SECOND QUARTER REPORT
Period ended November 30, 2011

MANAGEMENT'S DISCUSSION & ANALYSIS

This discussion is dated as of January 30, 2012 and explains the material changes in Thermal Energy International Inc.'s ("Thermal Energy" or the "Company") financial condition and results of operations for the second quarter of Fiscal Year 2012, ended November 30, 2011. The condensed consolidated interim financial statements and accompanying notes constitute an integral part of the discussion and should be read in conjunction with these comments. The condensed consolidated interim financial statements are prepared in accordance with International Financial Reporting Standards ("IFRS") and comparative periods have been restated in accordance with IFRS, where applicable. During the period ended November 30, 2011, the Company's critical accounting estimates, significant accounting policies and risk factors have remained substantially unchanged. Unless otherwise indicated, all amounts presented in this discussion are in Canadian dollars. This discussion and analysis of the financial condition and results of operations may contain forward-looking statements. These statements are not guarantees of future performance and are subject to risks and uncertainties that could cause actual results to differ materially from those in the forward-looking statements. Additional information relating to the Company is available on SEDAR at www.sedar.com.

Description of Business

Thermal Energy is an innovative cleantech company providing a variety of proprietary and proven energy and water efficiency, emission reduction, and bioenergy products and solutions to the industrial, commercial and institutional markets worldwide. Thermal Energy is also a fully accredited professional engineering firm, and can offer advanced process and applications engineering services. By providing a unique mix of proprietary products together with process, energy, environmental, and financial expertise Thermal Energy is able to deliver significant financial and environmental benefits to our customers.

Thermal Energy's products include; **GEM®** - Steam traps and condensate return systems, **FLU-ACE®** - Direct contact condensing heat recovery, and **Dry Rex™** - Low temperature biomass drying systems. These award winning products are effective in a wide range of industries and applications and have an excellent track record of longevity, proven reliability and performance providing significant energy savings, reduced GHG emissions, improved water efficiency, lower maintenance costs, improved product quality and increased production efficiency.

Thermal Energy International Inc. is headquartered in Ottawa, Canada, with offices in the UK and China. More information on Thermal Energy can be found at www.thermalenergy.com. GEM®, FLU-ACE®, THERMALONOx™, and DRY-REX™ are trademarks of Thermal Energy.

Discussion of Operations and Financial Conditions

Revenues and Gross Profits

Revenues were $4,676,322 in the quarter ended November 30, 2011, an increase of 59% compared to $2,938,131 in the quarter ended November 30, 2010. Sales of GEM® Condensate return systems decreased by $285,322 (27.2%) over the same period in the previous year, while sales of heat recovery systems increased by $2,023,513 (107.0%).

The decrease in GEM® Condensate return systems sales almost entirely resulted from reduced sales to a major pharmaceutical company in the quarter ended November 30, 2011 of $3,193, compared to $306,892 in the quarter ended November 30, 2010.

Heat recovery systems revenue of $1,890,302 in the quarter ended November 30, 2010 included $1,614,754 relating to the Kruger Products project announced December 23, 2009. This was replaced in the quarter ended November 30, 2011 by $1,880,809 from the $5.8 million contract with Fibrek, announced June 16, 2011. In addition, the quarter ended November 30, 2011 included $1,607,234 relating to St. Georges Healthcare NHS Trust in the U.K. announced August 5, 2011.

For the six months ended November 30, 2011, revenues were $6,108,008 compared to $5,923,798 for the same period of the previous year. Revenues from the sale of heat recovery systems increased to $4,431,836 from $4,091,062 in the previous period, due to the progress of the two projects mentioned above compared to just one in the prior year, while GEM® Condensate return systems sales decreased to $1,676,172 from $1,832,736, due mainly to the decrease in orders from the major pharmaceutical company.

The gross profit of $2,123,687 in the quarter ended November 30, 2011 represented an increase of $847,843, or 66.5%, on the $1,275,844 achieved in the quarter ended November 30, 2010. These results expressed as a percentage of sales were 45.4% in the second quarter of FY 2012 compared with 43.4% in the second quarter of FY 2011.

For the six months ended November 30, 2011, gross profit of $2,926,699 represented an increase of $447,195, or 18.0%, on the $2,479,504 achieved in the six months ended November 30, 2010. These results expressed as a percentage of sales were 47.9% in the first half of FY 2012 compared with 41.9% in the first half of FY 2011.

Expenses

The consolidated financial statements and notes to the consolidated financial statements which constitute an integral part of this discussion have been prepared in accordance with IFRS. IFRS requires the presentation of expenses in the statement of operations either by nature of expense or by function. This differs from the Company's previously reported statements in accordance with Canadian GAAP, which allowed a combination of both. It was determined that expenses should be disclosed by function within the condensed consolidated statement of operations, with further analysis being provided within this discussion.

Administration and Selling, Marketing and Business Development expenses in the quarter ended November 30, 2011 totalled $1,525,852 compared with $1,308,217 in the quarter ended November 30, 2010.

Within these costs for the quarter ended November 30, 2011 was a write down of the finance lease receivable, which was the result of a re-assessment of the finance lease receivable following a shutdown period of 45 days. The customer took advantage of a clause within the agreement allowing for shutdowns throughout the term of the contract totalling a maximum of 45 days without penalty. The effect of this shutdown during the winter period was to decrease the value of the finance lease receivable by approximately $92,539. This write off was partially offset by an increase of $37,781 due to the lease commencing one month earlier than originally anticipated. No adjustment was made in earlier statements due to the materiality of the increase combined with uncertainty over any potential shutdown. The net effect of correcting the finance lease receivable is $54,758 for the quarter ended and six months ended November 30, 2011. There were no such adjustments made during the quarter ended November 2010.

