

THERMAL ENERGY INTERNATIONAL INC.

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

	August 31 2011 \$	May 31 2011 \$	June 1 2010 \$
<b>ASSETS</b>			
<b>Current assets</b>			
Cash and cash equivalents (Note 13)	824,965	972,163	433,493
Trade and other receivables (Note 12)	2,428,554	1,851,377	1,919,440
Inventories (Note 11)	449,802	420,999	394,507
Financial Lease receivable (Note 9)	668,534	653,807	534,281
	<b>4,371,855</b>	<b>3,898,346</b>	<b>3,281,721</b>
<b>Non-current assets</b>			
Property, plant and equipment (Note 8)	90,321	74,527	95,684
Financial Lease receivable (Note 9)	339,833	467,523	1,159,060
Intangible assets (Note 7 )	914,273	940,047	995,448
Goodwill (Note 6)	3,313,008	3,318,520	3,163,356
	<b>4,657,435</b>	<b>4,800,617</b>	<b>5,413,548</b>
Total Assets	<b>9,029,290</b>	<b>8,698,963</b>	<b>8,695,269</b>
<b>LIABILITIES</b>			
<b>Current liabilities</b>			
Short term borrowings (Note 14)	-	-	11,093
Trade and other payables	706,916	657,096	527,759
Current tax liabilities	137,259	124,113	77,983
Pensions and other employee obligations	65,782	62,173	36,058
Other liabilities (Note 19)	695,267	574,477	425,164
Deferred consideration	-	854	19,377
Deferred revenue (Note 18)	885,399	343,699	769,801
Provisions (Note 20)	215,000	265,000	265,000
	<b>2,705,623</b>	<b>2,027,412</b>	<b>2,132,235</b>
<b>Non-current liabilities</b>			
Deferred taxation	255,786	265,846	354,100
Total liabilities	<b>2,961,409</b>	<b>2,293,258</b>	<b>2,486,335</b>
<b>EQUITY</b>			
Capital stock (Note 15)	33,136,184	33,148,184	33,148,184
Contributed surplus	2,370,330	2,354,784	2,292,153
Deficit	(29,704,176)	(29,373,653)	(29,232,826)
Accumulated other comprehensive loss	223,544	227,981	-
Equity attributable to owners of the parent	6,025,882	6,357,296	6,207,511
Non-controlling interest	41,999	48,409	1,423
Total equity	<b>6,067,881</b>	<b>6,405,705</b>	<b>6,208,934</b>
Total equity and liabilities	<b>9,029,290</b>	<b>8,698,963</b>	<b>8,695,269</b>

Provisions (Note 22)

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

On behalf of the Board





**THERMAL ENERGY INTERNATIONAL INC.**

**UNAUDITED CONDENSED CONSOLIDATED STATEMENT OF  
OPERATIONS AND COMPREHENSIVE LOSS**

3 months ended August 31

	2011	2010
	\$	\$
Sales	1,431,686	2,985,667
Cost of sales	628,674	1,782,007
<b>Gross profit</b>	<b>803,012</b>	<b>1,203,660</b>
<b>Expenses</b>		
Administration	542,234	674,850
Selling, marketing and business development	607,919	598,543
Research and development	120	1,913
	<b>1,150,273</b>	<b>1,275,306</b>
Operating income (loss)	<b>(347,261)</b>	<b>(71,646)</b>
Finance revenue	31,079	50,915
Income (loss) before income taxes	<b>(316,182)</b>	<b>(20,731)</b>
Income taxes	653	(8,360)
<b>Net income (loss) for the period</b>	<b>(315,529)</b>	<b>(29,091)</b>
<b>Other comprehensive income (loss) for the period</b>		
Exchange differences arising on translation of overseas operations	<b>(4,437)</b>	348,260
<b>Total comprehensive profit (loss)</b>	<b>(319,966)</b>	<b>319,169</b>
Net income (loss) for the period attributable to:		
Owners of the parent	<b>(308,496)</b>	(34,760)
Non-controlling interests	<b>(7,033)</b>	5,669
<b>Net profit (loss) for the period</b>	<b>(315,529)</b>	<b>(29,091)</b>
<b>Total comprehensive profit (loss) for the period attributable to:</b>		
Owners of the parent	<b>(312,933)</b>	313,500
Non-controlling interests	<b>(7,033)</b>	5,669
<b>Total comprehensive profit (loss) for the period</b>	<b>(319,966)</b>	<b>319,169</b>
<b>Earnings per Share</b>		
Net loss per share - basic and diluted (note 21)	<b>(0.002)</b>	(0.000)

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

**CONDENSED CONSOLIDATED INTERIM STATEMENTS OF CHANGES IN EQUITY  
FOR THE PERIOD ENDED 31 AUGUST 2011**

	Ordinary Shares \$	Contributed Surplus \$	Deficit \$	Accumulated other comprehensive loss \$	Total \$	Minority Interest \$	Total Equity \$
Balance at 1 June 2010	33,148,184	2,292,153	(29,232,826)	0	6,207,511	1,423	6,208,934
Profit (loss) for the period			(34,760)		(34,760)	5,669	(29,091)
Interest on loans to acquire common shares			1,773		1,773		1,773
Stock-based compensation		35,375			35,375		35,375
Exchange differences arising on translation of overseas operations				348,260	348,260	281	348,541
Balance at 31 August 2010	<u>33,148,184</u>	<u>2,327,528</u>	<u>(29,265,813)</u>	<u>348,260</u>	<u>6,558,159</u>	<u>7,373</u>	<u>6,565,532</u>
Balance at 1 June 2011	33,148,184	2,354,784	(29,373,653)	227,981	6,357,296	48,409	6,405,705
Profit (loss) for the period			(308,496)		(308,496)	(7,033)	(315,529)
Interest on cancelled loans			(22,027)		(22,027)		(22,027)
Stock-based compensation		15,546			15,546		15,546
Exchange differences arising on translation of overseas operations				(4,437)	(4,437)	623	(3,814)
Cancelled shares	(12,000)				(12,000)		(12,000)
Balance at 31 August 2011	<u>33,136,184</u>	<u>2,370,330</u>	<u>(29,704,176)</u>	<u>223,544</u>	<u>6,025,882</u>	<u>41,999</u>	<u>6,067,881</u>

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

**THERMAL ENERGY INTERNATIONAL INC.**

**UNAUDITED CONDENSED CONSOLIDATED INTERIM STATEMENT OF  
CASH FLOWS**

3 months ended August 31

	<b>2011</b>	<b>2010</b>
	<b>\$</b>	<b>\$</b>
<b>OPERATING ACTIVITIES</b>		
Net loss for the period	<b>(315,529)</b>	(29,091)
Add items not involving cash:		
Stock-based compensation charge	<b>15,547</b>	35,375
Depreciation of property, plant and equipment	<b>10,508</b>	12,857
Amortization of intangible assets	<b>24,623</b>	36,542
Future taxes	<b>(7,101)</b>	-
Non-controlling interest		
Changes in non-cash operating working capital		
Trade and other receivables	<b>(360,002)</b>	502,859
Inventories	<b>(27,518)</b>	(43,613)
Trade and other payables	<b>(102,795)</b>	215,865
Other liabilities	<b>97,345</b>	68,316
Deferred revenue	<b>445,893</b>	(478,474)
	<b>(219,029)</b>	320,636
<b>Net cash provided by (used in) operating activities</b>	<b>(219,029)</b>	320,636
<b>INVESTING ACTIVITIES</b>		
Acquisition of subsidiary	<b>(15,501)</b>	(8,823)
Additions to property, plant and equipment	<b>(26,290)</b>	(12,108)
<b>Net cash used in investing activities</b>	<b>(41,791)</b>	(20,931)
<b>FINANCING ACTIVITIES</b>		
Decrease in bank loan	-	(11,591)
Financial lease payments received	<b>112,964</b>	93,526
<b>Net cash provided by (used in) financing activities</b>	<b>112,964</b>	81,935
Effect of exchange rate fluctuations on cash and cash equivalents	<b>658</b>	12,617
Increase (decrease) in cash and cash equivalents for the year	<b>(147,198)</b>	394,257
Cash and cash equivalents, beginning of year	<b>972,163</b>	433,493
<b>Cash and cash equivalents, end of year</b>	<b>824,965</b>	827,750
Non-cash supplemental information:		
Interest on cancelled shares	<b>22,027</b>	-
Interest paid	<b>755</b>	807

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

# THERMAL ENERGY INTERNATIONAL INC.

## NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (Unaudited)

August 31, 2011

### 1. NATURE OF OPERATIONS AND GOING CONCERN

Thermal Energy International Inc. (the "Company") 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 Company's common shares are listed on the TSX Venture Exchange ("TSX.V") under the symbol TMG. The primary office is located at 36 Bentley Avenue, Ottawa, Ontario, Canada, K2E 6T8.

These unaudited condensed consolidated interim financial statements were approved by the Board of Directors on November 28, 2011.

The Company incurred losses from operations in the quarters ended August 31, 2011 and 2010 and has significant accumulated deficits as at those dates.

There is doubt about the Company's ability to continue as a going concern. The Company's ability to realize its assets and discharge its liabilities depends on any combination of the following: the continued financial support of its shareholders, its ability to arrange long-term financing and its ability to generate sufficient cash from operations.

Management is concentrating on building upon the revenue growth experienced in FY2010 and FY 2011 and continuing to manage expenditures in order to produce positive cash flows from operations in order to meet the Company's obligations. Consequently, management is of the opinion that there is no significant doubt concerning the Company's ability to continue as a going concern.

The financial statements have been prepared on the going concern basis which assumes the realization of assets and the satisfaction of liabilities in the normal course of business. These financial statements do not include any adjustments to the carrying value or classification of assets and liabilities, nor to the results of operations, should the Company not continue to operate as a going concern.

### 2. STATEMENT OF COMPLIANCE AND TRANSITION TO "INTERNATIONAL FINANCIAL REPORTING STANDARDS" ("IFRS")

These are the first IFRS condensed consolidated interim financial statements prepared in accordance with IAS 34 *Interim Financial Reporting*, and IFRS1 *First-time Adoption of International Financial Reporting Standards* has been applied. These financial statements do not include all the information required for full annual consolidated financial statements prepared in accordance with IFRS. An explanation of how the transition to IFRS has affected the reported financial results of the Company is provided in note 27.

These unaudited condensed consolidated interim financial statements should be read in conjunction with the audited consolidated financial statements contained in the Company's annual report for the year ended May 31, 2011 which were prepared in accordance with previous Canadian Generally Accepted Accounting Principles ("CGAAP"). Certain disclosures that are required to be included in the annual financial statements prepared in accordance with IFRS that are not included in the Company's most recent annual financial statements prepared in accordance with CGAAP have been included in these condensed consolidated interim financial statements for the comparative annual period. However, these interim financial statements do not include all of the information required for full annual consolidated financial statements.

The accounting policies described below have been used throughout all periods presented in the financial statements, except where the Company has applied certain accounting policies and exemptions upon transition to IFRS.

