THERMAL ENERGY INTERNATIONAL INC.

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

As at	**February 28, 2018**	May 31, 2017
	$	$
ASSETS		
Current assets		
Cash and cash equivalents (Note 5)	**2,075,696**	2,950,140
Trade and other receivables (Note 6)	**2,158,396**	2,706,124
Current tax receivable	**99,772**	17,783
Inventory (Note 7)	**513,985**	470,339
Finance lease receivable (Note 8)	**86,028**	77,328
	4,933,877	6,221,714
Non-current assets		
Finance lease receivable (Note 8)	**117,836**	182,399
Property, plant and equipment (Note 9)	**83,423**	76,623
Intangible assets (Note 10)	**656,781**	646,373
Goodwill (Note 11)	**1,247,934**	1,228,156
Deferred tax assets	**20,423**	21,524
	2,126,397	2,155,075
Total assets	**7,060,274**	8,376,789
LIABILITIES		
Current liabilities		
Trade payables (Note 13)	**1,154,550**	1,744,032
Current tax liabilities	**82**	63,960
Pensions and other employer obligations	**78,723**	94,989
Other liabilities (Note 14)	**1,157,576**	1,028,732
Deferred revenue (Note 15)	**1,082,747**	1,626,817
Provisions (Note 16)	**232,667**	232,387
	3,706,345	4,790,917
Non-current liabilities		
Deferred tax liabilities	**77,953**	76,713
Total liabilities	**3,784,298**	4,867,630
EQUITY		
Capital stock (Note 17)	**32,231,329**	32,231,329
Contributed surplus	**3,967,949**	3,929,224
Accumulated other comprehensive income	**350,478**	343,235
Deficit	**(33,234,846)**	(32,974,934)
Equity attributable to owners of the parent	**3,314,910**	3,528,854
Non-controlling interest	**(38,934)**	(19,695)
Total equity	**3,275,976**	3,509,159
Total liabilities and equity	**7,060,274**	8,376,789

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

On behalf of the Board:

Director

Director

THERMAL ENERGY INTERNATIONAL INC.

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

	Three months ended February 28		Nine months ended February 28	
Nine months ended February	**2018**	2017	**2018**	2017
	$	$	**$**	$
Revenue	**3,228,386**	3,224,530	**10,055,417**	8,438,027
Cost of sales	**1,628,615**	1,549,297	**5,084,339**	3,377,995
Gross profit	**1,599,771**	1,675,233	**4,971,078**	5,060,032
Expenses:				
Administration	**786,911**	685,337	**2,238,848**	1,993,946
Selling, marketing and business development	**970,476**	1,007,483	**2,962,772**	2,806,779
Research and development	**28,567**	26,734	**99,557**	96,696
	1,785,954	1,719,554	**5,301,177**	4,897,421
Operating income (loss)	**(186,183)**	(44,321)	**(330,099)**	162,611
Finance revenue	**7,784**	690	**25,191**	7,097
Income (loss) before income taxes	**(178,399)**	(43,631)	**(304,908)**	169,708
Income taxes (charge) recovery	**19,755**	(12,841)	**35,998**	(130,752)
Net income (loss) for the period	**(158,644)**	(56,472)	**(268,910)**	38,956
Other comprehensive loss for the period				
Items that may be reclassified subsequently to profit or loss:				
Exchange differences arising on translation of overseas operations	**23,161**	(57,173)	**(2,998)**	(380,414)
Total comprehensive income (loss) for the period	**(135,483)**	(113,645)	**(271,908)**	(341,458)
Net income (loss) for the period attributable to:				
Owners of the parent	**(159,764)**	(56,922)	**(259,912)**	39,105
Non-controlling interest	**1,120**	450	**(8,998)**	(149)
Net income (loss) for the period	**(158,644)**	(56,472)	**(268,910)**	38,956
Total comprehensive loss for the period attributable to:				
Owners of the parent	**(125,083)**	(112,990)	**(252,669)**	(324,436)
Non-controlling interest	**(10,400)**	(655)	**(19,239)**	(17,022)
Total comprehensive income (loss) for the period	**(135,483)**	(113,645)	**(271,908)**	(341,458)
Net income (loss) per share - basic and diluted (Note 21)	**(0.001)**	(0.001)	**(0.002)**	(0.002)

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

THERMAL 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, 2016	**32,069,073**	**3,853,739**	**(33,389,814)**	**554,990**	**3,087,988**	**17,514**	**3,105,502**
Stock-based compensation (Note 19)	**-**	**86,208**	**-**	**-**	**86,208**	**-**	**86,208**
Share options exercised	**162,256**	**(41,780)**	**-**	**-**	**120,475**	**-**	**120,475**
Transactions with owners	**162,256**	**44,428**	**-**	**-**	**206,683**	**-**	**206,683**
Net income (loss) for the period	**-**	**-**	**39,105**	**-**	**39,105**	**(149)**	**38,956**
Other comprehensive income: exchange differences arising on translation of overseas operations	**-**	**-**	**-**	**(363,541)**	**(363,541)**	**(16,873)**	**(380,414)**
Total comprehensive income (loss) for the period	**-**	**-**	**39,105**	**(363,541)**	**(324,436)**	**(17,022)**	**(341,458)**
Balance at February 28, 2017	**32,231,329**	**3,898,167**	**(33,350,709)**	**191,449**	**2,970,236**	**492**	**2,970,727**
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 19)	**-**	**38,725**	**-**	**-**	**38,725**	**-**	**38,725**
Share options exercised	**-**	**-**	**-**	**-**	**-**		**0**
Transactions with owners	**-**	**38,725**	**-**	**-**	**38,725**	**0**	**38,725**
Net income (loss) for the period	**-**	**-**	**(259,912)**	**-**	**(259,912)**	**(8,998)**	**(268,910)**
Other comprehensive income: exchange differences arising on translation of overseas operations	**-**	**-**	**-**	**7,243**	**7,243**	**(10,241)**	**(2,998)**
Total comprehensive income (loss) for the period	**-**	**-**	**(259,912)**	**7,243**	**(252,669)**	**(19,239)**	**(271,908)**
Balance at February 28, 2018	**32,231,329**	**3,967,949**	**(33,234,846)**	**350,478**	**3,314,910**	**(38,934)**	**3,275,976**