Other increases within general administration, selling, marketing and business development costs for the quarter ended November 30, 2011 over the same period of the previous year include additional commission payable on the increased revenues, increased incentive provision on the increased profit, salaries for two additional heat recovery and one additional GEM sales staff, one additional finance staff and a marketing and sales co-ordinator, recruitment costs relating to the staff additions and increased training costs relating to distributorships in the U.S.

For the six months ended November 2011, Administration and Selling, Marketing and Business Development expenses totalled $2,676,005, compared to $2,581,610 for the six months ended November 30, 2010, an increase of $94,395. In addition to the increases described above, other material variances on the year to date costs over the previous year to date include a reduction in legal fees of $49,792, mainly due to fees paid in the first quarter of FY 2010 relating to the TSX Venture Exchange review.

Research and development costs of $6,924 in the second quarter of FY 2012 compared to $nil in the second quarter of FY 2011. Year to date research and development costs totaled $7,044 for the six months ended November 30, 2011 and $1,913 for the six months ended November 2010. Current focus continues to be on increasing revenues from existing product lines, rather than developing new products.

Finance revenue in the second quarter of FY 2012 of $31,501 compared to $26,341 recognized in the second quarter of FY 2011.

For the six months ended November 30, 2011, finance revenue was $62,580, compared with $77,256 for the six months ended November 2010. The interest rate implicit in the lease of 14% is applied against the reducing finance lease receivable balance, hence lower finance revenues as the term of the agreement progresses.

Income before income taxes for the quarter ended November 30, 2011 was $622,412 compared to a loss of $6,032 in the same quarter of the previous year. The main reason behind the improved results in the current quarter was the increase in revenues in the heat recovery segment.

For the six months ended November 30, 2011, income before income taxes was $306,230, compared with a loss of $26,763 for the six months ended November 30, 2010.

Income taxes in the second quarter of FY 2012 were $163,957, compared to a credit of $2,480 as reported in the second quarter of FY 2011. A charge of $171,411 in respect of taxes payable in the United Kingdom by the Company's wholly owned subsidiary Gardner Energy Management Ltd was offset by a credit of $7,454 reflecting the reduction in the future tax liability related to intangible assets in the quarter ended November 30, 2011. The UK tax charge was the result of progress made on the heat recovery project at St. George Healthcare NHS Trust.

For the six months ended November 30, 2011, income taxes were $163,304, compared with $5,880 for the same period of the previous year.

Net income for second quarter of FY 2012 was $458,455 compared to a loss of $3,552 in the same quarter of the previous year. The main reason behind the improved results for the current quarter was the increase in revenue in the heat recovery segment from the St George and Fibrek projects, compared with Kruger alone in the previous year.

Net income for the six months ended November 30, 2011 was $142,926 compared to a loss of $32,643 for the six months ended November 30, 2010.

Comprehensive income was $487,671 for the second quarter of FY 2012 compared to a comprehensive loss of $21,888 for the second quarter of FY 2011.

For the six months ended November 30, 2011, comprehensive income was $167,705, compared with $7,000 for the same period of the previous year.

Liquidity & Capital Resources

The working capital was $2,302,350 at November 30, 2011 compared to working capital of $1,870,934 at May 31, 2011 – an increase of $431,416, with the Company's net cash position (Cash and cash equivalents less Bank loans) increasing by $353,532 from $972,163 at May 31, 2011 to $1,325,695 as at November 30, 2011.

Cash flow from operations (defined as net income (loss), plus items not involving cash, plus lease payments received) for the quarter ended November 30, 2011 was $609,587 and for the six months ended November 30, 2011 was $450,599.

The Company's working capital position since the start of the previous fiscal year can be summarized as follows:

	May 31, 2010 $	Aug 31, 2010 $	Nov 30, 2010 $	Feb 28, 2011 $	May 31, 2011 $	Aug 31, 2011 $	Nov 30, 2011 $
Current Assets	3,281,721	3,491,058	3,955,487	3,717,578	3,898,346	4,371,855	5,813,077
Current Liabilities	2,132,235	2,092,165	2,344,370	1,943,063	2,027,408	2,705,623	3,510,727
Working Capital	1,149,486	1,398,893	1,611,117	1,774,515	1,870,938	1,666,232	2,302,350

Current assets increased by $1,441,222 over the second quarter of FY 2012 to $5,813,077. This was mainly due to an increase in cash of $500,730 and an increase in trade and other receivables of $901,673, due predominantly to a November invoice raised regarding the St George heat recovery project. Current liabilities meanwhile increased by $805,104 to $3,510,727. Accounts payable increased by $1,190,178, of which $956,026 related to equipment purchases for the Fibrek project, accruals increased by $115,542, mainly due to sales taxes payable on the heat recovery invoices plus the incentive provision to date, while deferred revenue decreased by $500,616 due to the recognition of revenue in the second quarter relating to invoices raised in the first quarter to Fibrek.

After adjusting cash flow from operations for the quarter ended November 30, 2011 of$609,587 for $111,451 of negative changes in non-cash working capital items; and deducting $2,382 to acquire fixed assets, and adding $4,976 to allow for the effect of exchange rate fluctuations on cash and cash equivalents, the net cash flow was $500,730, increasing the net cash balance as at November 30, 2011 to $1,325,695 from $824,965 as at August 31, 2011.