These unaudited condensed consolidated interim financial statements have been prepared on the basis of IFRS that are expected to be effective or available for early adoption by the Company as at May 31, 2012. The policies applied in these condensed consolidated interim financial statements are based on IFRS issued and effective as of November 28, 2011, the date the Board approved the statements. Any subsequent changes to IFRS that are given effect in the Company's annual consolidated financial statements for the year ending May 31, 2012 could result in restatement of these condensed consolidated interim financial statements, including the transition adjustments recognized on change-over to IFRS.

### 3. SUMMARY OF ACCOUNTING POLICIES

#### 3.1. Presentation of financial statements

These unaudited condensed consolidated interim financial statements have been prepared on a historical cost basis.

## THERMAL ENERGY INTERNATIONAL INC.

### NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (Unaudited)

August 31, 2011

The condensed consolidated interim financial statements are presented in accordance with IAS 1 Presentation of Financial Statements (Revised 2007). The Company has elected to present the 'Statement of comprehensive income' in a single statement, the 'Statement of operations and comprehensive income'.

In accordance with IFRS 1, the Company presents three statements of financial position in its first IFRS financial statements. In future periods, IAS 1 requires two comparative periods to be presented for the statement of financial position only in certain circumstances.

#### 3.2. Basis of consolidation

These unaudited condensed consolidated interim financial statements incorporate the financial statements of the Company, which is the ultimate parent, and its subsidiaries. Subsidiaries are consolidated from the date on which the Company obtains control, and continue to be consolidated until control ceases. Control is established when the Company has the power to govern the financial and operating policy decisions of the entity, and generally exists when more than 50% of the voting power of the entity is held by the Company or where the Company has the ability to determine the strategic, operating, investing and financing policies of a company without the co-operation of others. The financial statements of the subsidiaries are prepared using consistent accounting policies and all material inter-company transactions are eliminated in full upon consolidation.

Where the ownership of a subsidiary is less than 100% and a non-controlling interest thus exists, any losses of that subsidiary are attributed to the owners of the parent and to the non-controlling interests even if that results in the non-controlling interests having a deficit balance. A change in the ownership interest of a subsidiary, without a loss of control, is accounted for as an equity transaction.

The following subsidiaries have been consolidated within the unaudited condensed consolidated interim financial statements:

Name of subsidiary	Place of incorporation	Ownership interest	Principal activity
ForEverGreen Energy Inc.	Ontario, Canada	100%	Finance leasing
2003356 Ontario Inc.	Ontario, Canada	100%	Non-operating
2153639 Ontario Inc.	Ontario, Canada	100%	Holding Company
Gardner Energy Management Ltd. <sup>(1)</sup>	United Kingdom	100%	Manufacture and sale of condensate return solutions and sale of heat recovery solutions
Thermal Energy International Corporation	Delaware, U.S.	100%	Non-operating
Thermal Energy International (Guangzhou) Ltd.	Guangzhou, China	55%	Sale of heat recovery and condensate return solutions

Gardner Energy Management Ltd. Owns 67% of GEMchem Ltd., a company incorporated in the United Kingdom.

#### 3.3. Business combinations

For acquisitions made on or after June 1, 2010, the Company measures goodwill at the acquisition date as the fair value of the consideration transferred including any contingent consideration to be transferred and the recognized amount of any non-controlling interests in the acquired entity, less the net recognized amount of the fair value of the identifiable assets acquired and liabilities assumed, all measured as of the acquisition date. When the excess is negative, a bargain purchase gain is recognized immediately in profit or loss. The Company elects on a transaction-by-transaction basis whether to measure non-controlling interests at fair value or at their proportionate share of the recognized amount of the identifiable net assets at the acquisition date. If the business combination is achieved in stages, the acquisition date fair value of the previously held interest in the acquired entity is re-measured to fair value as at the acquisition date through profit or loss. Transaction costs, other than those associated with the issue of debt or equity securities that the Company incurs in connection with a business combination, are expensed as incurred.

As part of its transition to IFRS, the Company elected to restate only those business combinations that occurred on or after June 1, 2010, the date of transition. In respect of acquisitions that arose prior to June 1, 2010, goodwill represents the amount recognized under the Company's previous accounting framework, CGAAP.

#### 3.4. Investments in Joint Ventures

Entities whose economic activities are controlled jointly by the Company and other venturers independent of the Company (joint ventures) are accounted for using the proportionate consolidation method, whereby the Company's share of the assets, liabilities, income and expenses is included line by line in the consolidated financial statements.

## THERMAL ENERGY INTERNATIONAL INC.

### NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (Unaudited)

August 31, 2011

The Company discontinues the use of proportionate consolidation from the date on which it ceases to have joint control over a jointly controlled entity.

#### 3.5. Functional currency and foreign currency translation

These unaudited condensed consolidated interim financial statements are presented in Canadian dollars, which is the functional currency of the Company. The functional currency of each entity consolidated with the Company is determined by the currency of the primary economic environment in which it operates.

In preparing the financial statements of the individual entities, transactions in currencies other than the entity's functional currency are recognized at the rates of exchange prevailing at the dates of the transactions. At the end of each reporting period, monetary assets and liabilities denominated in foreign currencies are translated at the rates of exchange prevailing at that date; non-monetary assets and liabilities carried at fair value that are denominated in foreign currencies are retranslated at the rates of exchange prevailing at that date; and non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are not retranslated. Such exchange differences arising from translation at period-end are recognized in profit or loss.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at the closing rate. Exchange differences arising are recognized in equity.

Foreign operations are translated from their functional currencies into Canadian dollars on consolidation by applying the exchange rates prevailing at the end of the reporting period for assets and liabilities and the average exchange rate for the period for consolidated statement of operations and comprehensive income or loss items. Such exchange differences, including differences that arise relating to long-term intercompany balances that form part of the net investment in the foreign operation, are recognized in other comprehensive income or loss.

#### 3.6. Segment reporting

In identifying its operating segments, management generally follows both the Company's product and service lines, which represent the main products and services provided by the Company, and key geographical areas, which reflect the business of the Company's two main operating units in Ottawa, Canada and Bristol, UK. In determining its reportable segments, the Company considers qualitative factors, such as operations which are considered to be significant by management, as well as quantitative factors, so that material revenues and expenses are appropriately disclosed. Management considers assets and liabilities on a global basis, and does not assess on a segment basis. The reportable segments' financial results are reviewed quarterly by senior management and the Board. Corporate costs which are not attributable to any particular operating segment are separately disclosed. The three reportable product segments are as follows:

- The heat recovery systems segment comprises customer financed projects regarding solutions for heat recovery and air emission control
- The Thermal-AUD™ segment comprises the same products, but financed by the Company which leases the facility to the customer
- The GEM™ segment is in the condensate return system solutions

The two geographical units are as follows:

- North America and China, managed from the Ottawa office
- Europe and rest of world, managed from the Bristol office.

#### 3.7. Revenue recognition

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

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

##### Sale of goods

Revenue from product sales is recognized when the Company has transferred to the buyer the significant risks and rewards of ownership of the goods supplied. Significant risks and rewards are generally considered to be transferred to

## THERMAL ENERGY INTERNATIONAL INC.

### NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (Unaudited)

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the buyer when the customer has taken undisputed delivery of the goods. Amounts received in advance of meeting the revenue recognition criteria is recorded as deferred revenue on the consolidated statement of financial position. Products shipped prior to agreed billing terms are included in unbilled product revenue.

#### Rendering of services

Services comprise surveys, installation of goods, project development and after-sales service and maintenance. Revenue is recognized when the services are provided by reference to the stage of completion of the contract at the reporting date. Amounts received in advance of meeting the revenue recognition criteria is recorded as deferred revenue on the consolidated statement of financial position. Services rendered prior to agreed billing terms are included in unbilled product revenue.

#### Contracts for heat recovery solutions

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

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

The stage of completion is determined by reference to the proportion that contract costs for work performed to date compare to the estimated total contract costs. Only those contract costs that reflect work performed are included in costs incurred to date. Contract costs relating to work not yet performed on the contract create an asset related to future contract activity. The gross amount due to customers for contract work is presented as deferred revenue for all contracts in progress for which progress billings exceed costs incurred plus recognized profits (less losses).

#### Finance leases

Finance leases are those where substantially all of the benefits and risks of ownership of the equipment are transferred to the customer. Sales revenue recognized at the inception of the lease represents the fair value of the asset or, if lower the present value of the minimum lease payments, net of any executory costs and related profit included therein, computed at the market rate of interest. The cost of sale recognized at the commencement of the lease term is the cost, or carrying amount if different, of the leased property less the present value of the unguaranteed residual value. Unearned finance income, effectively the difference between the total minimum lease payments adjusted for executory costs and the aggregate present value, is deferred and presented as financial lease receivable in the statement of financial position. The finance income is recognized in profit or loss over the lease term to produce a constant rate of return on the investment in the lease.

#### 3.8. Operating expenses

Operating expenses are recognized in profit or loss upon utilization of the service or at the date of their origin. Expenditure for warranties is recognized and charged against the associated provision when the related revenue is recognized. Depreciation of property, plant and equipment, amortization of intangible assets and gains or losses on disposals are included within administration expenses.

#### 3.9. Goodwill

Goodwill represents the future economic benefits arising from a business combination that are not individually identified and separately recognized. See note 3.3 for information on how goodwill is initially determined. Goodwill is carried at cost less accumulated impairment losses. See "impairment of long-lived assets" below for a description of impairment testing procedures. Impairment losses on goodwill are not reversed.

#### 3.10. Other intangible assets

Intangible assets were acquired at the fair market value with the acquisition of Gardner Energy Management on July 1, 2008. Amortization is computed using the following rates and methods which reflect the estimated useful life of the assets:



## THERMAL ENERGY INTERNATIONAL INC.

### NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (Unaudited)

August 31, 2011

Trade names and trademarks	indefinite life
Non-compete agreements	2 years straight-line
Industrial know-how	5 years straight-line
Designs and drawings	5 years straight-line
Customer relationships	5 years straight-line

Amortization methods, useful lives and residual values are reviewed each reporting period and adjusted if appropriate. Other intangible assets with indefinite lives are subject to annual impairment testing. See "impairment of long-lived assets" below for a description of impairment testing procedures.

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

#### 3.11. Research costs and government assistance

The Company carries on various research programs, and from time to time these are funded by the Government of Canada. Funding received is accounted for using the cost reduction approach and is netted against research costs. Research costs are expensed as incurred.

#### 3.12. Property, plant and equipment

Property, plant and equipment are carried at cost less accumulated depreciation and accumulated impairment losses. Subsequent costs of replacing components are recognized only if it is probable that future economic benefits embodied within the component will flow to the Company, and its cost can be measured reliably. The carrying amount of the replaced component is derecognized. The cost of other replacement parts and general servicing of property, plant and equipment is recognized immediately in profit or loss.

Depreciation is computed using the following annual rates and methods which reflect the estimated useful life of the assets less estimated residual value:

Plant and equipment	5 years straight-line
Furniture and fixtures	5 years straight-line
Laboratory equipment	5 years straight-line
Computers	3 years straight-line
Software	2 years straight-line
Leasehold improvements	3 years straight-line
Motor vehicles	4 years straight-line

Depreciation methods, useful lives and residual values are reviewed each reporting period and adjusted if appropriate.

