

Condensed Consolidated Interim Financial Statements of

**THERMAL ENERGY
INTERNATIONAL INC.**

Quarters ended February 29, 2020 and February 28, 2019

(Unaudited)

THERMAL ENERGY INTERNATIONAL INC.

Condensed Consolidated Interim Statements of Financial Position

As at February 29, 2020 and May 31, 2019
(Expressed in Canadian dollars) (Unaudited)

	February 29, 2020	May 31, 2019 ¹
	\$	\$
Assets		
Current assets:		
Cash and cash equivalents	3,836,840	4,177,260
Trade and other receivables (note 5)	3,886,920	3,017,209
Current tax receivable	51,364	42,697
Inventory	871,674	653,944
Finance lease receivable (note 6)	-	93,257
	8,646,798	7,984,367
Non-current assets:		
Property, plant and equipment (note 7)	451,606	260,202
Right-of-use assets (note 8)	456,153	-
Intangible assets	1,957,899	2,175,262
Goodwill	2,519,857	2,520,555
Deferred tax assets	105,252	105,406
	5,490,767	5,061,425
Total assets	14,137,565	13,045,792
Liabilities		
Current liabilities:		
Trade payables and accrued liabilities (note 9)	3,800,559	2,549,570
Current tax liabilities	11,271	2,965
Pensions and other employer obligations	93,792	143,948
Current portion of long-term debt (note 10)	396,650	371,993
Deferred revenue (note 11)	1,242,366	2,604,590
Provisions	283,520	283,478
Lease obligations (note 12)	31,511	-
	5,859,669	5,956,544
Non-current liabilities:		
Contingent payable (note 15)	123,370	110,148
Long-term debt (note 10)	2,323,245	2,633,867
Lease obligations (note 12)	448,630	-
Deferred tax liabilities	383,804	450,681
	3,279,049	3,194,696
Total liabilities	9,138,718	9,151,240
Equity		
Capital stock (note 16)	32,207,486	32,464,780
Contributed surplus	4,318,353	4,002,683
Accumulated other comprehensive income	272,616	267,889
Deficit	(31,707,289)	(32,760,222)
Equity attributable to owners of the parent	5,091,166	3,975,130
Non-controlling interest	(92,319)	(80,578)
Total equity	4,998,847	3,894,552
Total liabilities and equity	14,137,565	13,045,792

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

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

On behalf of the Board:

"William Crossland"

Director

"William Ollerhead"

Director

THERMAL ENERGY INTERNATIONAL INC.

Condensed Consolidated Interim Statements of Comprehensive Income

For the three and nine months ended February 29, 2020 and February 28, 2019
(Expressed in Canadian dollars) (Unaudited)

	Three months ended		Nine months ended	
	February 29 2020	February 28 2019 ²	February 29 2020	February 28 2019 ²
	\$	\$	\$	\$
Revenue (note 14)	5,811,626	3,114,757	18,625,511	15,108,710
Cost of sales ¹	3,394,176	1,971,653	11,099,186	10,184,801
Gross profit	2,417,450	1,143,104	7,526,325	4,923,909
Expenses:				
Administration	1,136,816	1,174,124	3,689,599	3,338,035
Selling, marketing and business development ¹	804,758	808,324	2,527,286	2,629,194
Research and development	(51,242)	44,790	2,720	132,311
	1,890,332	2,027,238	6,219,605	6,099,540
Operating income (loss)	527,118	(884,134)	1,306,720	(1,175,631)
Finance costs	(118,042)	(82,174)	(307,453)	(199,607)
Finance revenue	-	4,780	5,144	16,491
Income (loss) before income taxes	409,076	(961,528)	1,004,411	(1,358,747)
Income taxes recovery	20,711	72,047	51,818	307,686
Net income (loss) for the period	429,787	(889,481)	1,056,229	(1,051,061)
Items that may be reclassified subsequently to profit or loss:				
Exchange differences arising on translation of overseas operations	(8,610)	71,501	(278)	36,677
Total comprehensive income (loss) for the period	421,177	(817,980)	1,055,951	(1,014,384)
Net income (loss) for the period attributable to:				
Owners of the parent	436,439	(893,554)	1,052,933	(1,054,716)
Non-controlling interest	(6,652)	4,073	3,296	3,655
Net income (loss) for the period	429,787	(889,481)	1,056,229	(1,051,061)
Total comprehensive income (loss) for the period attributable to:				
Owners of the parent	427,740	(824,463)	1,057,660	(1,026,089)
Non-controlling interest	(6,563)	6,483	(1,709)	11,705
Total comprehensive income (loss) for the period	421,177	(817,980)	1,055,951	(1,014,384)
Net income (loss) per share - basic and diluted	0.003	(0.006)	0.007	(0.007)

1. Effective June 1, 2019, the Company changed its accounting policy to reclassify commission expense from selling, marketing and business development expense to cost of sales as described in note 3(a). As a result, commission expense for the comparative periods was also reclassified from selling, marketing and business development expense to cost of sales.

2. The Company adopted IFRS 16 as described in note 3(b). Under this adoption, the comparative information is not restated.

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

THERMAL ENERGY INTERNATIONAL INC.