In addition to its net cash balance of $1,325,695 as at November 30, 2011 the Company also had an estimated $123,000 of unused borrowing capacity under its bank loans.

With cash balances and unused borrowing capacity of approximately $1,448,695, management believes that it has sufficient capital resources to fund existing operations and anticipated capital requirements in the remainder of FY 2012. Order backlog as at November 30, 2011 was approximately $4.8 million compared to $822 thousand at the same time last year. As at January 30, 2012 the Company had approximately $6.2 million in purchase orders that had not yet been reflected as revenue in the Company's published quarterly financial statements.

Finance Lease Receivable

The Company's finance lease receivable includes the following:

	Nov 30, 2011 $	May 31, 2011 $
Total estimated minimum lease payments receivable	961,706	1,215,814
Less: unearned income	(58,660)	(94,484)
	903,046	1,121,330
Less: current portion	(691,250)	(653,807)
	211,796	467,523

The previous lease for this facility, entered into in August 2007 for a period of six years, was suspended in 2009 following the bankruptcy of the customer and the lease was renegotiated with the new owners of the facility, Fortress Paper Ltd. As at the suspension date, the finance lease receivable was included in the financial statements of the Company at $1,886,721.

The new lease was signed on June 29, 2010 with an effective date of May 1, 2010. Based on estimated minimum lease payments expected over the thirty month term of the agreement, the revised finance lease receivable was calculated at $1,693,341, resulting in a write down of $193,380 in the financial statements for the year ended May 31, 2010. In connection with the renegotiation of the agreement, an additional net charge to earnings of $97,638 was recorded in the year ended May 31, 2010 as a result of the bankruptcy of the previous customer.

The estimated minimum lease payments receivable in this new 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. The lease expires December 31, 2012, at which time the customer has the option to purchase the asset for $1,000,000 or extend the lease term for a further 24 months with a 15% reduction in the purchase price of the asset to $850,000 at the end of the extended term.

In the quarter ended November 30, 2011, the customer took advantage of a clause within the agreement allowing for a shutdown of a maximum of 45 days without penalty. The effect of this shutdown during the winter period was to decrease the value of the finance lease receivable by approximately $92,539. This write off was partially offset by an increase of $37,781 due to the lease commencing one month earlier than originally anticipated. No adjustment was made in earlier statements due to the materiality of the increase combined with uncertainty over any potential shutdown. The net result of these two issues was a write-down in the finance lease receivable at the end of November 2011 of $54,758. There are no further allowances available within the lease agreement for shutdowns without penalty.

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:

	$
FY 2012	430,925
FY 2013	391,251
	822,176
Residual value of equipment	139,530
	961,706

The estimated residual value of the equipment at the end of the new lease has been determined by assigning depreciation rates to various pieces of the equipment in order to derive a reasonable expected selling price or re-use value for the equipment upon the termination of the agreement. The residual value of the equipment is not guaranteed.

Dry-Rex™ Agreement

During the quarter ended November 30, 2011, the Company amended and extended its licensing and patent purchase agreement with Mabarex Inc. related to the Dry-Rex™ technology. In exchange for minimum annual royalty payments of $5,000 the agreement provides the Company with a sole and exclusive worldwide license to the Dry-Rex™ technology. The agreement also provides the Company the option to purchase the Dry-Rex™ technology at any time during the term of the agreement.

Related Party Transactions

Options outstanding for Directors (excluding the CEO) as at November 30, 2011 were 500,000 of which none were exercisable. There were no warrants outstanding for Directors.

Options outstanding for Officers (including the CEO) as at November 30, 2011 were 2,850,000 of which 1,283,333 were exercisable. There were no warrants outstanding for Officers.

Loans outstanding to shareholders, including accrued interest, to enable the exercise of options and purchase of shares at November 30, 2011 totalled $nil ($122,275 at May 31, 2011).

Officer and Director Compensation

During the second quarter ended November 30, 2011 compensation arrangements for directors was as follows:

$20,000 per annum per Director plus an additional $12,000 per annum payable to the Chairman of the Board, $8,000 per annum payable to individual committee chairpersons of the Audit

Committee and the Ethics, Governance and Compliance Committee, and $1,000 payable for each in-person meeting.

During the second quarter ended November 30, 2011, Directors fees paid were $22,083. Fees to the Chairperson of the Audit Committee were $2,000; fees to the Chairperson of the Ethics, Governance and Compliance Committee were $2,000; fees paid to the Chairman were $3,000; and a total of $9,000 was paid for in-person meetings.

Compensation paid to directors and officers during the second quarter ended November 30, 2011 (inclusive of the amounts described above) was as follows:

	Salaries and fees		**Commissions / incentives**		**Total**	
	2011 $	2010 $	**2011 $**	2010 $	**2011 $**	2010 $
Directors						
M. Williams	**9,000**	9,000	**-**	-	**9,000**	9,000
J. Ansell	**9,000**	9,000	**-**	-	**9,000**	9,000
J. Kelly	**10,000**	10,000	**-**	-	**10,000**	10,000
D. Gibbs	**7,000**	-	**-**	-	**7,000**	-
W. Ollerhead	**3,083**	-	**-**	-	**3,083**	-
Total	**38,083**	28,000	**-**	-	**38,083**	28,000
Officers						
W. Crossland	**60,000**	60,000	**-**	-	**60,000**	60,000
J. Flynn	**31,259**	30,000	**-**	-	**31,259**	30,000
R. Triebe	**33,750**	33,750	**-**	-	**33,750**	33,750
Total	**125,009**	123,750	**-**	-	**125,009**	123,750

Chinese Joint Venture

In 2007, the Company entered into a joint venture agreement with two partners under the laws of the Peoples Republic of China to establish a new company with the name of Thermal Energy International (Guangzhou) Ltd ("TEIG"). The Company owned a 55% interest of the joint venture, a Chinese based operating partner owned 40% and a Chinese consultant that assisted with the Company's activities in China owned 5%. The joint venture was set up to market, sell and install Thermal Energy International Inc.'s suite of products in China. The start-up capital required was $200,000 CDN and each partner contributed their respective share during the year ended May 31, 2009.