#### 3.13. Leases

- (i) The Company as a lessee

In accordance with IAS 17 *Leases*, the economic ownership of a leased asset is transferred to the lessee whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. The related asset is then recognized at the inception of the lease at the fair value of the leased asset or, if lower, the present value of the lease payments plus incidental payments, if any. A corresponding amount is recognized as a finance leasing liability, irrespective of whether some of these lease payments are payable up-front at the date of inception of the lease. Depreciation methods and useful lives for assets held under finance lease agreements correspond to those applied to comparable assets which are legally owned by the Company. The corresponding finance leasing liability is reduced by lease payments less finance charges, which are expensed as part of finance costs. The interest element of leasing payments represents a constant proportion of the capital balance outstanding and is charged to profit or loss over the period of the lease.

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

- (ii) The Company as a lessor – finance leases

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### NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (Unaudited)

August 31, 2011

Finance leases are those where substantially all of the benefits and risks of ownership of the equipment are transferred to the customer. Amounts due from lessees under finance leases are recorded as finance lease receivables at the amount of the Company's net investment in the leases. Finance lease income is allocated to accounting periods so as to reflect a constant periodic rate of return on the Company's net investment in the lease.

Finance leases receivable are measured at total estimated minimum lease payments receivable, net of estimated expected finance revenue. Finance leases receivable are assessed for recoverability at each period end. Any indication of impairment of the net investment in lease will result in a write down to the revised estimated recoverable amount. Indications that a finance lease receivable may be impaired include customers experiencing significant financial difficulties, the increasing possibility of a customer going bankrupt or undergoing a financial restructuring and payment default or delays.

#### 3.14. Impairment testing of goodwill, other intangible assets and property, plant and equipment

For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are largely independent cash inflows (cash-generating units). As a result, some assets are tested individually for impairment and some are tested at cash-generating unit level. Goodwill is allocated to those cash-generating units that are expected to benefit from synergies of the related business combination and represent the lowest level within the Company at which management monitors goodwill.

Cash-generating units to which goodwill has been allocated are tested for impairment at least annually. All other individual assets or cash-generating units are tested for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

An impairment loss is recognized for the amount by which the asset's or cash-generating unit's carrying amount exceeds its recoverable amount, which is the higher of fair value less costs to sell and value-in-use. To determine the value-in-use, management estimates expected future cash flows from each cash-generating unit and determines a suitable interest rate in order to calculate the present value of those cash flows. The data used for impairment testing procedures are directly linked to the Company's latest approved budget, adjusted as necessary to exclude the effects of future reorganisations and asset enhancements. Discount factors are determined individually for each cash-generating unit and reflect their respective risk profiles as assessed by management.

Impairment losses for cash-generating units reduce first the carrying amount of any goodwill allocated to that cash-generating unit. Any remaining impairment loss is charged pro rata to the other assets in the cash-generating unit. With the exception of goodwill, all assets are subsequently reassessed for indications that an impairment loss previously recognized may no longer exist. An impairment charge is reversed if the cash-generating unit's recoverable amount exceeds its carrying amount.

#### 3.15. Financial instruments

Financial assets and financial liabilities are recognized when the Company becomes a party to the contractual provisions of the financial instrument. Financial assets are derecognized when the contractual rights to the cash flows from the financial asset expire, or when the financial asset and all substantial risks and rewards are transferred. A financial liability is derecognized when it is extinguished, discharged, cancelled or expires.

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

##### Financial assets

For the purpose of subsequent measurement, financial assets other than those designated and effective as hedging instruments are classified into the following categories upon initial recognition

- Loans and receivables
- Financial assets at fair value through profit or loss
- Held-to-maturity investments
- Available-for-sale financial assets

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

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

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

#### **Loans and receivables**

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Trade receivables, related party and other accounts receivable are classified as loans and receivables. Trade receivables are measured at amortized cost, which is generally the initially recognized amount, less any allowance for doubtful debts. An allowance for trade receivables is made when the Company has obtained an objective indication that it will not be able to collect the amount due according to the original terms and conditions agreed to with customers. Indications that trade receivables are impaired include customers experiencing significant financial difficulties, the increasing possibility of a customer going bankrupt or undergoing a financial restructuring and payment default or delays. Individual receivables are considered for impairment when they are past due or when other objective evidence is received that a specific counterparty will default. Other accounts receivable and amounts due from directors, officers and related parties are recognized at amortized cost using the effective interest method, less any impairment. Impairment occurs when they are past due or when other objective evidence is received that a specific counterparty will default. Discounting is omitted where the effect of discounting is immaterial.

#### **Financial assets at fair value through profit or loss**

A financial asset is classified at fair value through profit or loss if it is classified as held for trading or is designated as such upon initial recognition. Financial assets are designated at fair value through profit or loss if the Company manages such investments and makes purchase and sale decisions based on their fair value in accordance with the Company's documented risk management or investment strategy. Attributable transaction costs are recognized in profit or loss when incurred. Financial assets at fair value through profit or loss are measured at fair value, and changes therein are recognized in profit or loss. Financial assets at fair value through profit or loss comprise cash and cash equivalents.

#### **Held-to-maturity investments**

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturity other than loans and receivables. Investments are classified as held-to-maturity if the Company has the intention and ability to hold them until maturity.

Held-to-maturity investments are measured subsequently at amortised cost using the effective interest method. If there is objective evidence that the investment is impaired, determined by reference to external credit ratings, the financial asset is measured at the present value of estimated future cash flows. Any changes to the carrying amount of the investment, including impairment losses, are recognized in profit or loss.

The Company currently has no held-to-maturity investments

#### **Available-for-sale financial assets**

Available-for-sale financial assets are non-derivative financial assets that are either designated to this category or do not qualify for inclusion in any of the other categories of financial assets. Available-for-sale investments are measured at fair value. Gains and losses are recognized in other comprehensive income, except for impairment losses and foreign exchange differences on monetary assets, which are recognized in profit or loss. When the asset is disposed of or is determined to be impaired, the cumulative gain or loss recognized in other comprehensive income is reclassified from the equity reserve to profit or loss and presented as a reclassification adjustment within other comprehensive income. Interest calculated using the effective interest method and dividends are recognized in profit or loss.

The Company currently has no available-for-sale financial assets

#### **Financial liabilities**

The bank loan, trade and other payables and finance leases are classified as other financial liabilities. They are measured initially at fair value. Subsequent measurements are at amortized cost using the effective interest method.

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#### **3.16. Inventories**

Inventories are valued at the lower of cost and net realizable value. Cost is determined by the first in, first out method and includes all direct costs and an appropriate proportion of fixed and variable overheads where applicable. Net realizable value is the estimated selling price in the ordinary course of business, less the estimated selling costs.

#### **3.17. Income taxes**

Tax expense recognized in profit or loss comprises the sum of deferred tax and current tax not recognized in other comprehensive income or directly in equity.

Current income tax assets and / or liabilities comprise those obligations to, or claims from, fiscal authorities relating to the current or prior reporting periods, that are unpaid at the reporting date. Current tax is payable on taxable profit, which differs from profit or loss in the financial statements.

Deferred income taxes are calculated using the liability method on temporary differences between the financial statement carrying amounts and the tax bases of assets and liabilities. Deferred tax liabilities are generally recognized for all taxable temporary differences, and deferred tax assets are generally recognized for all deductible temporary differences to the extent that it is probable that future taxable income will be available against which those deductible temporary differences can be utilized. Such assets and liabilities are not recognized if the taxable temporary difference arises from the initial recognition of goodwill or the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable income or loss, nor the income or loss for the period reported in the Company's statement of comprehensive income.

Deferred tax liabilities are recognized for taxable temporary differences associated with investments in subsidiaries and joint venture, except where the Company is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future. Deferred tax assets arising from deductible temporary differences associated with such investments are only recognized to the extent that it is probable that there will be sufficient taxable income against which to utilize the benefits of the temporary differences and they are expected to reverse in the foreseeable future.

Deferred tax assets and liabilities are measured, without discounting, at the tax rates that have been enacted or substantively enacted by the end of the reporting period and applicable in the period in which the liability is expected to be settled or the asset realized.

The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the Company expects, at the reporting date, to recover or settle the carrying amount of its assets and liabilities. The carrying amount of deferred tax assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that sufficient taxable income will be available to allow the benefit of all or part of the asset to be utilized. At the end of each reporting period, an entity reassesses unrecognized deferred tax assets. The entity recognizes a previously unrecognized deferred tax asset to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and the Company intends to settle its current tax assets and liabilities on a net basis.

Changes in deferred tax assets or liabilities are recognized as a component of tax income or expense in profit or loss, except where they relate to items that are recognized in other comprehensive income or directly in equity, in which case the related deferred tax is also recognized in other comprehensive income or equity, respectively.

#### **3.18. Cash and cash equivalents**

Cash and cash equivalents in the statements of financial position comprise cash at banks and on hand, and highly liquid investments with an original maturity of three months or less, and which are readily convertible into a known amount of cash and which are subject to an insignificant risk of change in value.

#### **3.19. Equity and reserves**

Capital stock and contributed surplus are classified as equity. Share issue expenses are recorded as a reduction of share capital when the related shares are issued.

Deficit includes all current and prior period retained losses.

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Accumulated other comprehensive loss represents foreign currency translation differences arising on the translation of the Company's foreign subsidiaries.

#### 3.20. Post employee benefits and short term employee benefits

Certain subsidiaries of the Company provide post-employment benefits through defined contribution plans. A defined contribution plan is a pension plan under which the Company pays fixed contributions into an independent entity. The Company has no legal or constructive obligations to pay further contributions after its payment of the fixed contribution. The Company contributes to several plans for individual employees that are considered defined contribution. The cost of the Company's pension benefits for defined contribution plans are expensed at the time active employees are compensated.

Short-term employee benefits, including holiday entitlement, are current liabilities included in "pension and other employee obligations", measured at the undiscounted amount that the Company expects to pay as a result of the unused entitlement.

#### 3.21. Stock-based compensation

The Company offers equity-settled stock-based compensation plan for its directors, officers and employees. The Company accounts for stock-based compensation using the fair value method of accounting. When employees are rewarded using share-based payments, the fair value of employees' services is determined indirectly by reference to the fair value of the equity instruments granted. This fair value is measured at the grant date and excludes the impact of non-market vesting conditions.

The stock-based compensation cost is recorded as an expense in profit or loss and credited to contributed surplus.

If vesting periods or other vesting conditions apply, the expense is allocated over the vesting period, based on the best available estimate of the number of awards expected to vest. Non-market vesting conditions are included in assumptions about the number of awards that are expected to become exercisable. Estimates are subsequently revised if there is any indication that the number expected to vest differs from previous estimates. Any cumulative adjustment prior to vesting is recognized in the current period. No adjustment is made to any expense recognized in prior periods if awards ultimately exercised are different to that estimated on vesting.

Each tranche of an award with different vesting dates is considered a separate grant for the calculation of fair value and the resulting fair value is amortized over the vesting period of the respective tranches.

When stock options are exercised or when restricted share units are released, any consideration paid by employees is credited to share capital in addition to the amount previously recorded in contributed surplus.