Condensed Consolidated Interim Statements of Changes in Equity

For the nine months ended February 29, 2020 and February 28, 2019

(Expressed in Canadian dollars) (Unaudited)

	Capital stock \$	Contributed surplus \$	Deficit \$	Accumulated other comprehensive income \$	Total attributable to owners of the parent \$	Non- controlling interest \$	Total equity \$
Balance at June 1, 2018	32,231,329	3,978,830	(32,335,936)	282,292	4,156,515	(51,162)	4,105,353
Share-based compensation (note 13)	-	61,798	-	-	61,798	-	61,798
Stock options exercised (note 16)	233,451	(91,493)	-	-	141,958	-	141,958
Dividends paid	-	-	-	-	-	(8,579)	(8,579)
Transactions with owners	233,451	(29,695)	-	-	203,756	(8,579)	195,177
Net (loss) income for the period	-	-	(1,054,716)	-	(1,054,716)	3,655	(1,051,061)
Other comprehensive income: exchange differences arising on translation of overseas operations	-	-	-	28,627	28,627	8,050	36,677
Total comprehensive (loss) income for the period	-	-	(1,054,716)	28,627	(1,026,089)	11,705	(1,014,384)
Balance at February 28, 2019 ¹	32,464,780	3,949,135	(33,390,652)	310,919	3,334,182	(48,036)	3,286,146
Balance at June 1, 2019	32,464,780	4,002,683	(32,760,222)	267,889	3,975,130	(80,578)	3,894,552
Share-based compensation (note 13)	-	153,562	-	-	153,562	-	153,562
Repurchase of Class A common shares (note 16)	(257,294)	162,108	-	-	(95,186)	-	(95,186)
Dividends paid	-	-	-	-	-	(10,032)	(10,032)
Transactions with owners	(257,294)	315,670	-	-	58,376	(10,032)	48,344
Net income for the period	-	-	1,052,933	-	1,052,933	3,296	1,056,229
Other comprehensive income (loss): exchange differences arising on translation of overseas operations	-	-	-	4,727	4,727	(5,005)	(278)
Total comprehensive income (loss) for the period	-	-	1,052,933	4,727	1,057,660	(1,709)	1,055,951
Balance at February 29, 2020	32,207,486	4,318,353	(31,707,289)	272,616	5,091,166	(92,319)	4,998,847

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

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

THERMAL ENERGY INTERNATIONAL INC.

Condensed Consolidated Interim Statements of Cash Flows

For the three and nine months ended February 29, 2020 and February 28, 2019

(Expressed in Canadian dollars) (Unaudited)

	Three months ended		Nine months ended	
	February 29 2020	February 28 2019 ¹	February 29 2020	February 28 2019 ¹
	\$	\$	\$	\$
Operating activities:				
Net income (loss) for the period	429,787	(889,481)	1,056,229	(1,051,061)
Add items not involving cash:				
Depreciation of property, plant and equipment (note 7)	29,341	21,735	78,944	60,871
Depreciation of right-of-use assets (note 8)	33,462	-	92,519	-
Loss (gain) on disposal of assets (note 7)	1,004	-	1,004	(191)
Amortization of intangible assets	68,964	69,705	207,346	183,830
Write-down of financial lease receivable (note 6)	-	-	45,848	-
Finance revenue	-	(4,780)	(5,144)	(16,491)
Finance costs	118,042	82,174	307,453	199,607
Share-based compensation (note 13)	50,230	53,548	153,562	61,798
Income taxes recovery	(20,711)	(72,047)	(51,818)	(307,686)
Unrealized foreign exchange and translation adjustments	3,248	11,196	105,880	42,430
Changes in working capital:				
Trade and other receivables	(344,319)	1,556,573	(817,158)	532,463
Inventory	74,450	(102,104)	(217,730)	(50,354)
Trade payables and accrued liabilities	(472,992)	(855,056)	1,169,934	(1,360,231)
Deferred revenue	(787,120)	1,788,911	(1,410,678)	2,066,677
Income taxes (paid) received	(16,101)	-	(11,800)	(40,236)
Interest received on finance lease	-	1,908	-	8,166
Other interest received	-	(456)	-	-
Interest paid	(111,958)	(59,460)	(252,923)	(157,071)
Net cash (used in) provided by operating activities	(944,673)	1,602,366	451,468	172,521
Investing activities:				
Finance lease principal payments received	-	7,591	-	29,834
Acquisition of subsidiary, net of cash	-	-	-	(2,672,894)
Proceeds from disposal of property, plant and equipment (note 7)	-	-	-	6,396
Additions to property, plant and equipment (note 7)	(24,771)	(2,401)	(272,333)	(46,235)
Net cash (used in) provided by investing activities	(24,771)	5,190	(272,333)	(2,682,899)
Financing activities:				
Issuance of long-term debt (note 10)	-	-	-	2,937,375
Repayment of long-term debt (note 10)	(98,776)	-	(263,609)	-
Repayment of lease obligations (note 12)	(26,354)	-	(68,412)	-
Stock options exercised (note 16)	-	-	-	141,958
Repurchase of Class A common shares (note 16)	(95,186)	-	(95,186)	-
Dividends paid	-	-	(10,032)	(8,579)
Net cash (used in) provided by financing activities	(220,316)	-	(437,239)	3,070,754
(Decrease) increase in cash and cash equivalents for the period	(1,189,760)	1,607,556	(258,104)	560,376
Cash and cash equivalents, beginning of period	5,034,207	2,235,481	4,177,260	3,282,208
Exchange differences on cash and cash equivalents	(7,607)	(40,042)	(82,316)	(39,589)
Cash and cash equivalents, end of period	3,836,840	3,802,995	3,836,840	3,802,995

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

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

THERMAL ENERGY INTERNATIONAL INC.