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 February 28	Three months ended February 28		Nine months ended February 28	
	2018	2017	**2018**	2017
	$	$	**$**	$
OPERATING ACTIVITIES:				
Net income (loss) for the period	**(158,644)**	(56,472)	**(268,910)**	38,956
Add items not involving cash:				
Depreciation of property, plant and equipment	**11,060**	10,300	**31,238**	28,397
Loss (gain) on disposal of assets	**-**	-	**(4,035)**	-
Finance revenue	**(7,784)**	(690)	**(25,191)**	(7,097)
Stock-based compensation (Note 19)	**10,880**	31,056	**38,725**	86,208
Income tax charge (recovery)	**(19,755)**	12,841	**(35,998)**	130,752
Unrealized foreign exchange and translation adjustments	**(6,624)**	4,033	**(23,703)**	(80,843)
Changes in working capital :				
Trade and other receivables	**(208,176)**	749,887	**547,728**	(202,411)
Inventory	**(12,733)**	20,179	**(43,646)**	79,341
Trade payables	**337,151**	227,160	**(588,111)**	109,011
Deferred revenue	**213,668**	314,312	**(544,070)**	1,349,889
Other liabilities	**90,015**	(192,277)	**112,858**	(99,552)
Income taxes refunded (paid)	**(29,318)**	(32,441)	**(103,847)**	(118,906)
Interests received on finance lease	**7,784**	690	**25,191**	7,097
Other interests received	**57**	988	**128**	1,176
Interest paid	**(500)**	(1,452)	**(1,499)**	(3,661)
Net cash used in operating activities	**227,081**	1,088,114	**(883,142)**	1,318,357
INVESTING ACTIVITIES:				
Finance lease principal payments received	**20,715**	11,310	**55,863**	69,957
Proceeds from disposal of property, plant and equipment	**-**	-	**7,757**	-
Additions to property, plant and equipment	**(13,982)**	(10,210)	**(41,053)**	(28,696)
Net cash provided by investing activities	**6,733**	1,100	**22,567**	41,261
FINANCING ACTIVITIES:				
Share options exercised	**-**	1,417	**-**	120,475
Repurchase of Class A common shares	**-**	-	**-**	-
Net cash used by financing activities	**-**	1,417	**-**	120,475
Decrease in cash and cash equivalents for the period	**233,814**	1,090,630	**(860,575)**	1,480,093
Cash and cash equivalents, beginning of period	**1,833,122**	1,521,707	**2,950,140**	1,143,148
Exchange differences on cash and cash equivalents	**8,760**	(28,834)	**(13,869)**	(39,737)
Cash and cash equivalents, end of period	**2,075,696**	2,583,504	**2,075,696**	2,583,504

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

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 April 19, 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 nine months ended February 28, 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 Standards (“IAS”) 34 *Interim Financial Reporting* as *issued by the International Accounting Standards Board (“IASB”)* and do not include all of the information required for a complete set of annual financial statements for International Financial Reporting Standards (“IFRS”). These unaudited condensed consolidated interim financial statements should be read in conjunction with the audited consolidated financial statements and notes of the Company for the year ended May 31, 2017.

The significant accounting policies are summarized in note 3.

The policies applied in these unaudited condensed consolidated interim financial statements are based on IFRS issued and effective as of April 19, 2018, the date the Board of Directors approved the unaudited condensed consolidated interim financial statements.

(b) Measurement basis:

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

(c) Significant accounting judgements and estimates:

The preparation of these 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.

2. Basis of presentation (continued):

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

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 10 and 11 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 8.

- 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 19.

2. Basis of presentation (continued):

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

- Allowance for doubtful accounts:

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

- 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(m) 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.

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.

(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%	CAD	Sale of heat recovery and condensate return solutions
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.

All subsidiaries have a reporting date of February 28.

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.

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.

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 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 years straight-line

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™ Trade name and Trademark, which are used to set the product apart from those of competitors producing traditional mechanical steam traps. Management considers the reputation of the GEM™ product as continuing to strengthen and cannot be assigned a finite life after which it will have no value.

Amortization is included within administrative expenses.

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.

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.

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.

3. Significant accounting policies (continued):

(n) Revenue recognition:

Revenue comprises revenue from the sale of goods and rendering of services. Revenue is measured by reference to the fair value of consideration received or receivable by the Company for goods supplied and services provided, excluding sales tax and trade discounts.

Revenue is recognized when the amount of revenue can be measured reliably, collection is probable, the costs incurred can be measured reliably, and when the criteria for each of the Company's different activities have been met, as described below.

Sale of goods

Revenue from product sales is recognized when the Company has transferred to the buyer the significant risks and rewards of ownership of the goods supplied. Significant risks and rewards are generally considered to be transferred to the buyer when the customer has taken undisputed delivery of the goods. 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. Revenue is recognized when the services are provided by reference to the stage of completion of the contract at the reporting date. Amounts received in advance of meeting the revenue recognition criteria is recorded as deferred revenue on the consolidated statements of financial position. Services rendered prior to agreed billing terms are included in unbilled product revenue.