#### 3.22. Provisions, contingent liabilities and contingent assets

Provisions are recognized when present obligations as a result of a past event will probably lead to an outflow of economic resources from the Company and amounts can be estimated reliably. Timing or amount of the outflow may still be uncertain. A present obligation arises from the presence of a legal or constructive commitment that has resulted from past events, for example, product warranties granted, legal disputes or onerous contracts. Provisions are not recognized for future operating losses.

Provisions are measured at the estimated expenditure required to settle the present obligation, based on the most reliable evidence available at the reporting date, including the risks and uncertainties associated with the present obligation. Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. Provisions are discounted to their present values, where the time value of money is material.

Any reimbursement that the Company can be virtually certain to collect from a third party with respect to the obligation is recognized as a separate asset. However, this asset may not exceed the amount of the related provision.

All provisions are reviewed at each reporting date and adjusted to reflect the current best estimate.

In those cases where the possible outflow of economic resources as a result of present obligations is considered improbable or remote, no liability is recognized, unless it was assumed in the course of a business combination. In a business combination, contingent liabilities are recognized on the acquisition date when there is a present obligation that arises from past events and the fair value can be measured reliably, even if the outflow of economic resources is not probable. They are subsequently measured at the higher amount of a comparable provision as described above and the amount initially recognized, less any amortization.

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#### Warranties

The Company guarantees its condensate return solution product against defects for ten years and does not offer extended warranties. An allowance for warranty expense is recorded when the revenue for the related product is recognized. The allowance is based upon the terms of the warranty, the Company's historical experience and management estimates of future expense for replacement or repairs. The allowance is recorded in cost of goods sold.

#### 3.23. Loss per share

The Company presents basic and diluted loss per share data for its common shares, calculated by dividing the loss attributable to common shareholders of the Company by the weighted average number of common shares outstanding during the period. The treasury stock method is used to arrive at the diluted loss per share, which is determined by adjusting the loss attributable to common shareholders and the weighted average number of common shares outstanding for the effects of all warrants and options outstanding that may add to the number of common shares. The diluted loss per share is equal to the basic loss per share because the effect of stock options is antidilutive.

#### 3.24. Significant accounting judgements and estimates

The preparation of these unaudited condensed consolidated interim financial statements requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of the valuation of assets and liabilities that are not readily apparent from other sources. The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected. Actual results may differ from these estimates.

The most significant estimates include, but are not limited to:

- Assumptions used in the determination of the recoverable amount of intangible assets and goodwill

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

In most cases, determining the applicable discount rate involves estimating the appropriate adjustment to market risk and the appropriate adjustment to asset-specific risk factors. Further information on the estimates used in determining the recoverable amount of goodwill is provided in note 6.

- Future production outputs related to the finance lease

In determining minimum lease payments receivable, management makes estimates regarding monthly energy outputs of the leased asset based on assumptions regarding the efficiency of the asset, the operations of the plant in which it is located, penalty payments resulting from temporary plant shut-downs and residual value of the equipment. These assumptions relate to future events and circumstances. Actual results may vary from estimate. Further information on the future production outputs related to the finance lease is provided in note 9.

- Assumptions used in the Black-Scholes fair value calculations

In calculating the share-based compensation expense, key estimates such as the rate of forfeiture of options granted, the expected life of the option, the volatility of the Company's stock price and the risk free interest rate are used. Further details of inputs used in the measurement of fair values at grant date are provided in note 15.

The most significant judgements include, but are not limited to:

- Lease classification

Judgements are made in determining whether the conditions of lease contracts indicate that substantially all of the risks and rewards incidental to ownership have been transferred to the customer. Management identifies the conditions indicating the ownership of the equipment at the end of the term, the option for the customer to

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purchase the equipment at the end of the term, the term of the lease versus the economic life of the equipment, and the present value of the minimum lease payments versus the fair value of the equipment among other conditions. When the risks and rewards of ownership are transferred, the transaction is accounted for as a finance lease and if not, the transaction is an operating lease.

- Allowance for doubtful accounts

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

- Heat recovery solutions contract revenue

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

- Valuation allowances against future tax assets.

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

#### **3.25. Standards, amendments and interpretations to existing standards that are not yet effective and have not been adopted early by the Company**

##### IFRS 9, "Financial Instruments"

This new standard is part of the IASB's project to replace IAS 39, "Financial Instruments: Recognition and Measurement" and provides guidance on the classification and measurement of financial liabilities, hedge accounting and de-recognition. This new standard will also supersede IFRIC 9, "Reassessment of Embedded Derivatives". This standard is effective for annual periods beginning on or after January 1, 2013. Earlier application is permitted. The Company has not yet assessed the impact of this pronouncement on its consolidated financial statements.

##### IFRS 10, "Consolidated Financial Statements"

This new standard provides guidance on the determination of control where this is difficult to assess and replaces the consolidation requirements in SIC 12, "Consolidation – Special Purpose Entities". This standard is effective for annual periods beginning on or after January 1, 2013. Earlier application is permitted. The Company is currently evaluating the impact of this pronouncement on its consolidated financial statements.

##### IFRS 11, "Joint Arrangements"

This new standard provides guidance on how to account for interests in jointly controlled entities. This standard is effective for annual periods beginning on or after January 1, 2013. Earlier application is permitted. This pronouncement is not expected to have a material impact on the Company's consolidated financial statements.

##### IFRS 12, "Disclosure of Interests in Other Entities"

This new standard provides disclosure guidance on interests in subsidiaries, joint arrangements, associates and unconsolidated structured entities. This standard is effective for annual periods beginning on or after January 1, 2013. Earlier application is permitted. This pronouncement is not expected to have a material impact on the Company's consolidated financial statements.

##### IFRS 13, "Fair Value Measurement"

This new standard sets out a single IFRS definition and measurement framework for fair value. This standard is effective for annual periods beginning on or after January 1, 2013. Earlier application is permitted. The Company is currently evaluating the impact of this pronouncement on its consolidated financial statements.

##### IAS 1 Amendments, "Presentation of Financial Statements"

The IAS 1 Amendments require an entity to group items presented in other comprehensive income into those that, in accordance with other IFRSs: (a) will not be reclassified subsequently to profit or loss and (b) will be reclassified subsequently to profit or loss when specific conditions are met. It is applicable for annual periods beginning on or after 1 July 2012. The Group's management expects this will change the current presentation of items in other comprehensive income; however, it will not affect the measurement or recognition of such items

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#### IAS 12, "Income Taxes"

This amendment contains new standards related to deferred tax: recovery of underlying assets and supersedes SIC 21, "Income Taxes – Recovery of Revalued Non-Depreciable Assets". This amendment is effective for annual periods beginning on or after January 1, 2012. Earlier application is permitted. The Company is currently evaluating the impact of this pronouncement on its consolidated financial statements.

#### 4. JOINTLY CONTROLLED ENTITY / ACQUISITION OF CONTROL

The Company entered into a partnership agreement on November 7, 2007 with two partners established under the laws of the People's Republic of China with the name of Thermal Energy International (Guangzhou) Ltd. in which the Company owns a 55% interest. The Joint Venture was established 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 in 2009.

In September 2010, the Company took management control over the operations of the joint venture. Until this date, the results of the joint venture were included in the consolidated financial statements of the Company on a proportionate share basis. As the Company has since assumed management control, from the second quarter onwards the results of Thermal Energy International (Guangzhou) Ltd are included in the Company's financial statements on a full consolidation basis. Thermal Energy International (Guangzhou) Ltd. is no longer considered a joint venture, but from the second quarter of FY 2011 is included in the consolidated financial statements as a subsidiary of Thermal Energy International Inc.

These consolidated financial statements include the Company's proportionate share of the revenue, expenses, assets and liabilities of the joint venture for the first quarter of FY 2011 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
<b>Cash flows used in investing activities</b>	<b>-</b>

The above figures represent the Company's 55% share in the joint venture.

The results of the Chinese entity for the remainder of FY 2011 are fully consolidated within the financial statements of Thermal Energy International Inc.

#### 5. SEGMENT REPORTING

In the quarters ended August 31, 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 by product segment within two distinct geographical areas. All other items of revenue and expenses are considered on a geographical and/or global basis in making strategic decisions regarding the Company's future. The Company has two operational bases ("reporting units"), one in Canada covering North America and China, and the other in the United Kingdom, covering Europe and the rest of the world. The chief operating decision maker focuses on revenues and costs by product and 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.



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Product segments:

In the heat recovery business, customers typically finance these projects entirely from their own resources and occasionally through the Company's Thermal-AUD™ system whereby the Company finances the project and leases the facility to the customer thereby giving rise to finance revenue and financial lease payments received. The second product segment is in the condensate return system solutions business which was acquired through via the Company's acquisition of Gardner Energy Management Limited (GEM™) on July 1, 2008. Costs of sale identifiable as attributable to each segment are recorded within each segment.

Geographical areas:

Below the gross profit line, management considers the results analyzed by geographical area. Management does not consider assets and liabilities on a geographical basis, but instead on a global basis. The two geographical areas are North America and China, which are managed from the Ottawa office, and Europe and Rest of world, which are managed from the UK office. 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.

Segment information for the quarter ended August 31, 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 \$
Revenue from heat recovery systems	157,394	1,835,267	360,627	365,493	-	-	518,021	2,200,760
Revenue from GEM	143,460	134,001	770,205	650,906	-	-	913,665	784,907
<b>Total revenue</b>	<b>300,854</b>	<b>1,969,268</b>	<b>1,130,832</b>	<b>1,016,399</b>	-	-	<b>1,431,686</b>	<b>2,985,667</b>
Cost of sales	142,896	1,430,921	485,778	351,086	-	-	628,674	1,782,007
<b>Gross profit</b>	<b>157,958</b>	<b>538,347</b>	<b>645,054</b>	<b>665,313</b>	-	-	<b>803,012</b>	<b>1,203,660</b>
Amortization of intangible assets			24,623	36,542			24,623	36,542
Other expenses	398,402	412,662	520,511	507,986	206,737	318,116	1,125,650	1,238,764
Finance revenue	31,079	50,915					31,079	50,915
<b>Profit (loss) before taxation</b>	<b>(209,365)</b>	<b>176,600</b>	<b>99,920</b>	<b>120,785</b>	<b>(206,737)</b>	<b>(318,116)</b>	<b>(316,182)</b>	<b>(20,731)</b>
Taxation	-	-	(19,481)	(29,137)	20,134	20,777	653	(8,360)
Profit (loss) after taxation	(209,365)	176,600	80,439	91,648	(186,603)	(297,339)	(315,529)	(29,091)
Attributable to:								
Owners of the parent	(199,174)	176,600	77,281	85,979	(186,603)	(297,339)	(308,496)	(34,760)
Non-controlling interests	(10,191)	-	3,158	5,669	-	-	(7,033)	5,669

During the quarter ended August 31, 2011 the company had one customer in the heat recovery systems segment that accounted for 23%, and one customer in the GEM segment that accounted for 17% of total revenue for the period. Both customers were within Europe and Rest of World geographical segment.

For the quarter ended August 31, 2010 the company had one customer in the heat recovery systems segment that accounted for 61% of total revenue for the period. This customer was based in the North America and China geographical segment.

