.

14. Trade payables:

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

	August 31, 2018	May 31, 2018
Trade payables	\$ 2,916,480	\$ 1,808,139

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

15. Other liabilities:

Other liabilities can be summarized as follows:

	August 31, 2018	May 31, 2018
Accruals	\$ 1,500,241	\$ 1,575,704
Other government remittances payable	232,204	189,993
	\$ 1,732,445	\$ 1,765,697

Included in accruals is \$30,975 due to directors (\$29,875 at May 31, 2018).

16. Long-term debt:

	August 31, 2018	May 31, 2018
Term loan, net of deferred financing costs of \$42,379 (equivalent to USD\$32,462), bearing interest at 9.10%, repayable in monthly principal instalments of \$32,638 (equivalent to USD\$25,000) starting July 1, 2019 and continuing up to the maturity date, with a balloon payment of \$620,113 (equivalent to USD\$475,000) payable on the maturity date, June 1, 2025	2,894,996	-
Less: current portion	(65,275)	-
Long term portion	\$ 2,829,721	\$ -

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16. Long-term debt (continued):

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 \$2,937,375 (equivalent to USD\$2,250,000). This loan bears interest at the institution's US dollar floating base rate (at 6.60%) plus a variance of 2.50%. Interest is payable monthly in arrears on the 1st day of the month commencing on the August 1st, 2018.

The initial variance is set at 2.50%. It will be reset annually based the 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 stock-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 August 31, 2018, the Company was in compliance with its covenants under the term loan agreement.

17. Deferred revenue:

	August 31, 2018	May 31, 2018
Deferred revenue relating to heat recovery solutions (note 7(a))	849,379	583,625
Deferred revenue relating to GEM™ product and services (note 7(b))	82,553	100,998
	\$ 931,932	\$ 684,623

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

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18. Provisions:

The change in provisions was as follows:

	Legal provision	Warranty provision	Total provisions
Balance, beginning of period, June 1, 2018	\$ 190,000	\$ 42,222	\$ 232,222
Additions	-	11,015	11,015
Translation adjustments	-	(392)	(392)
Balance, end of period, August 31, 2018	\$ 190,000	\$ 52,845	\$ 242,845

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. Damages are claimed in the approximate amount of \$4 million, plus an as yet undetermined value of share options, interest and legal costs. The Company has filed a statement of defence in response and has counterclaimed for approximately \$5 million in damages plus interest and costs.

Two attempts have been made at a mediated settlement. Neither attempt has been successful. Although the lawsuit was commenced in October, 2005, the plaintiff has yet to take the proceeding to the point of oral examinations for discovery.

In May, 2010, the plaintiff brought a motion for summary judgment, seeking judgment in the amount of \$1,105,047 plus interest and costs. This amount is comprised of: i) \$398,737 allegedly owing as a result of wrongful dismissal and calculated as 24 months of salary, commissions, and related benefits; ii) \$618,810 in alleged unpaid loans and advances; and iii) \$87,500 in stock options which are alleged to have vested. The motion was heard on September 6 and 7, 2011 and 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; iii) Permitted the remainder of the parties' claims and counterclaims to proceed to trial; iv) Declined to fix the amount of the damages for pay in lieu of notice of termination, suggesting instead that the parties try to agree on the amount; v) Stated that in the absence of the parties' agreement on the amount of damages for pay in lieu of notice of termination, the issue is to be referred to a Master; and vi) Stayed the execution of the partial summary judgment pending the determination of the outstanding claims at trial. The plaintiff has been awarded approximately \$37,000 in costs to date and the Company has paid this amount. The parties have not yet discussed or agreed on the amount of the damages for wrongful dismissal, and there has, as yet, been no reference to a Master.

The past President appealed from the dismissal of his claims for unpaid loans and advances. On September 25, 2012, the Court of Appeal for Ontario dismissed the appeal and ordered the appellant to pay the Company \$8,000 toward its legal costs. As such, the remainder of the parties' claims and counterclaims will proceed to trial.

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18. Provisions (continued):

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.

Until the remaining issues are determined, it is unclear what the net balance payable between the parties will be and to which party it is to be paid and the ultimate net impact of the partial judgment on the Company remains unknown at present. 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. In November 2009, the Company recorded a provision of \$190,000 in its financial statements. This provision remains unchanged 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 \$52,845 for warranty.

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.

Outstanding:

	Three months ended August 31, 2018		Year ended May 31, 2018	
	# Shares	\$	# Shares	\$
Class A Common shares issued				
Balance, beginning of period	159,088,950	32,231,329	159,088,950	32,231,329
Balance, end of period	159,088,950	32,231,329	159,088,950	32,231,329

20. Capital management:

The Company's objectives when managing capital is to safeguard the Company's ability to continue as a going concern and to maintain flexible capital structure for its projects for the benefit of its stakeholders. In the management of capital, the Company includes the components of equity attributable to the owners of the parent, excluding accumulated other comprehensive income, which at August 31, 2018 totalled \$3,822,944 (May 31, 2018 - \$3,874,223). 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. Management reviews the capital structure on a regular basis to ensure that objectives are met.