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

Nine months ended February 29, 2020 and February 28, 2019

(Expressed in Canadian dollars except share amounts)

1. Nature of operations:

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

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 29, 2020 and February 28, 2019.

2. Basis of presentation:

(a) Statement of compliance:

These unaudited condensed consolidated interim financial statements have been prepared in accordance with International Accounting Standard 34 Interim Financial Reporting as issued by the International Accounting Standards Board (“IASB”). These unaudited condensed consolidated interim financial statements do not include all of the information required for a complete set of financial statements prepared in accordance with International Financial Reporting Standards (“IFRS”) and should be read in conjunction with the audited consolidated financial statements of the Company for the year ended May 31, 2019. However, selected explanatory notes are included to explain events and transactions that are significant to an understanding of the changes in the Company’s financial position and performance since the last annual consolidated financial statements for the year ended May 31, 2019.

This is the first year where IFRS 16 has been applied. Changes to significant accounting policies are described in note 3.

The policies applied in these unaudited condensed consolidated interim financial statements are based on IFRS issued and effective as of May 26, 2020, the date the Board of Directors approved the unaudited condensed consolidated interim financial statements.

(b) Significant accounting judgments and estimates:

In preparing these unaudited condensed consolidated interim financial statements, management makes judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities, income and expenses. Actual results may differ from these estimates.

The significant judgments made by management in applying the Company’s accounting policies and the key sources of estimation uncertainty were the same as those that applied to the consolidated financial statements as at and for the year ended May 31, 2019, except for significant judgments and key sources of estimation uncertainty related to the application of IFRS 16, which are described in note 3(b).

THERMAL ENERGY INTERNATIONAL INC.

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

Nine months ended February 29, 2020 and February 28, 2019

(Expressed in Canadian dollars except share amounts)

3. Changes in significant accounting policies:

Except as described below, the accounting policies applied in these unaudited condensed consolidated interim financial statements are the same as those applied in the Company's consolidated financial statements as at and for the year ended May 31, 2019.

The changes in accounting policies will also be reflected in the Company's consolidated financial statements as at and for the year ending May 31, 2020.

(a) Reclassification of Commission Expense

Effective June 1, 2019, the Company changed its accounting policy with respect to commissions and reclassified commission expense from selling, marketing and business development expense to cost of sales. The Company believes that the revised policy and presentation provides more reliable and relevant information to users of the consolidated financial statements. The change in accounting policy has been applied retrospectively. The Company has restated the comparative figures in the consolidated statements of operation resulting in reclassification of commission expense in the amount of \$304,501 and \$836,091 for the three and nine months ended February 28, 2019 from selling, marketing and business development expense to cost of sales.

b) IFRS 16: Leases ("IFRS 16"):

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

Accounting policy under IFRS 16:

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

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

THERMAL ENERGY INTERNATIONAL INC.

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

Nine months ended February 29, 2020 and February 28, 2019

(Expressed in Canadian dollars except share amounts)

3. Changes in significant accounting policies (continued):

(b) IFRS 16: Leases (“IFRS 16”) (continued):

Accounting policy under IFRS 16 (continued):

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

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

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

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

Impact of transition to IFRS 16:

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

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

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

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

THERMAL ENERGY INTERNATIONAL INC.

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

Nine months ended February 29, 2020 and February 28, 2019

(Expressed in Canadian dollars except share amounts)

3. Changes in significant accounting policies (continued):

(b) IFRS 16: Leases (“IFRS 16”) (continued):

Impact of transition to IFRS 16 (continued):

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

Aggregate lease commitments as disclosed at May 31, 2019	\$1,351,406
*Less: lease committed but not commenced as at June 1, 2019	(1,074,642)
Less: recognition exemption for short-term leases (leases that expire on or prior to May 31, 2020)	(85,955)
Less: recognition exemption for low-value assets	(14,493)
Add: extension options reasonably certain to be exercised	75,994
Less: foreign exchange and other adjustments	16
Adjusted lease commitments	252,326
Less: impact of present value	(20,546)
Opening IFRS 16 lease liability as at June 1, 2019 (note 8)	\$ 231,780

*The Company entered a 10-year lease for an office space before May 31, 2019. The lease was included in the lease commitment note in the consolidated financial statements at May 31, 2019. The lease commencement date was September 1, 2019. On June 1, 2019, the Company did not recognize the lease obligation and the right-of-use asset for this lease because the lease term had not started (see note 12).

THERMAL ENERGY INTERNATIONAL INC.