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Further geographical analysis:

	Revenues for the 3 months ended August 31		Property, plant and equipment	Goodwill and intangibles	Sales-type lease
	2011	2010	Aug 31, 2011	May 31, 2011	Aug 31, 2011
	\$	\$	\$	\$	\$
Canada	157,155	1,862,799	36,015	20,115	1,008,367
U.S.A.	134,611	52,664	-	-	-
U.K.	840,086	679,593	51,993	51,824	4,258,567
Italy	150,221	104,620	-	-	-
Germany	13,112	73,388	-	-	-
Rest of Europe	51,019	33,352	-	-	-
China	9,245	53,806	2,313	2,588	-
Malaysia	-	47,544	-	-	-
Singapore	51,904	-	-	-	-
Rest of world	24,333	77,901	-	-	-
<b>Total</b>	<b>1,431,686</b>	<b>2,985,667</b>	<b>90,321</b>	<b>74,527</b>	<b>4,227,281</b>

#### 6. GOODWILL

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

	Aug 31, 2011	May 31, 2011
	\$	\$
Balance, beginning of year / period	3,318,520	3,163,356
Translation adjustments	(5,512)	155,164
<b>Balance, end of period</b>	<b>3,313,008</b>	<b>3,318,520</b>

Goodwill was tested for impairment as at May 31, 2011. For the purpose of annual impairment testing, goodwill is allocated to the following cash-generating units, which are the units expected to benefit from the synergies of the business combinations in which the goodwill arises: Gardner Energy Management Limited and GEMchem Limited, a 67% owned subsidiary of Gardner Energy Management Limited.

The recoverable amounts of the cash-generating units were determined based on value-in-use calculations, covering a one year budget, followed by an extrapolation of expected cash flows to be derived from the cash-generating units assuming growth rates as set out below, and applying a pre-tax discount rate of 24%.

Gardner Energy Management Limited's growth in the first year was assumed to be 32%, as per the detailed budget prepared with 16.5% in year 2 and 15% per annum thereafter. The year 1 growth of 32% reflects orders already received by Gardner Energy Management for heat recovery projects as at the impairment testing date. This growth rate is particularly high due to the receipt of one heat recovery contract for significantly more than the usual contract value. Subsequent years' growth of 16.5% and 15% reflects lower expected heat recovery sales due to the year 1 projections including this unusually large contract, but allows for growth in revenues due to expanding markets and global energy saving initiatives.

GEMchem Limited's growth in the first year was assumed to be 13%, as per the detailed budget prepared with 15% per annum thereafter. This is based on historical results, which demonstrate steady increases year on year.

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

Based on the above conditions as at May 31, 2011, no impairment was necessary.

At the date of transition to IFRS, June 1, 2010, the amount of goodwill was tested for impairment based on conditions at that date. The forecast at the transition date showed that no impairment was necessary.

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**7. INTANGIBLE ASSETS**

	Trade Names & Trademarks \$	Non-compete Agreement \$	Industrial Know-how \$	Designs & Drawings \$	Customer Relationships \$	Total \$
Cost, as at June 1, 2010	699,200	91,200	106,400	117,040	250,800	1,264,640
Translation adjustments	33,718	4,398	5,131	5,644	12,095	60,986
Cost, as at May 31, 2011	732,918	95,598	111,531	122,684	262,895	1,325,626
Translation adjustments	(735)	(96)	(112)	(123)	(265)	(1,331)
<b>Cost, as at Aug 31, 2011</b>	<b>732,183</b>	<b>95,502</b>	<b>111,419</b>	<b>122,561</b>	<b>262,630</b>	<b>1,324,295</b>
Accumulated amortization, June 1, 2010	-	87,400	40,787	44,865	96,140	269,192
Charge for the period	-	4,000	22,266	24,494	52,486	103,246
Translation adjustments	-	4,198	2,007	2,207	4,729	13,141
Accumulated amortization, May 31, 2011	-	95,598	65,060	71,566	153,355	385,579
Charge for the period	-	-	5,524	6,077	13,022	24,623
Translation adjustments	-	(96)	(19)	(21)	(44)	(180)
<b>Accumulated amortization, Aug 31, 2011</b>	<b>-</b>	<b>95,502</b>	<b>70,565</b>	<b>77,622</b>	<b>166,333</b>	<b>410,022</b>
Net Book Value, as at June 1, 2010	699,200	3,800	65,613	72,175	154,660	995,448
Net Book Value, as at May 31, 2011	732,918	-	46,471	51,118	109,540	940,047
<b>Net Book Value, as at Aug 31, 2011</b>	<b>732,183</b>	<b>-</b>	<b>40,854</b>	<b>44,939</b>	<b>96,297</b>	<b>914,273</b>

**THERMAL ENERGY INTERNATIONAL INC.**

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**August 31, 2011**

**8. PROPERTY, PLANT AND EQUIPMENT**

	Plant and equipment	Furniture and Fixtures	Laboratory equipment	Computers	Software	Leasehold improvements	Motor Vehicles	Total
	\$	\$	\$	\$	\$	\$	\$	\$
Cost June 1, 2010	77,562	112,889	52,857	272,649	33,213	13,789	19,576	582,535
Additions	13,762	-	-	10,475	-	1,145	-	25,382
Disposals				(1,946)				(1,946)
Translation adjustments	3,915	1,228	-	6,880	-	-	978	13,001
<b>Cost May 31, 2011</b>	<b>95,239</b>	<b>114,117</b>	<b>52,857</b>	<b>288,058</b>	<b>33,213</b>	<b>14,934</b>	<b>20,554</b>	<b>618,972</b>
Additions	3,498	-	-	6,766	16,026	-	-	26,290
Translation adjustments	(68)	(26)	-	113	-	-	(21)	(2)
<b>Cost Aug 31, 2011</b>	<b>98,669</b>	<b>114,091</b>	<b>52,857</b>	<b>294,937</b>	<b>49,239</b>	<b>14,934</b>	<b>20,533</b>	<b>645,260</b>
Accumulated depreciation, June 1, 2010	56,829	104,779	42,256	247,492	32,689	766	2,040	486,851
Charge for the period	10,962	2,163	8,531	18,124	524	4,596	5,122	50,022
Disposals				(973)				(973)
Translation adjustments	2,873	1,141	-	4,413	-	-	118	8,545
Accumulated depreciation, May 31, 2011	70,664	108,083	50,787	269,056	33,213	5,362	7,280	544,445
Charge for the period	2,106	470	834	4,010	668	1,149	1,272	10,509
Translation adjustments	(55)	(23)	-	66	-	-	(3)	(15)
<b>Accumulated depreciation Aug 31, 2011</b>	<b>72,715</b>	<b>108,530</b>	<b>51,621</b>	<b>273,132</b>	<b>33,881</b>	<b>6,511</b>	<b>8,549</b>	<b>554,939</b>
Net Book Value June 1, 2010	20,733	8,110	10,601	25,157	524	13,023	17,536	95,684
Net Book Value May 31, 2011	24,575	6,034	2,070	19,002	-	9,572	13,274	74,527
<b>Net Book Value Aug 31, 2011</b>	<b>25,954</b>	<b>5,561</b>	<b>1,236</b>	<b>21,805</b>	<b>15,358</b>	<b>8,423</b>	<b>11,984</b>	<b>90,321</b>

The Company has not elected to use fair value as deemed cost at the date of transition for all items of property, plant and equipment. The reported cost is the historical cost less accumulated depreciation.

The motor vehicles included in property, plant and equipment are held under a finance lease. At the end of the lease, full title to the motor vehicle may pass to the Company upon payment of a sundry fee. No other assets are held under finance leases. Other than the motor vehicles held under a finance lease, there are no items of property, plant or equipment subject to restrictions of title or pledged as security. Capital commitments relating to motor vehicles held under finance leases, as at August 31, 2011 were as follows:

	\$
Year 1	5,133
Year 2	5,133
Year 3	1,711
<b>Total</b>	<b>11,977</b>

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**9. FINANCE LEASE RECEIVABLE**

The Company's finance lease receivable includes the following:

	Aug 31, 2011	May 31, 2011	Jun 1, 2010
	\$	\$	\$
Total estimated minimum lease payments receivable	1,071,772	1,215,814	1,979,833
Less: unearned income	(63,405)	(94,484)	(286,492)
	1,008,367	1,121,330	1,693,341
Less: current portion	(668,534)	(653,807)	(534,281)
	339,833	467,523	1,159,060

Finance lease receivable relates to one arrangement. The previous lease for this facility was suspended in 2009 following the bankruptcy of the customer and the lease was renegotiated with the new owners of the facility.

In connection with the renegotiation of the agreement an amount of \$193,380 was recorded as impairment due to the reduction of the present value of the minimum lease payment. Also, an amount of \$96,149 related to accounts receivables was written off following 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.

The Company recognizes finance income over the period of the lease, reflecting a constant periodic return on the Company's net investment in the lease. Lease payments consist of blended monthly payments of principal and interest. The interest rate inherent in the lease is 14%.

Future estimated minimum lease payments receivable under the finance lease are as follows:

	\$
Less than one year	605,060
Between two and five years	327,182
More than five years	-
Residual value	139,530
	1,071,772

**10. OPERATING LEASES**

At August 31, 2011 the Company has operating lease commitments as follows:

	Total \$	Year 1 \$	Year 2 \$	Year 3 \$	Year 4 \$	Year 5 \$	Year 6 and thereafter \$
Operating Leases	255,270	140,576	100,531	5,670	5,364	3,129	nil

Lease payments recognized as an expense in the quarter ended August 31, 2011 totaled \$34,865 (\$34,501 in the quarter ended August 31, 2010).

## THERMAL ENERGY INTERNATIONAL INC.

### NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (Unaudited)

August 31, 2011

#### 11. INVENTORIES

	Aug 31, 2011	May 31, 2011	Jun 1, 2010
	\$	\$	\$
Work in process	449,802	420,999	394,507

Partly finished product is purchased from suppliers and held in inventory pending finishing to the customers' requirements.

In the quarter ended August 31, 2011, a total of \$116,968 of inventories was included in profit and loss as an expense (\$85,103 in the quarter ended August 31, 2010). There was no write down of inventories during the quarters ended August 31, 2011 or August 31, 2010.

#### 12. TRADE AND OTHER RECEIVABLES

	Aug 31, 2011	May 31, 2011	Jun 1, 2010
	\$	\$	\$
Trade receivables, gross	2,276,435	1,645,428	1,869,200
Allowance for doubtful debts	(232,155)	(232,155)	(248,517)
Trade receivables, net	2,044,280	1,413,273	1,620,683
Related party	-	34,029	46,741
Contracts for heat recovery solutions (see note 12.1)	80,957	107,104	-
Unbilled product revenue (see note 12.2)	37,448	65,296	-
Prepayments	155,170	118,908	239,416
Other	110,699	112,767	12,600
	2,428,554	1,851,377	1,919,440

All amounts are short-term. The net carrying value of trade receivables is considered a reasonable approximation of fair value. There were no adjustments to allowance for doubtful debts during the period.

Other receivables include \$96,431 due from a Chinese distributor receiving payments on the Company's behalf from a Chinese customer.