Initially, the management of TEIG was conducted by the Chinese based operating partner, with minimum input from the Company who had one board member out of a total of three. As a result, the financial results of TEIG were included in the consolidated financial statements of the Company on a proportionate share basis. That is, 55% of the operating results plus 55% of all assets and liabilities of the TEIG were included on a line by line basis in the consolidated financial statements of the Company. On September 6, 2010 however, the Chinese based operating partner resigned from management of the joint venture and as a board member and Thermal Energy added a board member. The retiring Director agreed to hand over the company seals and bank control to Thermal Energy. Thermal Energy International Inc assumed management control of TEIG. It was consequently determined that, from Q2 2011 onwards, the results of TEIG should be included in the group financial statements on a consolidated basis, i.e. 100% of the operating results plus 100% of all assets and liabilities of the joint venture to be included on a line by line basis in the consolidated financial statements of the Company with the 45% minority interest recorded accordingly.

The reported consolidated financial statements of the Company for the year ended May 31, 2011 therefore included the first quarter ended November 30, 2010 on a proportionate basis with the quarters ended November 30, 2010, February 28, 2011 and May 31, 2011 being included on a full consolidation basis.

There are no significant differences in the accounting policies of the Chinese entity and the Company.

The results of the joint venture for the first quarter of FY 2011, as included in the consolidated financial statements of Thermal Energy International Inc. were as follows:

	Quarter ended Aug 31, 2010 $
Current Assets	**122,235**
Current Liabilities	**109,056**
Sales	**1,419**
Cost of sales	**(2,705)**
Other expenses	**(19,112)**
Net profit (loss)	**(20,398)**
Cash flows provided (used in) operating activities	**1,272**
Cash flows used in investing activities	

The above figures represent the Company's 55% share in the joint venture.
The results of the Chinese entity for the remaining three quarters of FY 2011 were fully consolidated within the financial statements of Thermal Energy International Inc. The impact of the change to full consolidation from the second quarter of FY 2011 onwards for the year ended May 31, 2011 was as follows:

	Proportionate consolidation @ 55% $	**As reported $**	Difference $
Total Assets	**39,848**	**72,450**	32,602
Current Liabilities	**(2,502)**	**(4,548)**	(2,046)
Non-controlling interest	**-**	**(30,556)**	(30,556)
Net difference to balance sheet			-
Sales	**19,857**	**34,922**	15,065
Cost of sales	**(13,137)**	**(21,633)**	(8,496)
Other expenses	**(2,916)**	**9,441**	12,357
Non-controlling interest		**(18,926)**	(18,926)
Net profit (loss)	**3,804**	**3,804**	**-**

Sales in China through TEI (Guangzhou) Ltd came to a virtual halt during the last three quarters of FY 2011, pending resolution of management and staffing changes. Expenses incurred are related to the maintenance of the office plus technical and administrative staff. Management has now established a stable team to recommence the distribution of the Company's range of products in China. There was no revenue from the Chinese operation in either the first or second quarters of FY 2012, with expenses relating to office rental and three employees of $22,646 in the quarter ended August 31, 2011 and a net loss in the quarter ended November 2011 of $7,402, representing costs of $10,728 less the recovery of a previously written off bad debt of $3,326.

Segmented Information

In the quarters and six month periods ended November 30, 2011 and 2010, the Company operated in the energy conservation industry in North America, Europe, China and Rest of the World. Within this business segment, the Corporation markets, sells, engineers, fabricates, constructs, installs and supports three technology lines – heat recovery solutions, condensate return system solutions and low temperature biomass drying systems. Assets are located in Canada, Europe and China.

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

Segment information for the quarter ended November 30, 2011 and the comparative period are detailed in the table below.

	North America and China		**Europe and Rest of World**		**Reconciling items**		**Total**	
	2011	2010	**2011**	2010	**2011**	2010	**2011**	2010
	$	$	**$**	$	**$**	$	**$**	$
Total revenue	**2,190,922**	2,029,795	**2,485,400**	908,336			**4,676,322**	2,938,131
Cost of sales	**1,532,828**	1,363,558	**1,019,807**	298,729	**-**	-	**2,552,635**	1,662,287
Gross profit	**658,094**	666,237	**1,465,593**	609,607	**-**	-	**2,123,687**	1,275,844
Amortization of intangible assets			**25,008**	31,500			**25,008**	31,500
Other expenses	**447,435**	348,310	**661,365**	528,961	**398,968**	399,446	**1,507,768**	1,276,717
Finance revenue	**31,501**	26,341					**31,501**	26,341
Profit (loss) before taxation	**242,160**	344,268	**779,220**	49,146	**(398,968)**	(399,446)	**622,412**	(6,032)
Taxation	**-**	-	**(192,999)**	(9,723)	**29,042**	12,203	**163,957**	2,480
Profit (loss) after taxation	**242,160**	344,268	**586,221**	39,423	**(369,926)**	(387,243)	**458,455**	(3552)
Attributable to:								
Owners of the parent	**245,491**	346,285	**584,214**	37,772	**(369,926)**	(387,243)	**459,779**	(3,186)
Non-controlling interests	**(3,331)**	(2,017)	**2,007**	1,651	**-**	-	**(1,324)**	(366)

Segment information for six months ended November 30, 2011 and the comparative period are detailed in the table below.