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

Nine months ended February 29, 2020 and February 28, 2019

(Expressed in Canadian dollars except share amounts)

3. Changes in significant accounting policies (continued):

(b) IFRS 16: Leases (“IFRS 16”) (continued):

Impact of transition to IFRS 16 (continued):

The following table summarizes the impact of adopting IFRS 16 on the Company’s condensed consolidated interim statements of financial position as at February 29, 2020:

	February 29, 2020 as reported	Adjustments	February 29, 2020 without adoption of IFRS 16
	\$		\$
Assets			
Current assets:			
Cash and cash equivalents	3,836,840	-	3,836,840
Trade and other receivables	3,886,920	-	3,886,920
Current tax receivable	51,364	-	51,364
Inventory	871,674	-	871,674
Finance lease receivable	-	-	-
	8,646,798	-	8,646,798
Non-current assets:			
Property, plant and equipment	451,606	-	451,606
Right-of-use assets	456,153	(456,153)	-
Intangible assets	1,957,899	-	1,957,899
Goodwill	2,519,857	-	2,519,857
Deferred tax assets	105,252	-	105,252
	5,490,767	(456,153)	5,034,614
Total assets	14,137,565	(456,153)	13,681,412
Liabilities			
Current liabilities:			
Trade payables and accrued liabilities	3,800,559	-	3,800,559
Current tax liabilities	11,271	-	11,271
Pensions and other employer obligations	93,792	-	93,792
Current portion of long-term debt	396,650	-	396,650
Deferred revenue	1,242,366	-	1,242,366
Provisions	283,520	-	283,520
Lease obligations	31,511	(31,511)	-
	5,859,669	(31,511)	5,828,158
Non-current liabilities:			
Contingent payable	123,370	-	123,370
Long-term debt	2,323,245	-	2,323,245
Lease obligations	448,630	(448,630)	-
Deferred tax liabilities	383,804	-	383,804
	3,279,049	(448,630)	2,830,419
Total liabilities	9,138,718	(480,141)	8,658,577
Equity			
Capital stock	32,207,486	-	32,207,486
Contributed surplus	4,318,353	-	4,318,353
Accumulated other comprehensive income	272,616	80	272,696
Deficit	(31,707,289)	23,908	(31,683,381)
Equity attributable to owners of the parent	5,091,166	23,988	5,115,154
Non-controlling interest	(92,319)	-	(92,319)
Total equity	4,998,847	23,988	5,022,835
Total liabilities and equity	14,137,565	(456,153)	13,681,412

THERMAL ENERGY INTERNATIONAL INC.

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

Nine months ended February 29, 2020 and February 28, 2019

(Expressed in Canadian dollars except share amounts)

3. Changes in significant accounting policies (continued):

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

Impact of transition to IFRS 16 (continued):

The following table summarizes the impact of adopting IFRS 16 on the Company's condensed consolidated interim statements of comprehensive income for the nine months ended February 29, 2020:

	Nine months ended February 29, 2020 as reported	Adjustments	Nine months ended February 29, 2020 without adoption of IFRS 16
	\$	\$	\$
Revenue	18,625,511	-	18,625,511
Cost of sales	11,099,186	-	11,099,186
Gross profit	7,526,325	-	7,526,325
Expenses:			
Administration	3,689,599	(23,947)	3,665,652
Selling, marketing and business development	2,527,286	24,019	2,551,305
Research and development	2,720	-	2,720
	6,219,605	72	6,219,677
Operating income	1,306,720	(72)	1,306,648
Finance costs	(307,453)	23,980	(283,473)
Finance revenue	5,144	-	5,144
Income before income taxes	1,004,411	23,908	1,028,319
Income taxes recovery	51,818	-	51,818
Net income for the period	1,056,229	23,908	1,080,137
Items that may be reclassified subsequently to profit or loss:			
Exchange differences arising on translation of overseas operations	(278)	80	(198)
Total comprehensive income for the period	1,055,951	23,988	1,079,939
Net income (loss) for the period attributable to:			
Owners of the parent	1,052,933	23,908	1,076,841
Non-controlling interest	3,296	-	3,296
Net income for the period	1,056,229	23,908	1,080,137
Total comprehensive income (loss) for the period attributable to:			
Owners of the parent	1,057,660	23,988	1,081,648
Non-controlling interest	(1,709)	-	(1,709)
Total comprehensive income for the period	1,055,951	23,988	1,079,939
Net income per share - basic and diluted	0.007	0.00	0.007

THERMAL ENERGY INTERNATIONAL INC.

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

Nine months ended February 29, 2020 and February 28, 2019

(Expressed in Canadian dollars except share amounts)

3. Changes in significant accounting policies (continued):

(b) IFRS 16: Leases (“IFRS 16”) (continued):

Impact of transition to IFRS 16 (continued):

The following table summarizes the impact of adopting IFRS 16 on the Company’s condensed consolidated interim statements of cash flows for the nine months ended February 29, 2020:

	Nine months ended February 29, 2020 as reported	Adjustments	Nine months ended February 29, 2020 without adoption of IFRS 16
	\$	\$	\$
Net cash flows provided by operating activities	451,468	(68,412)	383,056
Net cash flows used in financing activities	(437,239)	68,412	(368,827)

4. Segment reporting:

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

THERMAL ENERGY INTERNATIONAL INC.