The Company's share capital is not subject to external restrictions.

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21. 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:

	Three months ended August 31, 2018		Three months ended August 31, 2017	
	# Options	Weighted Average Exercise Price \$	# Options	Weighted Average Exercise Price \$
Outstanding, beginning of period	20,495,531	0.08	20,495,531	0.08
Outstanding, end of period	20,495,531	0.08	20,495,531	0.08
Options exercisable, end of period	19,145,531	0.08	16,542,572	0.09

There were no options granted, forfeited, expired or exercised for the three months ended August 31, 2018 or 2017.

The following tables summarize information about stock options outstanding.

At August 31, 2018:

	Options outstanding			Options exercisable		
Range of exercise prices	Number outstanding August 31, 2018	Weighted average remaining contractual life	Weighted average exercise price	Number exercisable at August 31, 2018	Weighted average exercise price	
0.05-0.07	5,991,500	1.58	0.05	4,974,833	0.05	
0.07-0.10	4,071,360	1.71	0.08	4,071,360	0.08	
0.10-0.12	10,432,671	0.37	0.10	10,099,338	0.10	
	20,495,531	0.99	0.08	19,145,531	0.08	

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21. Share-based payments (continued):

At May 31, 2018:

Range of exercise prices	Options outstanding		Options exercisable		
	Number outstanding May 31, 2018	Weighted average remaining contractual life	Weighted average exercise price	Number exercisable at May 31, 2018	Weighted average exercise price
0.05-0.07	5,991,500	1.84	0.05	4,974,833	0.05
0.07-0.10	4,071,360	1.97	0.08	4,071,360	0.08
0.10-0.12	10,432,671	0.46	0.10	10,099,338	0.10
	20,495,531	1.16	0.08	19,145,531	0.08

At August 31, 2017:

Range of exercise prices	Options outstanding		Options exercisable		
	Number outstanding August 31, 2017	Weighted average remaining contractual life	Weighted average exercise price	Number exercisable at August 31, 2017	Weighted average exercise price
0.05-0.07	5,991,500	2.62	0.05	3,895,667	0.05
0.07-0.10	4,071,360	2.72	0.08	2,714,237	0.08
0.10-0.12	10,432,671	0.80	0.10	9,932,668	0.10
	20,495,531	1.71	0.08	16,542,572	0.09

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 August 31, 2018, there was \$11,479 (May 31, 2018 - \$15,604) 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:

	28-Nov-16
Grant date share price (\$) ⁽¹⁾	0.12
Exercise price (\$)	0.12
Expected volatility (%) ⁽²⁾	97.75
Expected life (years)	4.00
Expected dividend yield (%)	0.00
Risk-free interest rate (%)	0.95
Forfeiture rate (%)	17.00

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

(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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21. Share-based payments (continued):

Stock-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:

	Three months ended August 31, 2018	Three months ended August 31, 2017
Administration	\$ 3,290	\$ 10,617
Selling, marketing and business development	835	3,306
	\$ 4,125	\$ 13,923

22. Pension plan:

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 and amounted to \$9,418 in the three months ended August 31, 2018 (\$22,930 in the three months ended August 31, 2017).

23. Loss per share:

The calculation of basic and diluted loss per share for the period ended Aug 31, 2018 was based on the net loss attributable to owners of the parent of \$55,404 (2017 - \$176,385), a weighted average number of basic common shares outstanding of 159,088,950 (2017 – 159,088,950) and a weighted average number of diluted common shares outstanding of 166,058,165 (2017 – 166,012,931).

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.

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23. Loss per share (continued):

The following table summarized the calculation of the weighted average number of basic and diluted common shares:

	Three months ended August 31, 2018	Three months ended August 31, 2017
Issued common shares at beginning of the period	159,088,950	159,088,950
Weighted average number of basic common shares at end of the period	159,088,950	159,088,950
Effect of stock options on issue	6,969,215	6,923,981
Weighted average number of diluted common shares at end of the period	166,058,165	166,012,931

24. Operating lease commitments:

Thermal Energy International Inc., and its subsidiaries, Thermal Energy (UK) Ltd. and Boilerroom Equipment Inc, have entered into lease agreements for the use of land and buildings, motor vehicles, telecommunication systems and other office equipment. These leases range from one to five years with no renewal option included in the contracts. There are no restrictions placed upon the Company by entering into these leases.