	North America and China		**Europe and Rest of World**		**Reconciling items**		**Total**	
	2011	2010	**2011**	2010	**2011**	2010	**2011**	2010
	$	$	**$**	$	**$**	$	**$**	$
Total revenue	**2,491,776**	3,999,063	**3,616,232**	1,924,735			**6,108,008**	5,923,798
Cost of sales	**1,675,724**	2,794,479	**1,505,585**	649,815	**-**	-	**3,181,309**	3,444,294
Gross profit	**816,052**	1,204,584	**2,110,647**	1,274,920	**-**	-	**2,926,699**	2,479,504
Amortization of			**49,631**	68,042			**49,631**	68,042

intangible assets								
Other expenses	**838,422**	760,972	**1,155,821**	1,036,759	**639,175**	717,750	**2,633,418**	2,515,481
Finance revenue	**62,580**	77,256					**62,580**	77,256
Profit (loss) before taxation	**40,210**	520,868	**905,195**	170,119	**(639,175)**	(717,750)	**306,230**	(26,763)
Taxation	**-**	-	**(212,480)**	(38,860)	**49,176**	32,980	**(163,304)**	(5,880)
Profit (loss) after taxation	**40,210**	520,869	**692,715**	131,259	**(589,999)**	(684,770)	**142,926**	(32,643)
Attributable to:								
Owners of the parent	**53,732**	522,885	**687,550**	123,939	**(589,999)**	(684,770)	**151,283**	(37,946)
Non-controlling interests	**(13,522)**	(2,017)	**5,165**	7,320	**-**	-	**(8,357)**	5,303

During the quarter ended November 30, 2011 the company had one customer in North America and China that accounted for 40%, and one customer in Europe and rest of world that accounted for 34% of total revenue for the period.

For the quarter ended November 30, 2010 the company had one customer that accounted for 55% of total revenue for the period. This customer was based in the North America and China geographical segment.

During the six months ended November 30, 2011 the company had one customer in North America and China that accounted for 32%, and one customer in in Europe and rest of world that accounted for 26% of total revenue for the period.

During the six months ended November 30, 2010 the company had one customer that accounted for 58% of total revenue for the period, based in the North America and China geographical segment.

Further geographical analysis:

	Revenues for the 6 months ended Nov 30		Property, plant and equipment		Goodwill and intangibles		Sales-type lease	
	2011	2010	**Nov 30, 2011**	May 31, 2011	**Nov 30, 2011**	May 31, 2011	**Nov 30, 2011**	May 31, 2011
	$	$	**$**	$	**$**	$	**$**	$
Canada	**2,120,674**	3,631,140	**31,749**	20,115	**-**	-	**903,046**	1,121,330
U.S.A.	**345,011**	261,248	**-**	-	**-**	-	**-**	-
U.K.	**3,160,487**	1,195,888	**47,.882**	51,824	**4,227,004**	4,258,567	**-**	-
Italy	**213,965**	164,923	**-**	-	**-**	-	**-**	-
Germany	**27,811**	97,835	**-**	-	**-**	-	**-**	-
Rest of Europe	**127,443**	237,114	**-**	-	**-**	-	**-**	-
China	**26,091**	106,677	**2,055**	2,588	**-**	-	**-**	-
Malaysia	**4,484**	72,952	**-**	-	**-**	-	**-**	-
Singapore	**54,996**	5,496	**-**	-	**-**	-	**-**	-
Rest of world	**27,046**	150,525	**-**	-	**-**	-	**-**	-
Total	**6,108,008**	5,923,798	**81,686**	74,527	**4,227,004**	4,258,567	**903,046**	1,121,330

Supplementary financial information

Quarterly financial information (unaudited)
For the eight quarters ended November 30, 2011

	2010		2011				2012	
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Sales	1,306,548	1,636,644	2,985,667	2,938,131	1,863,635	1,913,163	1,431,686	4,676,322
Net profit (loss)	(646,842)	(843,849)	(34,760)	(3,186)	(53,842)	(50,794)	(308,496)	459,779
Net profit (loss) per share basic and diluted	(0.004)	(0.005)	(0.000)	(0.000)	(0.000)	(0.000)	(0.002)	0.003

Material Segmentation Variances

Revenue

Revenue within North America and China increased by $161,127 in the quarter ended November 30, 2011 over the same quarter of the previous year. The quarter ended November 30, 2011 included revenue from the Fibrek project of $1,880,809, whereas the quarter ended November 30, 2010 included Kruger revenue of $1,614,754.

Europe and rest of world revenue increased by $1,577,064 in the quarter ended November 30, 2011 over the same quarter of the previous year. This increase was the result of revenue from the previously announced St George Healthcare NHS trust in the U.K.