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

Nine months ended February 29, 2020 and February 28, 2019

(Expressed in Canadian dollars except share amounts)

4. Segment reporting (continued):

Segment information for the quarter ended February 29, 2020 and the comparative period are detailed in the table below.

	Thermal Energy Ottawa		Thermal Energy Bristol		Reconciling Items		Total	
	2020	2019	2020	2019	2020	2019	2020	2019
	\$	\$	\$	\$	\$	\$	\$	\$
Total revenue	3,003,194	2,092,664	2,808,432	1,022,093	-	-	5,811,626	3,114,757
Cost of sales ⁽¹⁾	(2,028,371)	(1,470,379)	(1,365,805)	(501,274)	-	-	(3,394,176)	(1,971,653)
Gross profit	974,823	622,285	1,442,627	520,819	-	-	2,417,450	1,143,104
Other expenses ⁽¹⁾	(753,137)	(851,120)	(766,320)	(843,155)	(370,875)	(332,963)	(1,890,332)	(2,027,238)
Net finance (costs) income	-	4,780	-	-	(118,042)	(82,174)	(118,042)	(77,394)
Income (loss) before taxation	221,686	(224,055)	676,307	(322,336)	(488,917)	(415,137)	409,076	(961,528)
Tax (expense) recovery	-	21,022	(98)	53,837	20,809	(2,812)	20,711	72,047
Net income (loss)	221,686	(203,033)	676,209	(268,499)	(468,108)	(417,949)	429,787	(889,481)
Attributable to:								
Owners of the parent	228,476	(194,861)	676,071	(280,744)	(468,108)	(417,949)	436,439	(893,554)
Non-controlling interest	(6,790)	(8,172)	138	12,245	-	-	(6,652)	4,073

(1) The Company reclassified commission expenses from other expenses to cost of sales for the three months ended February 29, 2020. As a result, commission expenses in the amount of \$304,501 for the three months ended February 28, 2019 were also reclassified to cost of sales to conform to the current period presentation.

Segment information for the nine months ended February 29, 2020 and the comparative period are detailed in the table below.

	Thermal Energy Ottawa		Thermal Energy Bristol		Reconciling Items		Total	
	2020	2019	2020	2019	2020	2019	2020	2019
	\$	\$	\$	\$	\$	\$	\$	\$
Total revenue	12,308,440	12,047,096	6,317,071	3,061,614	-	-	18,625,511	15,108,710
Cost of sales ⁽¹⁾	(7,949,449)	(8,463,613)	(3,149,737)	(1,721,188)	-	-	(11,099,186)	(10,184,801)
Gross profit	4,358,991	3,583,483	3,167,334	1,340,426	-	-	7,526,325	4,923,909
Other expenses ⁽¹⁾	(2,524,945)	(2,542,772)	(2,410,896)	(2,446,997)	(1,283,764)	(1,109,771)	(6,219,605)	(6,099,540)
Net finance (costs) income	5,144	16,491	-	-	(307,453)	(199,607)	(302,309)	(183,116)
Income (loss) before taxation	1,839,190	1,057,202	756,438	(1,106,571)	(1,591,217)	(1,309,378)	1,004,411	(1,358,747)
Tax (expense) recovery	-	55,454	(10,661)	200,015	62,479	52,217	51,818	307,686
Net income (loss)	1,839,190	1,112,656	745,777	(906,556)	(1,528,738)	(1,257,161)	1,056,229	(1,051,061)
Attributable to:								
Owners of the parent	1,851,545	1,129,168	730,126	(926,723)	(1,528,738)	(1,257,161)	1,052,933	(1,054,716)
Non-controlling interest	(12,355)	(16,512)	15,651	20,167	-	-	3,296	3,655

(1) The Company reclassified commission expenses from other expenses to cost of sales for the nine months ended February 29, 2020. As a result, commission expenses in the amount of \$836,091 for the nine months ended February 28, 2019 were also reclassified to cost of sales to conform to the current period presentation.

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4. Segment reporting (continued):

Reconciling items comprise the following:

	Three months ended February 29 (28)		Nine months ended February 29 (28)	
	2020 \$	2019 \$	2020 \$	2019 \$
Corporate admin costs	161,425	173,102	500,076	547,497
Stock-based compensation	50,230	53,548	153,562	61,798
Professional fees	31,814	23,138	185,307	125,306
Depreciation of property, plant and equipment	29,341	21,735	78,944	60,871
Depreciation of right-of-use assets	33,462	-	92,519	-
Amortization of intangible assets	68,964	69,705	207,346	183,830
Acquisition costs	-	(19,791)	-	148,313
Foreign exchange differences	(4,361)	11,526	66,010	(17,844)
Total	370,875	332,963	1,283,764	1,109,771

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

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

5. Trade and other receivables:

	February 29, 2020	May 31, 2019
Trade receivables, gross	\$ 3,169,521	\$ 1,981,726
Allowance for doubtful accounts	(156,078)	(22,864)
Trade receivables, net	3,013,443	1,958,862
Unbilled revenue related to heat recovery solutions	572,678	267,699
Unbilled revenue related to product and services	22,169	119,830
Prepayments	132,705	298,746
Sales tax and other miscellaneous receivables	145,925	372,072
Balance, end of period	\$ 3,886,920	\$ 3,017,209