Contracts for heat recovery solutions

The Company provides heat recovery solutions specifically customized to each customer. These contracts specify a fixed price for the development and installation of heat recovery equipment and are within the scope of IAS 11 "Construction Contracts".

Contract revenue includes the initial amount agreed in the contract plus any variations in contract work, to the extent that it is probable that they will result in revenue and can be measured reliably. As soon as the outcome of a contract can be estimated reliably, contract revenue is recognized by reference to the stage of completion of the contract. When the Company cannot measure the outcome of a contract reliably, revenue is recognized only to the extent of contract costs that have been incurred and are recoverable.

Contract costs are recognized in the period in which they are incurred. Any expected loss on a contract is recognized immediately in profit or loss.

3. Significant accounting policies (continued):

(n) Revenue recognition (continued):

The stage of completion is determined by reference to the proportion of contract costs for work performed to date compared to the estimated total contract costs. 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.

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.

3. Significant accounting policies (continued):

(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.

(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 year.

Deferred income taxes are calculated using the liability method on temporary differences between the financial statement carrying amounts and the tax bases of assets and liabilities.

Deferred tax liabilities are always recognized for all taxable temporary differences, and deferred tax assets are generally recognized for all deductible temporary differences to the extent that it is probable that future taxable income will be available against which those deductible temporary differences can be utilized. Such assets and liabilities are not recognized if the taxable temporary difference arises from the initial recognition of goodwill or the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable income or loss, nor the income or loss for the 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.

3. Significant accounting policies (continued):

(r) Income taxes (continued):

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.

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, all financial assets and liabilities are measured and recognized at their fair value plus transaction costs, except for financial assets and financial liabilities carried at fair value through profit or loss, which are measured initially at fair value. Subsequently, financial assets and liabilities are measured and recognized as described below.

3. Significant accounting policies (continued):

(t) Financial instruments (continued):

Financial assets

For the purpose of subsequent measurement, financial assets of the Company are classified into the loans and receivables category upon initial recognition.

The category determines subsequent measurement and whether any resulting income and expense is recognized in net income (loss) or in other comprehensive income (loss).

All financial assets except for those at fair value through profit or loss are subject to review for impairment at least at each reporting date. Financial assets are impaired when there is any objective evidence that impairment exists. Different criteria to determine impairment are applied for each category of financial assets, as described below.

All income and expenses relating to financial assets that are recognized in profit or loss are presented within ‘finance revenue’ or ‘other financial items’, which the Company has not incurred to date, except for impairment of trade receivables which is presented within ‘administration’ expenses.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Cash and cash equivalents, trade receivables, other miscellaneous receivables and finance lease receivable are classified as loans and receivables. Loans and receivables are recognized initially at fair value plus any directly attributable transaction costs and subsequently measured at amortized cost using the effective interest method, less any allowance for doubtful debts. An allowance for trade receivables is made when the Company has obtained an objective indication that it will not be able to collect the amount due according to the original terms and conditions agreed to with customers. Indications that loans and receivables are 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. Individual receivables are considered for impairment when they are past due or when other objective evidence is received that a specific counterparty will default.

Financial liabilities

The Company’s financial liabilities include trade payables and accruals which are initially recognized at fair value plus any directly attributable transaction costs. Subsequent to initial recognition, these financial liabilities are measured at amortized cost using the effective interest method.

3. Significant accounting policies (continued):

(t) Financial instruments (continued):

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 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 currently has no financial instruments measured at fair value on the statement of financial position. Therefore, a fair value hierarchy is not presented.

(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.

3. Significant accounting policies (continued):

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

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

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

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

Amendments to IAS 7: Statement of Cash Flows ("IAS 7")

In January 2016, the IASB issued amendments to IAS 7. These amendments require entities to provide disclosures that help users of the financial statements to better understand changes in liabilities that arise from financing activities, including both changes arising from cash flow and non-cash changes. These amendments became effective for annual periods beginning on or after January 1, 2017. The Company adopted the amendments on June 1, 2017. The adoption of these amendments did not have a material impact on the consolidated financial statements.

Amendments to IAS 12: Income Taxes ("IAS 12")

In January 2016, the IASB issued amendments to IAS 12. The amendments clarify the accounting for deferred tax assets for unrealized losses on debt instruments measured at fair value. These amendments became effective for annual periods beginning on or after January 1, 2017. The Company adopted the amendments on June 1, 2017. The adoption of these amendments did not have a material impact on the consolidated financial statements.

New standards and amendments yet to be adopted:

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

3. Significant accounting policies (continued):

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

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

IFRS 9, "Financial Instruments"

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

IFRS 15, "Revenue from Contracts with Customers"

In May 2014, the IASB issued IFRS 15, which provides a single, principles-based five-step model for revenue recognition to be applied to all customer contracts and requires enhanced disclosures. The standard also provides guidance relating to recognition of customer acquisition costs. In April 2016, the IASB issued Clarifications to IFRS 15 in relation to the identification of performance obligations, principal versus agent considerations, as well as licensing application guidance. This standard will be effective January 1, 2018 and allows early adoption. The Company does not intend to adopt this standard early and is currently evaluating the impact of adopting this standard on the consolidated financial statements.

3. Significant accounting policies (continued):

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

IFRS 16: Leases ("IFRS 16")

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

Amendments to 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. These amendments are to be applied prospectively for annual periods beginning on or after January 1, 2018. Early adoption is allowed and specific transitional provisions apply. The Company does not intend to adopt this standard early and is currently evaluating the impact of adopting these amendments on the consolidated financial statements.