Geographical segment profit (loss) before tax:

North America and China realized a pre-tax income of $242,160 in the second quarter of FY 2012, compared with a profit of $344,268 in the same period of the preceding year. Although revenues increased, the gross profit fell marginally due to the revenue increase coming from heat recovery sales and a decrease in GEM sales, which attract a higher margin. Costs in the second quarter of the current year increased over the same period of the previous year by $99,125, mainly due to the write down of the finance lease receivable, plus additional staff costs.

Europe and rest of the world income before tax increased by $730,074 in the quarter ended November 30, 2011 from the same period of the previous year. A drop in revenue from sales of the GEM product was made up for by increased heat recovery sales, due to revenues from the St George Healthcare NHS Trust project in the U.K. Other expenses increased by $132,404 over the same period in FY 2011, mainly due to additional commissions payable on the increased sales, advertising costs, plus the addition of one new admin and one new sales staff. There were no other significant changes.

Trend Analysis:

Q3 Fiscal Year 2010 saw a decrease in net loss over the previous quarter of $646,842. Despite the revenue matching that of Q1 2010, the loss was higher due to a higher percentage of the revenue in Q3 being generated from heat recovery systems, hence a lower gross margin. Of the $1,306,548 revenue in the quarter, $254,326 derived from sales of heat recovery systems, including $145,524 from the Kruger project, announced December 23, 2009. GEM® sales of $1,052,222 included $136,062 from the major pharmaceutical company, as well as two individual orders from the US for $85,214 and $90,183 respectively and one in Ireland for $105,710. The lower gross margins were offset by cost reductions within Administration and Selling, Marketing and Business Development.

In Q4 Fiscal Year 2010, revenues increased by $330,096, mainly due to the recognition of revenues from the Kruger project of $330,067. This, plus a small heat recovery project in the UK of $203,640 helped to bring sales of waste heat recovery systems in the quarter to $595,279. GEM® product sales of $1,041,365 were held at previous levels thanks to a smaller order from Kuwait National Petroleum Company of $149,336, plus the first order from the National Health Service (NHS) in the UK of $89,546 following a targeted drive towards this sector. In addition, Q4 saw a flurry of orders from the US and Canada. Despite this increased revenue, the loss incurred in the quarter was $843,849 due to $593,213 of provisions and write offs at year end.

The first quarter of Fiscal Year 2011 produced revenues of $2,985,667 and a net loss of $34,760. The increase in revenues came mainly from heat recovery products, which increased gross profit by $328,641 over the previous quarter. The majority of the revenue from this segment was generated from the Kruger Products contract at $1,827,267, with $296,689 coming from the partial recognition of a project at Kings College hospital in London for the installation of a waste heat recovery solution. Total revenue from heat recovery projects for the quarter was $2,200,760. GEM® product sales were $784,907, with no particularly large individual orders, but with $52,388 coming in from a new distributor in China. Continuing cost management ensured expenses were kept low, thus resulting in a relatively small loss in the quarter.

Q2 Fiscal Year 2011 produced revenues on a similar scale to Q1. With a higher level of GEM® sales than the prior quarter, gross profit was increased. Revenue from heat recovery systems for the quarter was $1,890,302, of which $1,614,754 related to the Kruger contract and $186,818 from the project at Kings College Hospital. GEM® product sales increased up to $1,047,829 for the quarter, due partly to sales to the major pharmaceutical company of $306,892. This higher level of sales combined with continued cost management generated a net loss of $3,186, an improvement of $31,574 over the first quarter.

Total sales in Q3 2011 of $1,863,635 were lower than the previous two quarters due to the stage of completion of the Kruger project, which generated $57,220 in the quarter. The installation of a heat recovery system at the Royal National Orthopaedic Hospital (RNOH) contributed $397,678 towards the total heat recovery systems sales of $607,056. Sales of GEM® products in the third quarter were $1,256,579, of which $317,925 related to orders received from a major food manufacturer in the UK, as announced December 23, 2010, and $87,810 from another hospital within the NHS in the UK. Resulting net loss for the quarter was $53,842, due in part to the provision for taxes generated from profits made in the UK entity of $100,156.

Q4 Fiscal Year 2011 saw revenues at a level similar to the previous quarter. Sales of GEM product were higher at $1,487,753, of which $558,016 related to the major food manufacturer in the UK and $220,448 related to sales within the NHS in the UK. At $425,410, revenues from heat recovery systems were less than Q3 which, as stated above, included the majority of the RNOH project. At $50,794, the net loss for the fourth quarter was a slight improvement on Q3, due mainly to the recovery of future taxes relating to intangible assets, which cancelled the effect of higher costs on a smaller heat recovery project plus higher cost of sales on GEM product due to more revenue coming from installation of traps in the quarter, which attract a lower margin that the product itself.

The first quarter of Fiscal Year 2012 experienced a drop in revenue of $481,477 over the previous quarter to $1,431,686. Of this revenue, $913,665 related to sales of GEM product, representing a decrease from the previous quarter of $574,088. $309,189 of this decrease was due to a significant proportion of the sales to the major food manufacturer in the UK being recognized in Q4 of Fiscal 2011, $191,246 related to sales to the NHS in the UK, with one hospital order in the quarter ended November 30, 2011 compared with three in the quarter ended May 31, 2011, and other general sales worldwide being down $103,675, except for sales to the major pharmaceutical company which increased by $30,022 over the previous quarter. Revenue from sales of heat recovery solutions in the quarter ended November 30, 2011 increased by $92,611 over the previous quarter. Of the order from Salisbury District Hospital Trust, announced April 11, 2011, $321,752 was recognized as revenue in the first quarter of FY 2012. This more than replaced the revenue from Qincunbao of $159,972 in the previous quarter, but the decrease of other smaller projects served to reduce the overall increase. These reductions in overall revenue of $481,477 resulted in a decreased gross profit from the previous quarter of $229,452. Net loss increased in the first quarter of FY 2012 over the previous quarter by $257,702, due to the decrease in gross profit, plus $26,248 audit fees paid in the current quarter. There were no other large fluctuations in costs during the quarter.