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

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5. Trade and other receivables (continued):

The change in allowance for doubtful accounts was as follows:

	February 29, 2020	May 31, 2019
Balance, beginning of period	\$ 22,864	\$ 23,074
Provisions	148,888	219,445
Amounts written off	(15,873)	(219,445)
Foreign exchange adjustments	199	(210)
Balance, end of period	\$ 156,078	\$ 22,864

The Company's trade and other receivables have been reviewed for indicators of impairment. At February 29, 2020, \$281,344 (8.9%) of the Company's trade receivables balance was over 90 days past due. \$123,310 of the past due balance was impaired at February 29, 2020. In addition, \$32,768 of trade receivables (including sales tax of \$4,268) that were not over 90 days past due on February 29, 2020 was also impaired (note 6). Total impaired balance was \$156,078 as at February 29, 2020. For the nine months ended February 29, 2020, total bad debt provision of \$130,133 (net of sales tax of \$18,755) was recognized under administration expense on the condensed consolidated interim statements of comprehensive income. \$125,241 (net of sales tax of \$18,755) of the total provision related to one customer (see note 6).

At May 31, 2019, \$123,223 (6.2%) of the Company's trade receivables balance was over 90 days past due. \$22,864 of the past due balance was impaired at May 31, 2019. For the nine months ended February 28, 2019, a provision of \$24,152 was made, but \$24,202 of the provision was subsequently released due to the collection on the doubtful account.

6. Finance lease receivable:

The Company's finance lease receivable includes the following:

	February 29, 2020	May 31, 2019
Total estimated minimum lease payments receivable	\$ 47,500	\$ 100,053
Less: unearned income	(1,652)	(6,796)
Less: write-down	(45,848)	-
	-	93,257
Less: current portion	-	(93,257)
	-	-

On December 16, 2019, Fortress Specialty Cellulose sought and obtained a First Day Initial Order under the Companies' Creditors Arrangement Act from the Quebec Superior Court. The Company's finance lease receivable was reviewed for indicators of impairment. For the nine months ended February 29, 2020, a write-down of \$45,848 was recognized on the remaining finance lease receivable under administrative expenses. A bad debt provision of \$125,241 net of \$18,755 sales tax was made on the Company's trade receivables from the customer, out of which \$28,500 was under 90 days (note 5).

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7. Property, plant and equipment:

	Plant and Equipment	Furniture and Fixtures	Laboratory Equipment	Computers	Leasehold Improve- ments	Motor Vehicles	Total
	\$	\$	\$	\$	\$	\$	\$
Cost, May 31, 2018	167,282	102,768	52,857	360,948	22,877	7,362	714,094
Additions	31,777	3,868	-	37,853	-	-	73,498
Additions from acquisition	192,770	-	-	-	-	4,643	197,413
Disposals	(7,923)	-	-	-	-	(7,456)	(15,379)
Translation adjustments	2,904	(35)	-	(675)	-	185	2,379
Cost, May 31, 2019	386,810	106,601	52,857	398,126	22,877	4,734	972,005
Additions	43,356	34,899	-	24,962	169,116	-	272,333
Disposals	(1,432)	-	-	-	-	-	(1,432)
Translation adjustments	(37)	48	-	834	-	(34)	811
Cost, February 29, 2020	428,697	141,548	52,857	423,922	191,993	4,700	1,243,717
Accumulated depreciation, May 31, 2018	115,747	102,768	52,857	336,931	22,877	5,519	636,699
Depreciation for the year	56,479	777	-	24,717	-	2,536	84,509
Disposals	(1,718)	-	-	-	-	(7,149)	(8,867)
Translation adjustments	39	(33)	-	(506)	-	(38)	(538)
Accumulated depreciation, May 31, 2019	170,547	103,512	52,857	361,142	22,877	868	711,803
Depreciation for the period	45,619	4,064	-	20,413	8,154	694	78,944
Disposals	(428)	-	-	-	-	-	(428)
Translation adjustments	1,017	42	-	728	-	5	1,792
Accumulated depreciation, February 29, 2020	216,755	107,618	52,857	382,283	31,031	1,567	792,111
Net book value, May 31, 2019	216,263	3,089	-	36,984	-	3,866	260,202
Net book value, February 29, 2020	211,942	33,930	-	41,639	160,962	3,133	451,606

During the nine months ended February 29, 2020, the Company disposed of a depreciated asset with a net book value of \$1,004 for \$nil in proceeds.

During the nine months ended February 28, 2019, the Company disposed of a depreciated asset with a net book value of \$6,205 for \$6,396 in proceeds.