4. Segment reporting:

In the quarters and nine-month periods ended February 28, 2018 and 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.

(Expressed in Canadian dollars)

4. Segment reporting (continued):

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 ("Thermal Energy Ottawa"), and the other in Bristol, United Kingdom, covering Europe and the rest of the world ("Thermal Energy Bristol"). 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 three months ended February 28, 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	**1,314,194**	1,042,297	**1,914,192**	2,182,233	**-**	-	**3,228,386**	3,224,530
Cost of sales	**(840,105)**	(398,413)	**(788,510)**	(1,150,884)	**-**	-	**(1,628,615)**	(1,549,297)
Gross profit	**474,089**	643,884	**1,125,682**	1,031,349	**-**	-	**1,599,771**	1,675,233
Other expenses	**(602,082)**	(633,607)	**(892,731)**	(766,867)	**(291,141)**	(319,080)	**(1,785,954)**	(1,719,554)
Finance revenue	**7,784**	690	**-**	-	**-**	-	**7,784**	690
Income (loss) before income taxes	**(120,209)**	10,967	**232,951**	264,482	**(291,141)**	(319,080)	**(178,399)**	(43,631)
Income taxes (expense) recovery	**33,108**	(24)	**(20,118)**	(44,812)	**6,765**	31,995	**19,755**	(12,841)
Net income (loss)	**(87,101)**	10,943	**212,833**	219,670	**(284,376)**	(287,085)	**(158,644)**	(56,472)
Attributable to:								
Owners of the parent	**(87,867)**	14,239	**212,479**	215,924	**(284,376)**	(287,085)	**(159,764)**	(56,922)
Non-controlling interest	**766**	(3,296)	**354**	3,746	**-**	-	**1,120**	450

(Expressed in Canadian dollars)

4. Segment reporting (continued):

Segment information for the nine months ended February 28, 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	**6,405,749**	2,897,650	**3,649,668**	5,540,377	**-**	-	**10,055,417**	8,438,027
Cost of sales	**(3,778,548)**	(968,162)	**(1,305,791)**	(2,409,833)	**-**	-	**(5,084,339)**	(3,377,995)
Gross profit	**2,627,201**	1,929,488	**2,343,877**	3,130,544	**-**	-	**4,971,078**	5,060,032
Other expenses	**(2,061,342)**	(1,963,867)	**(2,335,294)**	(2,133,283)	**(904,541)**	(800,271)	**(5,301,177)**	(4,897,421)
Finance revenue	**25,191**	7,097	**-**	-	**-**	-	**25,191**	7,097
Income (loss) before income taxes	**591,050**	(27,282)	**8,583**	997,261	**(904,541)**	(800,271)	**(304,908)**	169,708
Income taxes (expense) recovery	**(15,372)**	-	**24,306**	(203,853)	**27,064**	73,101	**35,998**	(130,752)
Net income (loss)	**575,678**	(27,282)	**32,889**	793,408	**(877,477)**	(727,170)	**(268,910)**	38,956
Attributable to:								
Owners of the parent	**585,155**	(11,095)	**32,410**	777,370	**(877,477)**	(727,170)	**(259,912)**	39,105
Non-controlling interest	**(9,477)**	(16,187)	**479**	16,038	**-**	-	**(8,998)**	(149)

Reconciling items comprise the following:

	Three months ended February 28		Nine months ended February 28	
	2018	2017	**2018**	2017
	$	$	**$**	$
Corporate admin costs	**193,865**	230,112	**649,070**	632,845
Stock-based compensation	**10,880**	31,056	**38,725**	86,208
Professional fees	**48,873**	17,643	**132,134**	136,737
Depreciation of property, plant and equipment	**11,061**	10,300	**31,238**	28,397
Bank charges and interest	**7,652**	8,104	**24,954**	27,433
Foreign exchange differences	**18,810**	21,865	**28,420**	(111,349)
Total	**291,141**	319,080	**904,541**	800,271

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

During the three months ended February 28, 2018, Thermal Energy Bristol had one customer that accounted for 31% of total group revenue.

During the three months ended February 28, 2017, Thermal Energy Ottawa had one customer that accounted for 11% and Thermal Energy Bristol had two customers that accounted for 14% and 18% respectively of the company's total revenue for the period.

During the nine months ended February 28, 2018, Thermal Energy Bristol had one customer that accounted for 10% and Thermal Energy Ottawa had two customers that accounted for 16% and 17% respectively of the company's total revenue for the period.

During the nine months ended February 28, 2017, Thermal Energy Ottawa had one customer that accounted for 11% and Thermal Energy Bristol had one customer that accounted for 12% of total revenue.

(Expressed in Canadian dollars)

4. Segment reporting (continued):

Further geographical analysis:

	Sales for the nine months ended		Property, Plant and Equipment as at		Goodwill and other Intangible assets as at		Finance lease receivable (non-current) as at	
	Feb 28, 2018	Feb 28, 2017	**Feb 28, 2018**	May 31, 2017	**Feb 28, 2018**	May 31, 2017	**Feb 28, 2018**	May 31, 2017
	$	$	**$**	$	**$**	$	**$**	$
Canada	**1,389,079**	490,508	**46,199**	40,984	**-**	-	**117,836**	182,399
U.S.A.	**5,014,422**	2,407,142	**-**	-	**-**	-	**-**	-
U.K.	**2,860,228**	3,730,513	**37,224**	35,639	**1,904,715**	1,874,529	**-**	-
Germany	**159,544**	82,431	**-**	-	**-**	-	**-**	-
Italy	**199,447**	1,287,795	**-**	-	**-**	-	**-**	-
Netherlands	**60,635**	46,627	**-**	-	**-**	-	**-**	-
Ireland	**33,272**	73,209	**-**	-	**-**	-	**-**	-
Greece	-	165,380	**-**	-	**-**	-	**-**	-
Slovenia	**32,879**	51,657	**-**	-	**-**	-	**-**	-
Norway	**44,196**	-	**-**	-	**-**	-	**-**	-
Rest of Europe	**41,432**	31,145	**-**	-	**-**	-	**-**	-
Kenya	**43,998**	23,231	**-**	-	**-**	-	**-**	-
India	**72,080**	40,935	**-**	-	**-**	-	**-**	-
China	**2,248**	-	**-**	-	**-**	-	**-**	-
U.A.E.	**46,197**	-	**-**	-	**-**	-	**-**	-
Rest of World	**55,760**	7,454	**-**	-	**-**	-	**-**	-
Total	**10,055,417**	8,438,027	**83,423**	76,623	**1,904,715**	1,874,529	**117,836**	182,399

5. Cash and cash equivalents:

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

	February 28, 2018	May 31, 2017
Cash	**$ 2,075,196**	$ 2,949,640
Cash equivalents	**500**	500
Cash and cash equivalents	**$ 2,075,696**	$ 2,950,140

(Expressed in Canadian dollars)

6. Trade and other receivables:

	February 28, 2018	May 31, 2017
Trade receivables, gross	**$ 1,828,804**	2,299,892
Allowance for doubtful accounts	**(15,869)**	(15,617)
Trade receivables, net	**1,812,935**	2,284,275
Contracts for heat recovery solutions (see note 6(a))	**109,401**	35,698
Unbilled product and service revenue (see note 6(b))	**19,348**	23,090
Prepayments	**98,400**	101,939
Sales tax and other miscellaneous receivables	**118,312**	261,122
	$ 2,158,396	$ 2,706,124

The net carrying value of trade receivables is considered a reasonable approximation of fair value. Other miscellaneous receivables include $37,140 ($36,370 at May 31, 2017) due from a Chinese distributor receiving payments on the Company's behalf from a Chinese customer, which is net of a provision of $67,171.

At February 28, 2018, $125,523 (6.9%) of the Company's trade receivables balance was over 90 days past due, but not impaired ($46,840 (2.0%) at May 31, 2017).

The change in allowance for doubtful accounts was as follows:

	February 28, 2018	May 31, 2017
Balance, beginning of period	**$ 15,617**	$ 12,157
Provisions	**–**	4,240
Foreign exchange adjustments	**252**	(780)
Balance, end of period	**$ 15,869**	$ 15,617

The Company's trade and other receivables have been reviewed for indicators of impairment. For the quarters ended February 28, 2018 and 2017, no provisions were made.

(Expressed in Canadian dollars)

6. 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:

	February 28, 2018	May 31, 2017
Aggregate amount of costs incurred and recognized profits and losses for all contracts in progress	**$ 5,593,203**	$ 4,886,412
Less progress billings	**(6,453,454)**	(6,389,100)
	$ (860,251)	$(1,502,688)

Recognized as:

	February 28, 2018	May 31, 2017
Due from customers for contract work, recognized in trade and other receivables	**$ 109,401**	$ 35,698
Due to customers for contract work, recognized in deferred revenue (note 15)	**(969,652)**	(1,538,386)
	$ (860,251)	$(1,502,688)

(Expressed in Canadian dollars)

6. Trade and other receivables (continued):

(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:

	February 28, 2018	May 31, 2017
Aggregate amount of costs incurred and recognized profits and losses for all contracts in progress	**$ 179,711**	$ 98,079
Less progress billings	**(273,458)**	(163,420)
	$ (93,747)	$ (65,341)
Recognized as:		
Due from customer for product and services performed, recognized in trade and other receivables	**$ 19,348**	$ 23,090
Due to customer for products and services not delivered yet, recognized in deferred revenue (note 15)	**(113,095)**	(88,431)
	$ (93,747)	$ (65,341)

7. Inventory:

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

For the three months ended February 28, 2018, a total of $211,209 of inventories was expensed to cost of sales (2017 - $272,942). For the nine months ended February 28, 2018, a total of $605,189 of inventories was expensed to cost of sales (2017 - $447,063). 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 February 28, 2018 and 2017.

(Expressed in Canadian dollars)

8. Finance lease receivable:

The Company's finance lease receivable includes the following:

	February 28, 2018	May 31, 2017
Total estimated minimum lease payments receivable	**$ 238,108**	$ 319,161
Less: unearned income	**(34,244)**	(59,434)
	203,864	259,727
Less: current portion	**(86,028)**	(77,328)
	$ 117,836	$ 182,399

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.

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.