The second quarter of FY 2012 saw an increase in revenues of $3,244,636 over the previous quarter, resulting from an increase in heat recovery revenues of $3,395,794 and a reduction in GEM revenues of $151,158. GEM revenues relating to the orders from the major food manufacturer and the global pharmaceutical company were $227,730 and $74,711 respectively less in the current quarter than the quarter ended August 31, 2011, while revenues from the NHS and other general sales were up $74,607 and $47,860 respectively over the prior quarter. The increase in heat recovery revenues over the first quarter came predominantly from St. Georges Healthcare NHS Trust in the U.K. contributing $1,607,234, and Fibrek, which generated an extra $1,775,452 over the previous quarter. Resulting gross profit represented an increase of $1,320,675 over the $803,012 generated in the first quarter. Net profit before tax for the second quarter of FY 2012 was $622,412 – an improvement of $938,594 over the net loss before tax in the first quarter of $316,182. Costs increased by $382,081 over the prior quarter, mainly the result of increased commissions on the increased revenues, incentive accrued on the profit made in the year to date, audit bills, legal fees relating to the dispute with a former president of the company and other issues, the write off of the finance lease receivable of approximately $54,758 and the recruitment of two new heat recovery sales people; one based in North America and the other covering the U.K. and Europe. These increases were partially offset by a tax credit of around $52,000 relating to historical research and development expenditure.

Business Update:

1. On December 23, 2010 and February 18, 2011 the Company announced it had received purchase orders totalling approximately $1.3 million from a major food manufacturer based in the UK, to provide GEM® condensate return systems for use at twelve of its manufacturing sites. Sales for the year ending May 31, 2011 included approximately $0.9 million related to these orders with a further $0.25 million earned in the first quarter of fiscal 2012.

2. On April 11, 2011 the Company announced it had received a purchase order for approximately £246 thousand (approximately CDN $386 thousand) from Salisbury District Hospital Trust, a major hospital in South West England, to install a heat recovery system for use on its heating and hot water system. This system was largely completed in the first quarter of fiscal 2012.

3. On May 6, 2011 the Company received a purchase orders for approximately £208 thousand (approximately $334 thousand) from Frimley Park Hospital NHS Trust in the UK to provide to provide GEM® condensate return products and a heat recovery solution for use on its heating and hot water system. This project was completed within the first half of this fiscal year.

4. On June 16, 2011 the Company announced it had signed a contract valued at approximately $5.8 million with Fibrek to provide a heat recovery solution for its pulp mill located in Saint-Félicien, Québec. This project is now underway and is expected to be substantially completed this fiscal year.

5. On July 21, 2011 the Company received a purchase order for approximately $340 thousand from a major multi-national bakery company to provide a heat recovery solution for one of its United States based manufacturing facilities. This project is now underway and is expected to be substantially completed over the next quarter.

6. On August 5, 2011 the Company announced it had received a purchase order for approximately £1.29 million (approximately CDN $2.06 million) from St Georges Healthcare NHS Trust, a major hospital in London, UK to provide a heat recovery solution for use on its heating and hot water system. This project is now underway and is expected to be substantially completed this fiscal year.

7. On August 31, 2011 the Company amended and extended its distributor, licensing and patent purchase agreement with Mabarex Inc. related to the Dry-Rex™ technology. In exchange for minimum annual royalty payments of approximately $5,000, the agreement provides the Company with a sole and exclusive worldwide licence to the Dry-Rex™ technology for the next 10 years. The agreement also provides the Company the option to purchase the Dry-Rex™ technology at any time during the term of the agreement.

8. On January 4 and January 6, 2012, the Company received orders from a major food manufacturer in the U.K. for heat recovery solutions at two of its sites. The orders total approximately $832,000 and are both expected to be substantially completed this fiscal year.

9. The Company's order backlog as at November 30, 2011 was approximately $4.8 million compared to $822 thousand at the same time last year. As at January 30, 2012 the Company had approximately $6.2 million in purchase orders that had not yet been reflected as revenue in the Company's published quarterly financial statements, indicating that revenue earned for the six months ended November 30, 2011 plus additional purchase orders in hand total approximately $12.3 million.

Critical Accounting Estimates

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 on part of the claim. In the motion, the plaintiff seeks damages 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, 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, the quantification of damages is to be referred to a Master;
vi) Stayed the execution of the partial summary judgment pending the determination of the outstanding claims at trial;
vii) Reserved the matter of costs on the motion pending either an agreement between the parties or the receipt of written submissions on costs.

The plaintiff has been awarded approximately $37,000 in costs but to date, the parties have not yet discussed or agreed on the amount of the damages for wrongful dismissal and have not agreed on an award of costs. There has, as yet, been no reference to a Master. Written submissions on costs have been provided to 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 Thermal Energy 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 former president's case. In November 2009, the Company recorded a charge of $190,000 in its financial statements. This charge is intended to account for possible net liabilities resulting from the claim and the counterclaim.