##### 12.1 Contracts for heat recovery solutions

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

	Aug 31, 2011	May 31, 2011	Jun 1, 2010
	\$	\$	\$
Aggregate amount of costs incurred and recognized profits and losses for all contracts in progress	4,418,866	4,281,849	490,363
Less progress billings	(5,107,070)	(4,312,054)	(1,242,922)
	(688,204)	(30,205)	(752,559)
Recognized as:			
Due from customers for contract work, recognized in trade and other receivables	80,957	107,104	-
Due to customers for contract work, recognized in deferred revenue within liabilities (note 17)	769,161	137,309	752,559

##### 12.2 Unbilled product revenue

The amounts recognized in the statement of financial position relate to orders in progress for one customer at the end of the reporting period. Ordinarily sales of GEM product are invoiced upon despatch of goods, however the customer agreed to a staged payments arrangement due to the relatively high value of the numerous orders. The amounts are calculated as the net amounts of costs incurred plus recognized profits, less recognized losses and progress billings. The carrying amounts of assets and liabilities are analysed as follows:

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**August 31, 2011**

	Aug 31, 2011 \$	May 31, 2011 \$
Aggregate amount of costs incurred and recognized profits and losses for all contracts in progress	1,123,721	878,085
Less progress billings	<b>(1,187,586)</b>	<b>(996,937)</b>
	<b>(63,865)</b>	<b>(118,852)</b>
Recognized as:		
Due from customer for product sent, recognized in trade and other receivables	<b>37,448</b>	65,296
Due to customer for product not yet sent, recognized in deferred revenue within liabilities (note 17)	<b>101,313</b>	184,148

There were no amounts for unbilled product revenue at June 1, 2010

**13. CASH AND CASH EQUIVALENTS**

Cash equivalents consist of excess cash invested in money market funds

	Aug 31, 2011 \$	May 31, 2011 \$	Jun 1, 2010 \$
Cash	<b>823,854</b>	971,052	412,587
Money market funds	<b>1,111</b>	1,111	20,906
Trade payables	<b>824,965</b>	972,163	433,493

**14. BANK LOANS**

At August 31, 2011 and at May 31, 2011, the Company had no bank loans outstanding. At June 1, 2010, a subsidiary had a bank loan amounting to \$11,093, secured by certain trade accounts receivable of a subsidiary which carries a service charge of 0.805% of the gross loan subject to a minimum annual charge of approximately \$24,000 and an interest rate of 1.95% over the LIBOR rate. The Company has continued access to this short term financing facility.

**15. CAPITAL STOCK**

	Quarter ended Aug 31, 2011		Year ended May 31, 2011	
	# Shares	\$	# Shares	\$

**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.

**Class A Common shares issued**

Balance, beginning of period / year	<b>163,770,922</b>	<b>35,151,630</b>	163,840,922	35,161,630
Cancelled shares	<b>(684,306)</b>	<b>(112,246)</b>	(70,000)	(10,000)
	<b>163,086,616</b>	<b>35,039,384</b>	163,770,922	35,151,630
Less: loans outstanding to assist shareholders in purchasing capital stock (i)		-		(100,246)
Share issue costs		<b>(1,903,200)</b>		(1,903,200)
Balance, end of period / year	<b>163,086,616</b>	<b>33,136,184</b>	163,770,922	33,148,184

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### NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (Unaudited)

#### August 31, 2011

- (i) Repayments of \$nil and cancellations of \$100,246 were made on these loans in the quarter ended August 31, 2011. In addition an accounts receivable of \$12,000 for shares which were cancelled was forgiven. In the year ended May 31, 2011, loans of \$10,000 were cancelled.

	Loans to acquire shares	
	Aug 31, 2011	May 31, 2011
	\$	\$
Shareholders	-	110,246
Market value of shares held as security	-	19,833

Loans were extended to shareholders to acquire shares of the Company through the exercise of options. These loans bore interest at a rate of 5% and matured at dates which ranged from 2 to 5 years from the date of issue. In certain instances, the borrowers' liabilities in respect of these loans were at all times limited to the value of the underlying shares for which the loan was granted. They could be repaid in part or in full at any time before maturity, at which time the shares with an equivalent value to the repayment would be released to the borrower by the Company.

The loans outstanding as at May 31, 2011 were not all secured by share certificates.

#### Warrants

In fiscal 2009, the Company completed a private placement and as a result, the agent was issued 5,236,363 transferable warrants, valued at \$636,200. These warrants expired in the quarter ended August 31, 2010. Activity in share purchase warrants was as follows:

	Quarter ended August 31, 2011		Quarter ended August 31, 2010	
	# Warrants	Weighted Average Exercise Price	# Warrants	Weighted Average Exercise Price
		\$		\$
Balance, beginning of period	-	-	5,236,363	0.22
Issued	-	-	-	-
Exercised	-	-	-	-
Expired	-	-	5,236,363	0.22
Balance, end of period	-	-	-	0.28

#### 16. SHARE BASED PAYMENTS

The Company established the Company's Share Option Plan applicable to Directors, Officers and full-time and part-time employees of the Company. In the plan, the aggregate number of options may not exceed 20% of the outstanding shares and the total number of shares to be optioned to any optionee may not exceed 5% of the number of issued and outstanding shares as at the option granting date. The options are granted with an exercise price equal to the market value of the common shares of the Company at the date of grant, less any permissible discounts, and may be exercised at any time after the vesting date, not to exceed five years from the date of granting. Vesting period for options granted is at the discretion of the Board of Directors. No options were granted in the quarter ended August 31, 2010.

The following share-based payment arrangements were in existence at August 31, 2011, May 31, 2011 and August 31, 2010:

At August 31, 2011 :

Number outstanding	Grant date	Expiry date	Exercise price (\$)	Fair value at grant date (\$)	Number exercisable
250,000	09-Sep-2008	09-Sep-2011	0.25	0.12	250,000
2,750,000	04-May-2010	04-May-2015	0.10	0.03	1,583,333
2,656,250	10-May-2011	10-May-2016	0.10	0.03	-
500,000	12-Jul-2011	12-Jul-2016	0.10	0.03	-
<b>6,156,250</b>			<b>0.11</b>		<b>1,833,333</b>



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**August 31, 2011**

At May 31, 2011:

Number outstanding	Grant date	Expiry date	Exercise price (\$)	Fair value at grant date (\$)	Number exercisable
225,000	15-Aug-2008	15-Aug-2011	0.33	0.11	225,000
250,000	09-Sep-2008	09-Sep-2011	0.25	0.12	250,000
2,750,000	04-May-2010	04-May-2015	0.10	0.03	1,583,333
2,656,250	10-May-2011	10-May-2016	0.10	0.03	-
<b>5,881,250</b>			<b>0.12</b>		<b>2,058,333</b>

At August 31, 2010:

Number outstanding	Grant date	Expiry date	Exercise price (\$)	Fair value at grant date (\$)	Number exercisable
250,000	25-Jan-2008	25-Jan-2011	0.20	0.10	250,000
250,000	16-May-2008	16-May-2011	0.27	0.13	250,000
225,000	15-Aug-2008	15-Aug-2011	0.33	0.11	225,000
250,000	09-Sep-2008	09-Sep-2011	0.25	0.12	250,000
2,750,000	04-May-2010	04-May-2015	0.10	0.03	1,000,000
<b>3,725,000</b>			<b>0.14</b>		<b>1,975,000</b>

The fair value of services received in return for share options granted is based on the fair value of share options granted, measured using the Black-Scholes model. As at August 31, 2011, there was \$86,286 (May 31, 2011 – \$84,929) of total unrecognized share-based compensation costs related to unvested stock option awards granted under the Plan which are expected to be recognized over a weighted-average period of 3 years.

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

	Grant Date						
	25-Jan-08	16-May-08	15-Aug-08	09-Sep-08	04-May-10	10-May-11	12-Jul-11
Grant date share price (\$) <sup>(1)</sup>	0.20	0.27	0.26	0.25	0.06	0.05	0.06
Exercise price (\$)	0.20	0.27	0.33	0.25	0.10	0.10	0.10
Expected volatility <sup>(2)</sup> (%)	79.76	79.78	78.64	78.98	85.67	91.01	93.27
Expected life (years)	2.40	2.40	2.40	2.40	4.00	4.00	4.00
Expected dividend yield (%)	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Risk-free interest rate (%)	4.50	4.50	2.50	2.50	2.56	1.13	1.05
Forfeiture rate (%) <sup>(3)</sup>	0.00	0.00	0.00	0.00	0.00	0.00	0.00

- (1) The closing market price of the shares on the TSX Venture Exchange on the date of grant or the first day of trading immediately following the date of grant if no shares traded on the grant date.
- (2) The expected volatility was based on historical volatility of the Company over a period of time that is commensurate with the expected life of the options.
- (3) Under Canadian GAAP, forfeitures of share options were recognized as they occurred. Under IFRS, a forfeiture rate is estimated for the number of options expected to vest. A review of outstanding unvested options undertaken as of each date above revealed no material expected forfeitures, hence a forfeiture rate of 0%. A review will be undertaken each quarter and forfeiture rates amended accordingly, in accordance with IFRS 2 *Share based payments*.

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Activity in stock options was as follows:

	Quarter ended Aug 31, 2011		Quarter ended August 31, 2010	
	# Options	Weighted Average \$	# Options	Weighted Average \$
Outstanding, beginning of period	5,881,250	0.12	4,075,000	0.16
Granted	500,000	0.10	-	-
Exercised	-	-	-	-
Forfeited	-	-	-	-
Expired	(225,000)	0.33	(350,000)	0.39
Outstanding, end of period	6,156,250	0.11	3,725,000	0.14
Number of options exercisable as at August 31	1,833,333	0.12	1,975,000	0.26

There were no options exercised in the quarters ended August 31, 2011 and 2010

Stock-based compensation expense related to the issuance of stock option is included in administration and sales expense and is broken down as follows:

	August 31, 2011		August 31, 2010	
	Administration \$	Selling, marketing and business development \$	Administration \$	Selling, marketing and business development \$
Employees	4,501	4,400	3,328	1,867
Directors and Officers	5,439	1,206	29,794	386
	9,940	5,606	33,122	2,253

**17. TRADE AND OTHER PAYABLES**

Trade and other payables recognized in the statement of financial position can be analysed as follows:

	Aug 31, 2011 \$	May 31, 2011 \$	Jun 1, 2010 \$
Trade payables	706,916	657,096	527,759

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

**18. DEFERRED REVENUE**

	Aug 31, 2011 \$	May 31, 2011 \$	Jun 1, 2010 \$
Deferred revenue relating to heat recovery solutions	769,161	137,309	752,559
Deferred revenue relating to GEM product	101,313	184,148	-
Deferred revenue relating to services	14,925	22,242	17,242
	885,399	343,699	769,801

All amounts are short-term, and will generally be utilized within the next reporting period.

## THERMAL ENERGY INTERNATIONAL INC.

### NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (Unaudited)

August 31, 2011

#### 19. OTHER LIABILITIES

Other liabilities can be summarized as follows:

	Aug 31, 2011	May 31, 2011	Jun 1, 2010
	\$	\$	\$
Finance leases	11,978	13,274	12,642
Accruals	652,493	530,394	412,522
Other	30,796	30,809	-
	<b>695,267</b>	<b>574,477</b>	<b>425,164</b>

#### 20. PROVISIONS

	Aug 31, 2011	May 31, 2011	Jun 1, 2010
	\$	\$	\$
Provisions	<b>215,000</b>	<b>265,000</b>	<b>265,000</b>

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.