(Expressed in Canadian dollars)

8. Finance lease receivable (continued):

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		128,554
Residual value		-
	$	238,108

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

9. Property, plant and equipment:

	Plant and Equipment	Furniture and Fixtures	Laboratory Equipment	Computers	Leasehold Improve-ments	Motor Vehicles	Total
	$	$	$	$	$	$	$
Cost, May 31, 2016	137,309	103,080	52,857	323,885	22,877	8,118	648,126
Additions	20,338	–	–	17,826	–	–	38,164
Disposals	–	–	–	–	–	–	–
Translation adjustments	(6,636)	(283)	–	(4,069)	–	(685)	(11,673)
Cost, May 31, 2017	151,011	102,797	52,857	337,642	22,877	7,433	674,617
Additions	20,567	–	–	20,486	–	–	41,053
Disposals	(5,475)	–	–	(1,805)	–	–	(7,280)
Translation adjustments	1,637	49	–	1,530	–	119	3,335
Cost, February 28, 2018	**167,740**	**102,846**	**52,857**	**357,853**	**22,877**	**7,552**	**711,725**
Accumulated depreciation, May 31, 2016	89,268	99,844	52,857	302,812	22,877	2,031	569,689
Depreciation for the year	16,296	2,199	–	17,809	–	1,810	38,114
Disposals	–	–	–	–	–	–	–
Translation adjustments	(5,965)	(283)	–	(3,436)	–	(125)	(9,809)
Accumulated depreciation, May 31, 2017	99,599	101,760	52,857	317,185	22,877	3,716	597,994
Depreciation for the period	14,858	933	–	14,101	–	1,346	31,238
Disposals	(3,558)	–	–	–	–	–	(3,558)
Translation adjustments	1,193	49	–	1,258	–	128	2,628
Accumulated depreciation, February 28, 2018	**112,092**	**102,742**	**52,857**	**332,544**	**22,877**	**5,190**	**628,302**
Net book value, May 31, 2017	51,412	1,037	–	20,457	–	3,717	76,623
Net book value, February 28, 2018	**55,648**	**104**	**–**	**25,309**	**–**	**2,362**	**83,423**

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.

During the three months ended February 28, 2018 the Company did not dispose of any assets.

During the three months ended February 28, 2017, the Company did not dispose of any assets.

During the nine months ended February 28, 2018, the Company disposed of depreciated assets with a net book value of $3,722 for $7,757 in proceeds.

During the nine months ended February 28, 2017, the Company did not dispose of any assets.

(Expressed in Canadian dollars)

10. Intangible assets:

	Trade Names & Trademarks $	Non-compete Agreement $	Industrial Know-how $	Designs & Drawings $	Customer Relationships $	Total $
Cost, May 31, 2016	873,495	113,934	133,025	146,216	313,320	1,579,990
Translation adjustments	(73,693)	(9,612)	(11,316)	(12,336)	(26,435)	(133,392)
Cost, May 31, 2017	799,802	104,322	121,709	133,880	286,885	1,446,598
Translation adjustments	12,881	1,680	1,960	2,156	4,620	23,297
Cost, February 28, 2018	**812,683**	**106,002**	**123,669**	**136,036**	**291,505**	**1,469,895**
Accumulated amortization, May 31, 2016	167,565	113,934	133,025	146,216	313,320	874,060
Translation adjustments	(14,136)	(9,612)	(11,316)	(12,336)	(26,435)	(73,835)
Accumulated amortization, May 31, 2017	153,429	104,322	121,709	133,880	286,885	800,225
Translation adjustments	2,473	1,680	1,960	2,156	4,620	12,889
Accumulated amortization, February 28, 2018	**155,902**	**106,002**	**123,669**	**136,036**	**291,505**	**813,114**
Net Book Value, May 31, 2017	646,373	–	–	–	–	646,373
Net Book Value, February 28, 2018	**656,781**	**–**	**–**	**–**	**–**	**656,781**

Trade Names and Trademarks are intangible assets with indefinite lives and are not subject to amortization. Trade Names and Trademarks relate specifically to the GEM™ product. They are tested for impairment at each year-end. No impairment was recognized for the three months ended February 28, 2018 or February 28, 2017. The growth rates attributed by Management to the GEM™ product line are 10% in 2018, followed by positive 10% in each of the subsequent four years. This is higher than the compound annual growth rate over the previous five years of 7%, 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 11).

11. Goodwill:

Goodwill arose as a result of the acquisition of Gardner Energy Management Limited on July 1, 2008. Goodwill consists of the following amounts:

	February 28, 2018	May 31, 2017
Balance, beginning of period	**$ 1,228,155**	$ 1,341,316
Translation adjustments	**19,779**	(113,160)
Balance, end of period	**$ 1,247,934**	$ 1,228,156

11. Goodwill (continued):

Goodwill is tested for impairment as at each year end, resulting in no impairment charge as at 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 18% (2016 - 19%) 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 18% (2016 - 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% (2016 - 15%) debt and 85% (2016 - 85%) equity was assumed, after considering the capital structure of comparable companies.

For purposes of the May 31, 2017 impairment testing, Thermal Energy International (UK) Limited's growth from 2017 to 2018 was assumed to be 7%, as per the detailed budget prepared with 7% growth in the following year and 8% per annum thereafter. This fairly consistent 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 2017 to 2018 was assumed to be 1%, as per the detailed budget prepared with subsequent growth of 10% in 2019 through to 2022. The future expected growth is the result of additional sales staff in 2018.

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.

(Expressed in Canadian dollars)

12. Short-term borrowings:

The Company has an authorized credit facility of up to approximately $442,000 dependent on the level of certain UK accounts receivable balances. The available facility as at February 28, 2018 was in the amount of $246,000 (May 31, 2017 - $435,000), of which $Nil was utilized as at February 28, 2018 (May 31, 2017 - $Nil). The Company has continued access to this short-term financing facility.

13. Trade payables:

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

	February 28, 2018	May 31, 2017
Trade payables	**$ 1,154,550**	$ 1,744,032

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

14. Other liabilities:

Other liabilities can be summarized as follows:

	February 28, 2018	May 31, 2017
Accruals	**$ 637,495**	$ 906,034
Other government remittances payable	**520,081**	122,698
	$ 1,157,576	$ 1,028,732

Included in accruals is $27,975 due to directors ($35,350 at May 31, 2017).