Disclaimer

The information provided in this document is not intended to be a comprehensive review of all matters concerning the Company. It should be read in conjunction with all other disclosure documents provided. No securities commission or regulatory authority has reviewed the accuracy or adequacy of the information presented herein and, as noted in the condensed consolidated interim financial statements for the quarter and six months ended November 30, 2011, these statements were not subject to an audit.

Business Risks

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

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

- The Company's history of operating losses and uncertainty of future profitability;
- The ability to grow sales through the establishment of new cooperative partnerships and strategic alliances;
- The ability to grow sales through the licensing of the corporation's technologies;
- The ability to secure and maintain the required outside working capital financing;
- The ability to achieve profitable operations through increased sales,
- Reliance on third party collaborations and license arrangements;
- Reliance on proprietary technology;
- Competition in the energy conservation and environmental compliance solutions;
- Product liability claims and insurance;
- Reliance on key personnel;
- The ongoing litigation with its former President & CEO;
- The ability to control costs and achieve a positive gross margin on projects; and,
- The effect of a prolonged recession in Canada, USA and Europe to the financial markets in securing project financing and in particular to industrial and commercial customers in committing capital to projects.

Management's addressing of the risks:

The management of the Company realizes that the operating losses in FY 2010, FY 2011 and the first quarter of FY 2012 display a consistent pattern of losses as in previous years. However the operating losses in FY 2010 were partly attributed to $963,213 in one-time provisions and write-offs. FY 2011 also resulted in a loss, however this was much reduced from previous years' losses due to achieving a larger number of both heat recovery projects and GEM sales, along with improved cost controls. The loss suffered in the first quarter of FY 2012 was due to the lack of revenue from heat recovery projects, which was recovered in the second quarter, as both the Fibrek project and St. Georges Healthcare NHS Trust project, announced August 5, 2011, progressed, producing a profit for the quarter and for the six months ended November 30, 2011.

In addition on June 29th, 2010 the Company signed an arm's length Greenpower Purchase Agreement with Fortress Specialty Cellulose Inc. ("Fortress Specialty"). The agreement is to supply recovered energy to the Fortress Specialty mill in Thurso, Quebec from a FLU-ACE® Waste Heat Recovery System installed at the site. Based on the amount of heat expected to be recovered, this agreement is expected to provide the Company approximately $720,000 of additional cash flow per year between now and December 31, 2012.

The Company actively protects its proprietary technology through registered trademarks and confidentiality agreements.

The Company maintains adequate forms of general liability insurance including product liability and errors and omission coverage.

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

INTERNATIONAL FINANCIAL REPORTING STANDARDS

In February 2008, the Canadian Institute of Chartered Accountants (CICA) announced that Canadian GAAP for publicly accountable enterprises will be replaced by IFRS for interim and annual financial statements for fiscal years beginning on or after January 1, 2011. The standard also requires that comparative figures for 2010 be based on IFRS. Accordingly, the Company has adopted IFRS on June 1, 2011, with restatement for comparative purposes of amounts reported by the Company for the fiscal year beginning June 1, 2010. The unaudited condensed consolidated interim financial statements, which should be read in conjunction with this discussion, have been prepared in accordance with International Accounting Standard 34, Interim Financial Reporting.

The significant accounting policies adopted under IFRS are included in note 3 to the unaudited condensed consolidated interim financial statements for the quarter ended November 30, 2011. These accounting policies have been applied consistently to all periods presented in the financial statements. They also have been applied in preparing an opening IFRS statement of financial position as at June 1, 2010, the Company's transition date, as required by IFRS 1. The accounting policies have been selected to be consistent with IFRS as is expected to be effective on May 31, 2012, the Company's first annual IFRS reporting date. The standards and interpretations within IFRS are subject to change and accordingly, the accounting policies for the annual period that are relevant to these unaudited condensed consolidated interim financial statements will be finalized only when the first full IFRS financial statements are prepared for the year ending May 31, 2012.

Reconciliations and descriptions of the effect of the transition from Canadian GAAP to IFRS are included in note 27 to the unaudited condensed consolidated interim financial statements for the quarter ended November 30, 2011.

The transition from Canadian GAAP to IFRS had no impact on total comprehensive income (loss).

Summary of Outstanding Shares and Dilutive Instruments

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

Shares

163,336,616 class A common shares.

Options

Number of options outstanding	Number of options exercisable	Exercise price per share $	Expiry date
2,750,000	1,583,333	0.10	May 4, 2015
2,656,250	-	0.10	May 10, 2016
500,000	-	0.10	July 12, 2016
5,370,000	-	0.10	December 1, 2016
11,276,250	1,583,333		

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

The unaudited condensed consolidated interim financial statements of Thermal Energy and all the information in this interim financial report have been prepared by management, which is solely responsible for the integrity and fairness of the data presented, including the many amounts, which due to necessity, are based on estimates and judgments. The accounting policies followed in the preparation of these unaudited condensed consolidated interim financial statements conform to IFRS. Financial information presented throughout this report is consistent with that in the unaudited condensed consolidated interim financial statements.

Thermal Energy maintains systems of internal accounting and administrative controls to provide reasonable assurance that the financial information is relevant, reliable and accurate and that transactions are authorized, assets are safeguarded and proper records are maintained.

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

Thermal Energy's external auditors, Raymond Chabot Grant Thornton LLP, conducted an independent audit of the consolidated financial statements for the year ended May 31, 2011 in accordance with Canadian generally accepted auditing standards, performing such tests and other procedures as they consider necessary to express an audit opinion. The condensed consolidated financial statements for the quarter and six months ended November 30, 2011, prepared in accordance with IFRS, have not been audited.