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.

#### 21. NET LOSS PER SHARE

The calculation of basic and diluted loss per share for the three months ended August 31, 2011 and 2010 was based on the loss attributable to common shareholders of \$308,496 and \$34,760 respectively and the weighted average number of common shares outstanding of 163,086,616 and 163,126,612 respectively. Diluted loss per share for the three months ended August 31, 2011 did not include the effect of 6,156,250 stock options as they are anti-dilutive.

#### 22. RELATED PARTY TRANSACTIONS

Related parties include the Board of Directors and key management personnel, as well as close family members and enterprises that are controlled by these individuals, and shareholders.

## THERMAL ENERGY INTERNATIONAL INC.

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Related party transactions conducted in the normal course of operations are measured at the fair value, which represents the amounts established and agreed upon by both parties.

	August 31, 2011	May 31, 2011
Balances due to directors:		
Accrued liabilities	\$29,333	\$25,000
Directors share options outstanding:		
Issued	2,250,000	1,750,000
Exercisable	1,250,000	1,250,000
Officers share options outstanding:		
Issued	1,350,000	1,450,000
Exercisable	283,333	383,333
Balance due from shareholders		
Loans receivable, including accrued interest	-	\$122,275

#### 22.1. 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:

	Aug 31, 2011 \$	Aug 31, 2010 \$
Salaries and other short term employee benefits	221,388	213,673
Incentives	-	31,701
Directors' fees	29,333	25,000
Share-based payments	10,624	33,885
	261,345	304,259

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. Incentives represent the amount expensed in the period as due to key management personnel under the Company's employee incentive plan. Directors' fees include meeting fees, committee chairman fees, and retainers. Share-based payments include the intrinsic value of equity settled share-based payment arrangements awarded during the period.

## 23. FINANCIAL RISK MANAGEMENT

In the normal course of business, the Company is exposed to financial risks that have the potential to negatively impact its financial performance. The Company does not use derivative financial instruments to manage these risks, as management believes the risks arising from the Company's financial instruments to be at an already acceptably low level. These risks are discussed in more detail below.

#### Market risk

Market risk is the risk that changes in market prices, such as interest rates and foreign exchange, will affect the Company's net earnings or loss or the value of its financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable limits, while maximising returns.

#### Foreign exchange risk

The following table shows the foreign currency risk on the financial assets and liabilities of the Company's operations denominated in currencies other than the functional currency of the different Company entities.

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Functional currency of Company entity	Net financial assets/(liabilities) in CAD\$			
	US\$	£	Euro	Total CAD \$
<b>August 31, 2011</b>				
Canadian Dollar	125,407	-	-	125,407
British Pound	(160,416)	n/a	314,797	154,381
	<b>(35,009)</b>	<b>-</b>	<b>314,797</b>	<b>279,788</b>
<b>May 31, 2011</b>				
Canadian Dollar	156,975	(16,106)	-	140,869
British Pound	(32,226)	n/a	258,765	226,539
	124,749	(16,106)	258,765	367,408

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

	Aug 31, 2011			May 31, 2011		
	US\$	£	Euros	US\$	£	Euros
Net profit (loss)	<b>(3,501)</b>	-	<b>31,480</b>	12,475	(1,611)	25,877

The Company operates internationally with a subsidiary in the United Kingdom, a joint venture in China and operations in the United States. The Company incurs expenses and earns revenues in U.S. dollars, Euros and Chinese renminbi. The majority of the transactions are in U.S. dollars, GBP and Euros.

The Company does not enter into arrangements to hedge its foreign exchange risk. The Company's policy is to ensure that its net exposure is kept to an acceptable level by buying or selling foreign currencies at spot rates when necessary to address short term imbalances.

#### Credit risk

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its obligations. The financial instruments that potentially expose the Company to credit risk are accounts receivable and money market funds.

#### Accounts receivable

Each new customer is assessed individually for creditworthiness before standard payment and delivery terms and conditions are offered. Consideration is given to the country and industry in which the customer operates, as well as maturity of the customer, existence of previous financial difficulties and general reputation. Within the US market for GEM Product, a significant percentage of revenue is attributable to a small number of country-wide distributors with whom the Company has a trading history of at least two years. Within the European market for GEM Product, credit insurance is available in accordance with the existing borrowing facility held by the UK subsidiary. In the case of refused credit insurance, a full or partial deposit is required from the customer which will at least cover the cost of producing the goods. Documentary credits may be requested for larger orders to geographical regions where credit insurance is not applicable. Goods are sold subject to retention of title clauses, so that in the event of non-payment the Company may have a secured claim.

Construction contracts are planned to ensure cash flow positivity throughout the life of the project. A project may be halted pending payment by a customer, thus preventing further commitments under the contract.

The amounts reported for trade receivables in the statement of financial position are net of allowances for doubtful debts.

#### Liquidity risk

Liquidity risk is the risk that the Company will encounter difficulty in meeting the obligations of its financial liabilities that are settled by cash or another financial asset. Liquidity risk management serves to maintain a sufficient amount of cash and cash

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equivalents and to ensure that the Company has financing sources such as bank loans for a sufficient authorized amount. The Company continues to actively seek external financing to ensure it has the necessary funds to fulfill its obligations. In addition, a UK subsidiary of the Company has access to borrowings secured against certain accounts receivable.

#### Investments

Interest rate risk is defined as the risk that the fair value or future cash flows of a financial instrument will fluctuate because of a change in market interest rates. The Company minimizes risk by investing only with credit worthy banking institutions or draws on its available facility with floating rate borrowings, as mentioned in liquidity risk above.

The Company currently does not use interest rate hedges or fixed interest rate contracts to manage the Company's exposure to interest rate fluctuations.

#### 24. CAPITAL MANAGEMENT

The Company's objectives when managing capital is to safeguard the Company's ability to continue as a going concern and to maintain flexible capital structure for its projects for the benefit of its stakeholders. In the management of capital, the Company includes the components of shareholders' equity, excluding accumulated other comprehensive loss, which at August 31, 2011 totalled \$5,802,338 (May 31, 2011 - \$6,129,315 and June 1, 2010 - \$6,207,511). The Company manages the capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of the underlying assets. To maintain or adjust the capital structure, the Company may attempt to issue new shares. Management reviews the capital structure on a regular basis to ensure that objectives are met.

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

#### 25. PENSION PLAN

The Company contributes to defined contribution pension plans for permanent employees of one of its subsidiaries. The Company matches employee contributions. The plans and their assets are held by independent managers. The pension charge represents contributions paid by the company and amounted to \$10,226 for the quarter ended August 31, 2011 (\$9,462 in the quarter ended August 31, 2010).

#### 26. COMPARATIVE FIGURES

Certain of the comparative figures have been reclassified to conform with the current period's presentation.

#### 27. EXPLANATION OF TRANSITION TO IFRS

As stated in note 2 these are the Company's first unaudited condensed consolidated interim financial statements prepared in accordance with IFRS.

The accounting policies set out in note 3 have been applied in preparing the condensed consolidated interim financial statements for the three months ended August 31, 2011, the comparative information and the opening statement of financial position at June 1, 2010 (the Company's date of transition). In accordance with IFRS 1, estimates under IFRS at the date of transition are consistent with estimates made for the same date under Canadian GAAP.

##### 27.1. IFRS 1 exceptions and exemptions

The provisions under IFRS 1 allow for certain mandatory exceptions and optional exemptions for first time adopters to alleviate the retrospective application of all standards under IFRS. The Company has applied the mandatory exceptions and certain optional exemptions, as set out below.

##### Mandatory exceptions adopted

The application of the following mandatory exemptions did not have a financial impact on the Company's condensed consolidated statements of financial position at June 2010 and May 31, 2011 or the condensed consolidated statements of comprehensive loss for the three month and one year periods ended August 31, 2010 and May 31, 2011 respectively.

- I. De-recognition of financial assets and liabilities

The Company has applied the de-recognition requirements in IAS 39, "Financial Instruments: Recognition and Measurement" ("IAS 39"), prospectively from the Transition Date. As a result, any non-derivative financial assets

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or non-derivative financial liabilities derecognized prior to the Transition Date in accordance with CGAAP have not been reviewed for compliance with IAS 39.

II. Estimates

The estimates previously made by the Company under CGAAP were not revised for the application of IFRS except where necessary to reflect any difference in accounting policy.

#### Optional exemptions applied

I. Cumulative translation differences

IFRS 1 allows a first time adopter to elect to eliminate all previously recorded cumulative translation differences related to foreign operations at the transition date. The Company has chosen to apply this election.

II. Share-based payments

The Company has elected not to restate its share-based payments for share options granted after November 7, 2002 and vested prior to the date of transition.

III. Business Combinations

The Company has elected to use the exemption to adopt by IFRS 3 *Business Combinations* prospectively from the date of transition. See note 27.3.f

IV. Leases

The Company has elected not to reassess whether an arrangement contains a lease under IFRIC 4 for contracts that were assessed under previous Canadian GAAP.

In preparing its opening IFRS statement of financial position, the Company has adjusted amounts reported previously in financial statements prepared in accordance with Canadian GAAP. An explanation of how the transition from previous GAAP to IFRS has affected the Company's financial position, financial performance and cash flows is set out in the following tables and the notes that accompany those tables.