15. Deferred revenue:

	February 28, 2018	May 31, 2017
Deferred revenue relating to heat recovery solutions (note 6(a))	**969,652**	1,538,386
Deferred revenue relating to GEM™ product and services (note 6(b))	**113,095**	88,431
	$ 1,082,747	$ 1,626,817

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

(Expressed in Canadian dollars)

16. Provisions:

The change in provisions was as follows:

	February 28, 2018	May 31, 2017
Balance, beginning of period	**$ 232,387**	$ 215,000
Provisions	**–**	17,387
Foreign exchange adjustments	**280**	-
Balance, end of period	**$ 232,667**	$ **232,387**

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.

(Expressed in Canadian dollars)

16. Provisions (continued):

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. 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 $42,667 for warranty.

17. 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:

	Nine months ended February 28, 2018		Year ended May 31, 2017	
	# Shares	**$**	# Shares	$
Class A Common shares issued				
Balance, beginning of period				
Unrestricted shares	**159,088,950**	**32,231,329**	157,834,616	32,069,073
Share options exercised[(1)]	**-**	**-**	1,254,334	162,256
Balance, end of period	**159,088,950**	**32,231,329**	159,088,950	32,231,329
Unrestricted shares	**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

(1) For the nine months ended February 28, 2018, no share options were exercised. For the year ended May 31, 2017,1,254,334 shares were issued following the exercise of stock options, resulting in an increase to capital stock of $162,256 and a reduction in contributed surplus of $41,780.

(Expressed in Canadian dollars)

17. Capital stock (continued):

Normal Course Issuer Bid:

During the 12-month period commencing February 15, 2016 and ending February 15, 2017, the Company was able to purchase on the TSX up to 12,758,701 common shares, representing approximately 8% of the then issued and outstanding common shares, pursuant to a Normal Course Issuer Bid as approved by the TSX Venture Exchange on February 12, 2016.

18. 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 February 28, 2018 totalled $2,964,432 (May 31, 2017 - $3,185,619). 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.

19. 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 February 28, 2018		Three months ended February 28, 2017	
	# Options	**Weighted Average Exercise Price $**	# Options	Weighted Average Exercise Price $
Outstanding, beginning of period	**20,495,531**	**0.08**	21,548,720	0.08
Granted	**-**	**-**	-	
Forfeited			(567,500)	0.08
Exercised	**-**	**-**	(28,334)	0.05
Outstanding, end of period	**20,495,531**	**0.08**	20,952,886	0.09
Options exercisable, end of period	**16,959,238**	**0.09**	13,213,027	0.08

(Expressed in Canadian dollars)

19. Share-based payments (continued):

	Nine months ended February 28, 2018		Nine months ended February 28, 2017	
	# Options	**Weighted Average Exercise Price $**	# Options	Weighted Average Exercise Price $
Outstanding, beginning of period	**20,495,531**	**0.08**	22,728,720	0.08
Granted	**-**	**-**	500,000	0.12
Forfeited	**-**	**-**	(1,011,500)	0.08
Exercised	**-**	**-**	(1,254,334)	0.05
Outstanding, end of period	**20,495,531**	**0.08**	20,952,886	0.08
Options exercisable, end of period	**16,959,238**	**0.09**	13,213,027	0.09

There were no options exercised for the nine months ended February 28, 2018. There were 1,254,334 options exercised in the nine months ended February 28, 2017.

The following share-based payment arrangements were in existence at February 28, 2018, May 31, 2017 and February 28, 2017:

At February 28, 2018:

	Options outstanding			**Options exercisable**	
Range of exercise prices	**Number outstanding February 28, 2018**	**Weighted average remaining contractual life**	**Weighted average exercise price**	**Number exercisable at February 28, 2018**	**Weighted average exercise price**
0.05-0.07	**5,991,500**	**2.09**	**0.05**	**3,895,667**	**0.05**
0.07-0.10	**4,071,360**	**2.22**	**0.08**	**2,797,570**	**0.08**
0.10-0.12	**10,432,671**	**0.54**	**0.10**	**10,266,001**	**0.10**
	20,495,531	**1.33**	**0.08**	**16,959,238**	**0.09**

At May 31, 2017:

	Options outstanding			Options exercisable	
Range of exercise prices	Number outstanding May 31, 2017	Weighted average remaining contractual life	Weighted average exercise price	Number exercisable at May 31, 2017	Weighted average exercise price
0.05-0.07	5,991,500	2.87	0.05	2,754,000	0.05
0.07-0.10	4,071,360	2.97	0.08	1,357,121	0.08
0.10-0.12	10,432,671	1.05	0.10	8,939,551	0.10
	20,495,531	1.96	0.08	13,050,672	0.09

(Expressed in Canadian dollars)

19. Share-based payments (continued):

At February 28, 2017:

	Options outstanding			Options exercisable	
Range of exercise prices	Number outstanding February 28,2017	Weighted average remaining contractual life	Weighted average exercise price	Number exercisable at February 28, 2017	Weighted average exercise price
0.05-0.07	6,116,500	3.64	0.05	2,754,000	0.05
0.07-0.10	4,213,026	3.53	0.08	1,385,453	0.08
0.10-0.12	10,623,360	1.55	0.10	9,073,574	0.10
	20,952,886	2.56	0.08	13,213,027	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 February 28, 2018, there was $26,484 (May 31, 2017 - $65,209) 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:

	01-Dec-14	29-May-15	30-May-16	28-Nov-16
Grant date share price ($)(1)	0.08	0.06	0.04	0.12
Exercise price ($)	0.09	0.08	0.05	0.12
Expected volatility (%)(2)	89.64	87.70	90.20	97.75
Expected life (years)	4.00	4.00	4.00	4.00
Expected dividend yield (%)	0.00	0.00	0.00	0.00
Risk-free interest rate (%)	1.38	0.88	0.79	0.95
Forfeiture rate (%)	0.00	13.00	17.00	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.