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8. Right-of-use assets:

	Offices	Vehicles	Equipment	Total right-of-use assets
	\$	\$	\$	\$
Balance, May 31, 2019	-	-	-	-
Balance, June 1, 2019, on the adoption date of IFRS 16 (note 3(b))	123,114	90,666	18,000	231,780
Additions (note 12)	296,519	35,231	-	331,750
Lease modification	(15,258)	-	-	(15,258)
Depreciation	(65,344)	(21,915)	(5,260)	(92,519)
Translation adjustments	(154)	402	152	400
Balance, end of period	338,877	104,384	12,892	456,153

9. Trade payables and accrued liabilities:

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

	February 29, 2020	May 31, 2019
Trade payables	\$ 1,928,337	\$ 914,497
Accruals	1,327,839	1,387,381
Other government remittances payable	544,383	247,692
	\$ 3,800,559	\$ 2,549,570

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

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

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10. Long-term debt:

	February 29, 2020	May 31, 2019
Term loan, net of deferred financing costs of \$33,050 (\$37,715 as at May 31, 2019), bearing interest at US dollar floating base rate plus a variance of 8.00%, repayable in monthly principal instalments of USD\$25,000 starting July 1, 2019 and continuing up to the maturity date, with a balloon payment of USD\$475,000 payable on the maturity date, June 1, 2025*	\$ 2,719,895	\$ 3,005,860
Less: current portion	(396,650)	(371,993)
Long term portion	2,323,245	2,633,867

*The maturity date was subsequently extended to December 1, 2025. See note 19 for more details.

This loan bears interest at the institution's US dollar floating base rate plus a variance. The US dollar floating base rate was 6.05% on February 29, 2020 (7.00% on May 31, 2019). The variance is reset annually based on the Company's consolidated total funded debt to EBITDA ratio. As at February 29, 2020, the variance was at 8.00% (1.50% at May 31, 2019). Interest is payable monthly in arrears on the 1st day of the month.

The Company has certain covenants in accordance with this term loan. As at February 29, 2020, the Company was in compliance with its covenants under the term loan agreement.

11. Deferred revenue:

	Deferred revenue related to heat recovery solutions	Deferred revenue related to GEM™ product and services	Total deferred revenue
Balance, beginning of period	\$ 2,530,047	\$ 74,543	\$ 2,604,590
Increase from payments received	12,610,351	73,819	12,684,170
Decrease from revenue recognized	(14,054,951)	(39,897)	(14,094,848)
Translation adjustments	46,781	1,673	48,454
Balance, end of period	\$ 1,132,228	\$ 110,138	\$ 1,242,366

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

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12. Lease obligations:

The following table presents the contractual undiscounted cash flows for lease obligations as of February 29, 2020:

Less than one year	\$ 159,176
One to five years	304,289
Six to ten years	301,125
Total undiscounted lease obligations	\$ 764,590

For the nine months ended February 29, 2020, interest expense on lease obligations was \$23,980; total cash outflow for leases was \$183,482, including \$91,090 for short-term leases. Expenses for leases of low-dollar value items are not material. Extension options are included in the measurement of lease obligations when the Company is reasonably certain to exercise that option.

The Company entered a 10-year lease for an office space before May 31, 2019. The lease was included in the lease commitment note in the consolidated financial statements at May 31, 2019 in the amount of \$1,074,642 (note 3(b)), which included variable lease payments of \$579,642. On September 1, 2019, the lease commencement date, the Company recognized the lease obligation and the right-of-use asset of \$296,519 for this lease (note 8) under IFRS 16. Variable lease payments were not included in the measurement of the lease obligation.

13. Share based compensation:

Activity in stock options was as follows:

	Three months ended February 29, 2020		Three months ended February 28, 2019	
	# Options	Weighted Average Exercise Price \$	# Options	Weighted Average Exercise Price \$
Outstanding, beginning of period	18,344,193	0.08	16,936,303	0.08
Expired	(250,000)	0.08	-	-
Forfeited	(111,667)	0.08	(93,750)	0.07
Outstanding, end of period	17,982,526	0.07	16,842,553	0.08
Options exercisable, end of period	8,892,526	0.07	8,246,720	0.08

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13. Share based compensation (continued):

	Nine months ended February 29, 2020		Nine months ended February 28, 2019	
	# Options	Weighted Average Exercise Price \$	# Options	Weighted Average Exercise Price \$
Outstanding, beginning of period	14,259,193	0.07	20,495,531	0.08
Granted	4,085,000	0.08	7,650,000	0.08
Exercised	-	-	(2,796,667)	0.05
Expired	(250,000)	0.08	(6,995,311)	0.10
Forfeited	(111,667)	0.08	(1,511,000)	0.08
Outstanding, end of period	17,982,526	0.07	16,842,553	0.08
Options exercisable, end of period	8,892,526	0.07	8,246,720	0.08

The following tables summarize information about stock options outstanding at February 29, 2020:

Range of exercise prices	Options outstanding			Options exercisable	
	Number outstanding February 29, 2020	Weighted average remaining contractual life	Weighted average exercise price	Number exercisable at February 29, 2020	Weighted average exercise price
0.05-0.07	2,770,833	1.25	0.05	2,770,833	0.05
0.08-0.10	14,961,693	3.25	0.08	5,871,693	0.08
0.11-0.12	250,000	1.75	0.12	250,000	0.12
	17,982,526	2.92	0.07	8,892,526	0.07

The fair value of services received in return for share options granted is based on the fair value of share options granted, measured using the Black-Scholes model.