At August 31, 2018, the Company had operating lease commitments as follows:

	Total	Less than 1 year	1-5 years	More than 5 years
Operating leases	\$ 243,074	\$ 174,587	\$ 68,487	\$ –

Lease payments recognized as an expense for the three months ended August 31, 2018 totalled \$53,724 (2017 - \$37,369).

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25. Financial instruments:

Fair value hierarchy:

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.

Financial assets and financial liabilities measured at fair value as at August 31, 2018 in the condensed consolidated interim financial statements are summarized below. There was no financial assets or financial liabilities measured at fair value as at May 31, 2018.

As at August 31, 2018:

Liabilities:

Contingent payable

Level 1	Level 2	Level 3	Total
\$ -	\$ -	\$94,110	\$94,110

The Company has no additional financial liabilities measured at fair value after initial recognition other than those recognized in connection with business combination.

There were no transfers of fair value measurement between level 1, 2 and 3 of the fair value hierarchy in the three months ended August 31, 2018 and 2017.

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	August 31, 2018
Balance at June 1, 2018	\$ -
Increase from business acquisition (note 4)	93,222
Charges through profit or loss	2,384
Foreign exchange	(1,496)
	94,110
Classified as current liabilities	-
Classified as non-current liabilities	\$ 94,110

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25. Financial instruments (continued):

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, liquidity risk, and capital risk. These risks are discussed in more detail below.

(a) Market risk:

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 maximising returns.

(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.

	Net financial assets/(liabilities) in CAD\$		
	US \$	Euros	Total CAD \$
Functional currency of Company entity			
August 31, 2018			
Canadian Dollar	802,148	–	802,148
British Pound	(177,953)	88,828	(89,125)
	624,195	88,828	713,023
May 31, 2018			
Canadian Dollar	1,154,941	–	1,154,941
British Pound	–	144,691	144,691
	1,154,941	144,691	1,299,632
August 31, 2017			
Canadian Dollar	805,783	–	805,783
British Pound	–	200,668	200,668
	805,783	200,668	1,006,451

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25. Financial instruments (continued):

Financial risk management (continued):

(a) Market risk (continued):

(i) Foreign currency risk (continued):

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

	Three months ended August 31, 2018			Three months ended August 31, 2017		
	US\$	Euros	Total	US\$	Euros	Total
Net income (loss)	62,419	8,883	71,302	80,578	20,067	100,645

	As at August 31, 2018			As at May 31, 2018		
	US\$	Euros	Total	US\$	Euros	Total
Equity	62,419	8,883	71,302	115,494	14,469	129,963

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 and Chinese Renminbi. The majority of the foreign denominated transactions are in U.S. dollars, GBP and Euros.

The Company does not enter into arrangements to hedge its foreign exchange risk. The Company's policy is to endeavour to keep its net exposure 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 quarter ended August 31, 2018, a 1% increase or decrease in interest rate applied to the Company's long-term debt would result in a decrease/increase in profit before tax of \$7,368.

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25. Financial instruments (continued):

Financial risk management (continued):

(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 receivables, cash and cash equivalents, other miscellaneous receivables and finance lease receivable. Credit risk relating to the finance lease receivable is considered to be low, based upon the payment history of the customer.

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.

Accounts receivable

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. Within the US market for GEM and Boilerroom 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. Within the European market for GEM products, credit insurance is available in accordance with the existing borrowing facility held by the UK subsidiary. In the case of refused credit insurance, a full or partial deposit is required from the customer which will at least cover the cost of producing the goods. Documentary credits may be requested for larger orders to geographical regions where credit insurance is not applicable. Goods are sold subject to retention of title clauses, so that in the event of non-payment, the Company may have a secured claim.

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 receivables in the statement of financial position are net of allowances for doubtful accounts. 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 8). 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 August 31, 2018 was \$181,107 (May 31, 2018 - \$209,607).

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

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25. Financial instruments (continued):

Financial risk management (continued):

(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.

As at August 31, 2018, the carrying values of trade payables, current tax liabilities and other liabilities approximate their fair values due to their short-term nature. The fair values of contingent payable and long-term debt approximate their carrying values.

26. 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:

	Three months ended August 31, 2018	Three months ended August 31, 2017
Salaries and other short-term employee benefits	\$ 233,268	\$ 213,221
Share-based payments	1,576	8,853
	\$ 234,844	\$ 222,074

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 period 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 period.

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27. Subsequent events:

On September 18 and 19, 2018, an unknown party was able to access the Company's US dollar bank account with a major Canadian chartered bank and make two fraudulent bank transfers totaling USD\$263,412. On October 16, 2018, USD\$131,283 was recovered from the bank. The Company is working with its insurer, the bank, and a cyber security firm to recover the rest of the loss.