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**27.2. Reconciliation of equity**

The June 1, 2010 Canadian GAAP equity has been reconciled to IFRS as follows:

<b>ASSETS</b>					
<b>Canadian GAAP description ASSETS</b>	<b>Per GAAP \$</b>	<b>Effect of transition to IFRS \$</b>	<b>Per IFRS \$</b>	<b>IFRS description ASSETS</b>	<b>Note</b>
<b>Current assets</b>					
Cash and cash equivalents	433,493		433,493	Cash and cash equivalents	
Accounts receivable	1,680,024	239,416	1,919,440	Trade and other receivables	a
Inventories	394,507		394,507	Inventories	
Net investment in lease	534,281		534,281	Finance lease receivable	
Prepays and other assets	239,416	(239,416)	-		a
	3,281,721	-	3,281,721		
<b>Non-current assets</b>					
Property, plant and equipment	95,684		95,684	Property, plant and equipment	
Net investment in lease	1,159,060		1,159,060	Finance lease receivable	
Intangible assets	995,448		995,448	Intangible assets	
Goodwill	3,143,979	19,377	3,163,356	Goodwill	b
	5,394,171	19,377	5,413,548		
	<b>8,675,892</b>	<b>19,377</b>	<b>8,695,269</b>	<b>Total assets</b>	
<b>LIABILITIES</b>					
<b>Current liabilities</b>					
Bank loans	11,093		11,093	Short-term borrowings	
Accounts payable	527,759		527,759	Trade and other payables	
		77,983	77,983	Current tax liabilities	c
		36,058	36,058	Pensions and other employee obligations	c
		425,164	425,164	Other liabilities	c
		19,377	19,377	Deferred consideration	b
Deferred revenue	769,801		769,801	Deferred revenue	
		265,000	265,000	Provisions	c
Accrued liabilities	804,205	(804,205)	-		c
	<b>2,112,858</b>	<b>19,377</b>	<b>2,132,235</b>	<b>Total current liabilities</b>	
<b>Non-current liabilities</b>					
Future taxes	354,100		354,100	Deferred taxation	
Non-controlling interest	1,423	(1,423)	0		d
	<b>2,468,381</b>	<b>17,954</b>	<b>2,486,335</b>	<b>Total liabilities</b>	
<b>SHAREHOLDERS' EQUITY</b>					
Capital stock	32,623,584	524,600	33,148,184	Capital stock	e
Contributed surplus	2,292,153		2,292,153	Contributed surplus	
Deficit	(27,343,537)	(1,889,289)	(29,232,826)	Deficit	e/f
Accumulated other comprehensive loss	(1,364,689)	1,364,689	-	Accumulated other comprehensive loss	f
	6,207,511	-	6,207,511	Equity attributable to owners of the parent	
		1,423	1,423	Non-controlling interest	d
	<b>6,207,511</b>	<b>1,423</b>	<b>6,208,934</b>	<b>Total equity</b>	
	<b>8,675,892</b>	<b>19,377</b>	<b>8,695,269</b>	<b>Total equity and liabilities</b>	



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The May 31, 2011 Canadian GAAP equity has been reconciled to IFRS as follows:

<b>Canadian GAAP description</b>	<b>Per GAAP</b>	<b>Effect of transition to IFRS</b>	<b>Per IFRS</b>	<b>IFRS description</b>	<b>Note</b>
<b>ASSETS</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>ASSETS</b>	
<b>Current assets</b>					
Cash and cash equivalents	972,163		972,163	Cash and cash equivalents	
Accounts receivable	1,558,000	293,377	1,851,377	Trade and other receivables	a
Contracts In progress	174,469	(174,469)	-		a
Inventories	420,999		420,999	Inventories	
Net investment in lease	653,807		653,807	Finance lease receivable	
Prepaid and other assets	118,908	(118,908)	-		a
	<u>3,898,346</u>	<u>-</u>	<u>3,898,346</u>		
<b>Non-current assets</b>					
Property, plant and equipment	74,527		74,527	Property, plant and equipment	
Net investment in lease	467,523		467,523	Finance lease receivable	
Intangible assets	940,047		940,047	Intangible assets	
Goodwill	3,317,666	854	3,318,520	Goodwill	b
	<u>4,799,763</u>	<u>854</u>	<u>4,800,617</u>		
	<b>8,698,109</b>	<b>854</b>	<b>8,698,963</b>	<b>Total assets</b>	
<b>LIABILITIES</b>					
<b>Current liabilities</b>					
Accounts payable	657,096		657,096	Trade and other payables	
		124,113	124,113	Current tax liabilities	c
		62,173	62,173	Pensions and other employee obligations	c
		574,477	574,477	Other liabilities	c
		854	854	Deferred consideration	b
Deferred revenue	343,699		343,699	Deferred revenue	
		265,000	265,000	Provisions	c
Accrued liabilities	1,025,763	(1,025,763)	-		c
	<u>2,026,558</u>	<u>854</u>	<u>2,027,412</u>	<b>Total current liabilities</b>	
<b>Non-current liabilities</b>					
Future taxes	265,846		265,846	Deferred taxation	
Non-controlling interest	48,409	(48,409)	-		d
<b>Total liabilities</b>	<b>2,340,813</b>	<b>(47,555)</b>	<b>2,293,258</b>	<b>Total liabilities</b>	
<b>SHAREHOLDERS' EQUITY</b>					
Capital stock	32,623,584	524,600	33,148,184	Capital stock	e
Contributed surplus	2,354,784		2,354,784	Contributed surplus	
Deficit	(27,484,364)	(1,889,289)	(29,373,653)	Deficit	e/f
Accumulated other comprehensive loss	(1,136,708)	1,364,689	227,981	Accumulated other comprehensive loss	f
	6,357,296	-	6,357,296	Equity attributable to owners of the parent	
		48,409	48,409	Non-controlling interest	d
	<u>6,357,296</u>	<u>48,409</u>	<u>6,405,705</u>	<b>Total equity</b>	
	<b>8,698,109</b>	<b>854</b>	<b>8,698,963</b>	<b>Total equity and liabilities</b>	

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The August 31, 2010 Canadian GAAP equity has been reconciled to IFRS as follows:

Canadian GAAP description	Per GAAP (restated) \$	Effect of transition to IFRS \$	Per IFRS \$	IFRS description	Note
<b>ASSETS</b>					
<b>Current assets</b>					
Cash and cash equivalents	827,750		827,750	Cash and cash equivalents	
Accounts receivable	1,183,145	405,801	1,588,946	Trade and other receivables	a
Inventories	482,914		482,914	Inventories	
Net investment in lease	591,448		591,448	Finance lease receivable	
Prepaid and other assets	405,801	(405,801)	-		a
	<u>3,491,058</u>	<u>-</u>	<u>3,491,058</u>		
<b>Non-current assets</b>					
Property, plant and equipment	99,470		99,470	Property, plant and equipment	
Net investment in lease	1,008,367		1,008,367	Finance lease receivable	
Intangible assets	1,040,404		1,040,404	Intangible assets	
Goodwill	3,388,454	10,554	3,399,008	Goodwill	b
	<u>5,536,695</u>	<u>10,554</u>	<u>5,547,249</u>		
	<b>9,027,753</b>	<b>10,554</b>	<b>9,038,307</b>	<b>Total assets</b>	
<b>LIABILITIES</b>					
<b>Current liabilities</b>					
Accounts payable	874,191		874,191	Short-term borrowings	
	-	97,080	97,080	Trade and other payables	c
	-	61,032	61,032	Current tax liabilities	c
	-	448,990	448,990	Pensions and other employee obligations	c
	-	10,554	10,554	Other liabilities	b
Deferred revenue	335,318		335,318	Deferred consideration	
	-	265,000	265,000	Deferred revenue	c
Accrued liabilities	872,102	(872,102)	-	Provisions	c
	<u>2,081,611</u>	<u>10,554</u>	<u>2,092,165</u>		
				<b>Total current liabilities</b>	
Future taxes	380,610		380,610	<b>Non-current liabilities</b>	
Non-controlling interest	7,373	(7,373)	-	Deferred taxation	d
<b>Total liabilities</b>	<b>2,469,594</b>	<b>3,181</b>	<b>2,472,775</b>	<b>Total liabilities</b>	
<b>SHAREHOLDERS' EQUITY</b>					
Capital stock	32,623,584	524,600	33,148,184	<b>EQUITY</b>	e
Contributed surplus	2,327,528		2,327,528	Capital stock	
Deficit	(27,376,524)	(1,889,289)	(29,265,813)	Contributed surplus	e/f
Accumulated other comprehensive loss	(1,016,429)	1,364,689	348,260	Deficit	f
	6,558,159	-	6,558,159	Accumulated other comprehensive loss	
		7,373	7,373	Equity attributable to owners of the parent	d
	<u>6,558,159</u>	<u>7,373</u>	<u>6,565,532</u>	Non-controlling interest	
	<b>9,027,753</b>	<b>10,554</b>	<b>9,038,307</b>	<b>Total equity</b>	

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#### 27.3. Notes to the reconciliations

- a) Under IFRS, prepayments and contracts in progress do not require separate disclosure but instead are included within Trade and other receivables. This disclosure change has no impact on either total assets or total equity and liabilities.
- b) Deferred consideration relating to the purchase of Gardner Energy Management, estimated as \$19,377 as at the opening position was not provided under Canadian GAAP, however under IFRS 3 Business Combinations, contingent consideration should be included in the cost of the acquisition at the date of the acquisition if payment of the amount is probable and it can be measured reliably. This adjustment impacts goodwill and deferred consideration by \$19,377, \$10,554 and \$854 within the statement of financial position as at June 1, 2010, August 31, 2010 and May 31, 2011 respectively.
- c) Under IFRS, accrued liabilities are shown as other liabilities. In addition IFRS requires separate disclosure of provisions, pensions and other employee obligations and current tax liabilities. This disclosure change has no impact on either total assets or total equity and liabilities.
- d) Under Canadian GAAP, non-controlling interests were recorded as long term liabilities. Under IFRS however, they are included within equity. There is no net impact on total equity and liabilities.
- e) Under Canadian GAAP, the Company would record the gross proceeds relating to flow-through shares to share capital at the time of issuance. The Company would then record a charge (reduction) to share capital on the date the tax benefits of the flow-through shares were renounced to the subscribers. The charge was calculated by multiplying the amount of the renounced tax benefits (which are equal to the gross proceeds of the flow-through share issuance) by the effective tax rate at the time. The offset would be recorded as a deferred tax liability to reflect the fact that the Company could no longer use the tax attributes for its benefit. As a result of the deferred tax liability, the Company reduced the valuation allowance related to deferred tax assets arising from tax loss carry-forwards. This reduction would be recorded as a deferred tax recovery in the statement of earnings.

Under IFRS, the proceeds from issuing flow-through shares are allocated between the offering of shares and the sale of tax benefits. The allocation is based on the difference ("premium.") between the quoted price of the Company's existing shares, at the date of closing, and the amount the investor pays for the actual flow-through shares. A liability is recognized for the premium, and is extinguished when the tax effect of the temporary differences, resulting from the renunciation, is recorded. The difference between the liability and the value of the tax assets renounced is recorded as a deferred tax expense. There is no subsequent reduction in share capital. If the flow-through shares are not issued at a premium, a liability is not established and on renunciation the full value of the tax assets renounced is recorded as a deferred tax expense with an off-setting deferred tax recovery related to loss carry forwards.

As there is no exemption under IFRS 1 for first-time adopters regarding flow-through shares, the treatment under IFRS needs to be applied retrospectively.

The impact on the Company's transition to IFRS is an increase to share capital and an increase to deficit by \$524,600 as at May 31, 2011, August 31, 2010 and June 1, 2010.

- f) Under IFRS, the Company elected to re-set its cumulated foreign exchange adjustments to zero. The adjustment of \$1,364,689 impacts accumulated other comprehensive loss and retained deficit.
- g) The Company has elected to not restate business combinations that occurred before the date of transition to IFRS. The carrying amount of goodwill has not been adjusted for intangible assets subsumed within goodwill or for intangible assets that do not qualify for recognition under IFRS. The amount of goodwill at the date of transition relates to the Gardner Energy Management Limited cash-generating unit. At the date of transition, this goodwill was tested for impairment based on cash flow forecasts made at that date. No impairment was identified. The amount of goodwill recognized upon transition to IFRS is therefore the carrying amount under previous GAAP at June 1, 2010.

#### Material adjustments to total comprehensive income and statement of cash flows

There are no material differences between total comprehensive income presented under IFRS and total comprehensive income presented under previous GAAP, nor are there any material differences between the statement of cash flows presented under IFRS and the statement of cash flows presented under previous GAAP.

There are a number of amendments to the statement of financial position, however as there have been no changes to total comprehensive income, comprehensive loss or cash flows, no reconciliations are presented.