(Expressed in Canadian dollars)

19. 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 February 28, 2018	Three months ended February 28, 2017
Administration	**$ 7,574**	$ 21,572
Selling, marketing and business development	**3,306**	9,484
	$ 10,880	$ 31,056

	Nine months ended February 28, 2018	Nine months ended February 28, 2017
Administration	**$ 28,806**	$ 55,871
Selling, marketing and business development	**9,919**	30,337
	$ 38,725	$ 86,208

20. 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 $25,563 in the three months ended February 28, 2018 (2017 - $18,626) and $72,224 in the nine months ended February 28, 2018 (2017 - $56,351)

21. Income (loss) per share:

The calculation of basic and diluted earnings (loss) per share for the three months ended February 28, 2018 was based on the net loss attributable to owners of the parent of $159,764 (2017 - net loss of $56,922), a weighted average number of basic common shares outstanding of 159,088,950, (2017 – 159,069,746) and a weighted average number of diluted common shares outstanding of 165,966,803 (2017 – 174,930,193). The calculation of basic and diluted earnings (loss) per share for the nine months ended February 28, 2018 was based on the net loss attributable to owners of the parent of $259,912 (2017 - net income of $39,105), a weighted average number of basic common shares outstanding of 159,088,950, (2017 – 158,255,274) and a weighted average number of diluted common shares outstanding of 165,876,593 (2017 – 166,124,525).

(Expressed in Canadian dollars)

21. Income (loss) per share (continued):

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

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

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

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

	Three months ended February 28, 2018	Three months ended February 28, 2017
Issued common shares at beginning of the period	159,088,950	159,060,616
Effect of shares issued	-	9,130
Weighted average number of basic common shares in the period	159,088,950	159,069,746
Effect of stock options on issue	6,877,853	15,860,447
Weighted average number of diluted common shares in the period	165,966,803	174,930,193

	Nine months ended February 28, 2018	Nine months ended February 28, 2017
Issued common shares at beginning of the period	159,088,950	157,834,616
Effect of shares issued	-	420,658
Weighted average number of basic common shares in the period	159,088,950	158,255,274
Effect of stock options on issue	6,787,643	7,869,251
Weighted average number of diluted common shares in the period	165,876,593	166,124,525

(Expressed in Canadian dollars)

22. Operating lease commitments:

Thermal Energy International Inc. and its UK subsidiary 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 February 28, 2018, the Company had operating lease commitments as follows:

	Total	Less than 1 year	1-5 years	More than 5 years
Operating leases	$ 312,070	$ 155,405	$ 156,665	$ –

Lease payments recognized as an expense for the three months ended February 28, 2018 totalled $ 38,043 (2017 - $33,479). Lease payments recognized as an expense for the nine months ended February 28, 2018 totalled $111,889 (2017 - $102,412).

23. Financial instruments:

Financial risk management:

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

(Expressed in Canadian dollars)

23. Financial instruments (continued):

Financial risk management (continued):

(a) Market risk (continued):

(i) Foreign currency risk (continued):

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			
February 28, 2018			
Canadian Dollar	**606,682**	**–**	**606,682**
British Pound	**–**	**15,734**	**15,734**
	606,682	**15,734**	**622,416**
May 31, 2017			
Canadian Dollar	1,133,586	–	1,133,586
British Pound	–	493,203	493,203
	1,133,586	493,203	1,626,789
February 28, 2017			
Canadian Dollar	740,327	–	740,327
British Pound	–	588,521	588,521
	740,327	588,521	1,328,848

23. 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:

	Nine months ended February 28, 2018			Nine months ended February 28, 2017		
	US$	**Euros**	**Total**	US$	Euros	Total
Net income (loss)	**60,668**	**1,574**	**62,242**	74,073	58,852	132,855

	As at February 28, 2018			As at May 31, 2017		
	US$	**Euros**	**Total**	US$	Euros	Total
Equity	**60,668**	**1,574**	**62,642**	113,359	49,320	162,679

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. There were no significant investments or borrowings to expose the Company to interest rate sensitivity either at February 28, 2018 or May 31, 2017.

23. 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 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 5), trade receivables, other miscellaneous receivables (see note 6) and finance lease receivable. 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 February 28, 2018 was $238,108.

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

(Expressed in Canadian dollars)

23. 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. In addition, a UK subsidiary of the Company has access to borrowings secured against certain accounts receivable.

As at February 28, 2018, the Company's financial liabilities, which consist of trade payables and other liabilities, have a carrying value of $2,312,126 ($2,772,764 at May 31, 2017) and are all due within one year.

24. 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 February 28, 2018	Three Months Ended February 28, 2017
Salaries and other short-term employee benefits	**$ 238,433**	$ 222,237
Share-based payments	**5,454**	15,079
	$ 243,887	$ 237,316

	Nine Months Ended February 28, 2018	Nine Months Ended February 28, 2017
Salaries and other short-term employee benefits	**$ 658,086**	$ 655,790
Share-based payments	**22,591**	37,180
	$ 680,677	$ 692,970

24. Related party transactions (continued):

Salaries and other short-term employee benefits include cash payments for base salaries and related social security costs and employee benefits, as well as payments made into defined contribution pension plans of the Company's UK based subsidiary, amounts expensed in the 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.