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13. Share based compensation (continued):

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

	29-Nov-19
Grant date share price (\$) ⁽¹⁾	0.08
Exercise price (\$)	0.08
Expected volatility (%) ⁽²⁾	84.01
Expected life (years)	4.00
Expected dividend yield (%)	0.00
Risk-free interest rate (%)	1.49
Forfeiture rate (%)	11.00

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

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

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 29, 2020	Three months ended February 28, 2019
Administration	\$ 40,339	\$ 43,091
Selling, marketing and business development	9,891	10,457
	\$ 50,230	\$ 53,548

	Nine months ended February 29, 2020	Nine months ended February 28, 2019
Administration	\$ 124,425	\$ 49,671
Selling, marketing and business development	29,137	12,127
	\$ 153,562	\$ 61,798

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14. Revenue:

	Three months ended February 29, 2020	Three months ended February 28, 2019
Sale of goods	\$ 1,329,513	\$ 870,366
Rendering of services	493,455	342,440
Contracts for heat recovery solutions	3,988,658	1,901,951
	\$ 5,811,626	\$ 3,114,757

	Nine months ended February 29, 2020	Nine months ended February 28, 2019
Sale of goods	\$ 3,259,863	\$ 2,401,782
Rendering of services	1,296,160	1,430,643
Contracts for heat recovery solutions	14,069,488	11,276,285
	\$ 18,625,511	\$ 15,108,710

15. Financial instruments:

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

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

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

	Level 1	Level 2	Level 3
As at February 29, 2020:			
Contingent payable	\$ -	\$ -	\$ 123,370
As at May 31, 2019:			
Contingent payable	\$ -	\$ -	\$ 110,148

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

There were no transfers of fair value measurement between level 1, 2 and 3 of the fair value hierarchy in the nine months ended February 29, 2020 or February 28, 2019.

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15. Financial instruments (continued):

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

Contingent payable	
Balance, beginning of period	\$ 110,148
Charges through profit or loss under finance costs	13,786
Foreign exchange	(564)
Balance, end of period	123,370
Classified as current liability	-
Classified as non-current liability	\$ 123,370

Estimates of the fair value of contingent payable is performed by the Company on a quarterly basis. Key unobservable inputs include revenue growth rates and discount rate applied (16%). The estimated fair value increases as the annual revenue growth rate increases and decreases as the discount rate increases, and vice versa.

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

The carrying value of cash and cash equivalents, trade and other receivables, finance lease receivable, trade payables and accrued liabilities approximate their fair values due to their short-term to maturity. Lease obligations and long-term debt are subject to incremental borrowing rate and market interest rate, respectively.

16. Capital stock:

Authorized:

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

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

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16. Capital stock (continued):

Outstanding:

	Nine months ended February 29, 2020		Year ended May 31, 2019	
	# Shares	\$	# Shares	\$
Class A Common shares issued				
Balance, beginning of period	161,885,616	32,464,780	159,088,950	32,231,329
Stock options exercised ⁽¹⁾	-	-	2,796,666	233,451
Shares purchased and cancelled ⁽²⁾	(1,283,000)	(257,294)	-	-
Balance, end of period	160,602,616	32,207,486	161,885,616	32,464,780

(1) For the nine months ended February 28, 2019, 2,796,666 shares were issued for \$141,958 following the exercise of stock options, resulting in an increase to capital stock of \$233,451 and a reduction in contributed surplus of \$91,493.

(2) For the nine months ended February 29, 2020, 1,283,000 shares were purchased for cancellation by the Company for a total purchase price of \$95,186, resulting in a reduction to capital stock of \$257,294 and an increase in contributed surplus of \$162,108.

Normal Course Issuer Bid:

On November 19, 2019, the Company announced its intent to re-launch the Normal Course Issuer Bid ("NCIB") for a further period of twelve months. The NCIB was approved by the TSX Venture Exchange on November 18, 2019. During the 12-month period commencing November 22, 2019 and ending November 21, 2020, the Company may purchase on the TSX up to 8,094,280 common shares, representing approximately 5% of the then issued and outstanding common shares. The actual number of common shares purchased, if any, and the timing of such purchases will be determined by the Company by considering market conditions, share prices, its cash position, and other factors. All of the purchased Class A common shares were purchased and cancelled directly under the NCIB for the nine months ended February 29, 2020.

17. 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.

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17. Related party transactions (continued):

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 29, 2020	Three months ended February 28, 2019
Salaries and other short-term employee benefits	\$ 216,638	\$ 216,663
Share-based payments	18,720	29,032
	\$ 235,358	\$ 245,695

	Nine months ended February 29, 2020	Nine months ended February 28, 2019
Salaries and other short-term employee benefits	\$ 638,514	\$ 665,936
Share-based payments	68,472	32,184
	\$ 706,986	\$ 698,120

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.

18. Comparative information:

Certain figures and information from prior period have been adjusted to conform to the current period presentation.

19. Subsequent events:

On March 19, 2020, the lender agreed to postpone the next 3 payments of principal to the end of the payment schedule. On May 13, 2020, the lender agreed to further postpone another 3 payments to the end of the payment schedule. Consequently, the maturity date of the loan was extended by 6 months from June 1, 2025 to December 1, 2025.

On May 11 and 12, 2020, the Company obtained financing in the total amount of \$296,951 (equivalent to USD\$221,127) under the Paycheck Protection Program pursuant to the CARES Act in U.S. The loans bear interest at 1% per annum and are repayable over the next 2 years.