SECOND QUARTER REPORT
Period ended November 30, 2012

MANAGEMENT'S DISCUSSION & ANALYSIS

This discussion is dated as of January 29, 2013 and explains the material changes in Thermal Energy International Inc.'s ("Thermal Energy" or the "Company") financial condition and results of operations for the second quarter of Fiscal Year 2013, ended November 30, 2012. The condensed consolidated interim financial statements and accompanying notes constitute an integral part of the discussion and should be read in conjunction with these comments. During the period ended November 30, 2012, the Company's critical accounting estimates, significant accounting policies and risk factors have remained substantially unchanged. This discussion and analysis of the financial condition and results of operations may contain forward-looking statements. These statements are not guarantees of future performance and are subject to risks and uncertainties that could cause actual results to differ materially from those in the forward-looking statements. Additional information relating to the Company is available on SEDAR at www.sedar.com. All financial information in this report is stated in Canadian Dollars, which is both the presentation and functional currency of the Company.

Description of Business

Thermal Energy, established in 1991, is an innovative cleantech company providing a variety of proprietary and proven energy and water efficiency, emission reduction, and bioenergy products and solutions to the industrial, commercial and institutional markets. Thermal Energy International Inc. is headquartered in Ottawa, Canada, with offices in the UK and China and sales worldwide.

Thermal Energy engages clients through a unique mix of process, energy, environmental, and financial expertise to deliver significant financial and environmental benefits to our customers. The Company's award winning products have an excellent track record of longevity, proven reliability and performance and have been shown to provide: significant energy savings; improved water efficiency; reduced greenhouse gas emissions; lower maintenance costs; improved product quality; and increased production efficiency. Thermal Energy's products are effective in a wide range of industries and applications.

More information on Thermal Energy can be found at www.thermalenergy.com. GEM®, FLU-ACE®, THERMALONOx™, and DRY-REX™ are trademarks of Thermal Energy.

Discussion of Operations and Financial Conditions

Revenues and Gross Profits

Revenues were $1,259,984 in the quarter ended November 30, 2012, a decrease of 73% compared to $4,676,322 in the quarter ended November 30, 2011. Sales of GEM® Condensate return systems increased by $404,890 (53.3%) over the same period in the previous year, while sales of heat recovery systems decreased by $3,821,228 (97.6%).

Of the increase in GEM® Condensate return systems sales, $101,116 related to a major pharmaceutical company and $133,289 came from additional sales to the National Health Service in the UK, with the remaining increase coming predominantly from sales to the rest of the world.

Heat recovery systems revenue of $3,917,021 in the quarter ended November 30, 2011 included $1,880,809 from the $5.8 million contract with Fibrek, announced June 16, 2011 plus $1,607,234 relating to St. Georges Healthcare NHS Trust in the U.K. announced August 5, 2011, as well as a smaller hospital conversion of $281,527. There was no equivalent revenue in the quarter ended November 30, 2012.

For the six months ended November 30, 2012, revenues were $2,122,061 compared to $6,108,008 for the same period of the previous year. Revenues from the sale of heat recovery systems decreased by $4,198,011 from $4,435,042 in the previous period, due to the three projects mentioned above in the previous period compared to none in the current year to date, while GEM® Condensate return systems sales increased by $212,064 to $1,885,030 from $1,672,966, despite a decrease in revenues from sales to a major food manufacturer of $229,414 from the prior period, due to increased sales within the National Health Service in the UK as well as within North America and the rest of the world.

The gross profit of $799,717 in the quarter ended November 30, 2012 represented a decrease of $1,323,970, or 62.3%, from the $2,123,687 achieved in the quarter ended November 30, 2011. These results expressed as a percentage of sales were 63.5% in the second quarter of FY 2013 compared with 45.4% in the second quarter of FY 2012. Although the gross profit was down on the previous period, the margins were improved due to the product split.

For the six months ended November 30, 2012, gross profit of $1,324,680 represented a decrease of $1,602,019, or 54.7%, from the $2,926,699 achieved in the six months ended November 30, 2011. These results expressed as a percentage of sales were 62.4% in the first half of FY 2013 compared with 47.9% in the first half of FY 2012.

Expenses

Sales and Marketing and General and Administrative expenses in the quarter ended November 30, 2012 totalled $1,448,303 compared with $1,525,852 in the quarter ended November 30, 2011.

Staff costs within Sales and Marketing and General and Administrative expenses increased in the quarter ended November 30, 2012 over the same period of the previous year due to the addition of two sales staff, two technical staff and one additional finance staff. Other cost increases include the retainer paid to the investor relations firm, as announced April 19, 2012, as well as travel costs relating to investor meetings. These cost increases were offset by reductions in commissions payable and incentive provisions, as a result of reduced revenues and profits, plus a reduction in legal fees from the same period of the previous year. In addition, within Sales and Marketing and General and Administrative expenses for the quarter ended November 30, 2011 was a write down of the finance lease receivable, which was the result of a re-assessment of the finance lease receivable following a shutdown period of 45 days. The customer took advantage of a clause within the agreement allowing for shutdowns throughout the term of the contract totalling a maximum of 45 days without penalty. The effect of this shutdown during the winter period was to decrease the value of the finance lease receivable by approximately $92,539. This write off was partially offset by an increase of $37,781 due to the lease commencing one month earlier than originally anticipated.

For the six months ended November 30, 2012, Sales and Marketing and General and Administrative expenses totalled $2,956,220, compared to $2,676,005 for the six months ended November 30, 2011, an increase of $280,215. This was predominantly the result of the additional staff in the first half of FY 2013 plus the increased investor relations costs.

Research and development costs of $112,672 in the second quarter of FY 2013 compared to $6,924 in the second quarter of FY 2012. The current quarter includes costs relating to the product development project targeting the Chinese petrochemical market, for which the Company had previously received an offer of government funding through ISTP Canada, as announced February 8, 2012. The funding agreement was signed by both parties on January 21, 2013. Funding will be credited to research and development costs when it is received. Research and development costs also include time spent on the development of sundry ancillary products relating to the GEM product range.

Year to date research and development costs totalled $112,672 for the six months ended November 30, 2012 and $7,044 for the six months ended November 2011. Other than the activity described above, focus continues to be on increasing revenues from existing product lines, rather than developing new products.

Finance revenue in the second quarter of FY 2013 of $6,482 compared to $31,501 recognized in the second quarter of FY 2012.

For the six months ended November 30, 2012, finance revenue was $17,515, compared with $62,580 for the six months ended November 2011. The interest rate implicit in the lease of 14% is applied against the reducing finance lease receivable balance, hence lower finance revenues as the term of the agreement progresses.

Loss before income taxes for the quarter ended November 30, 2012 was $754,776 compared to income of $622,412 in the same quarter of the previous year. The decrease of $1,377,188 was due to the lack of heat recovery projects in progress during the quarter.

For the six months ended November 30, 2012, loss before income taxes was $1,726,697, compared with income of $306,230 for the six months ended November 30, 2011. This was the result of the decrease in heat recovery activity in the first half of FY 2013 compared to the first half of FY 2012, plus the increased staff costs mentioned above.

Income tax charge in the second quarter of FY 2013 was $32,131, compared to $163,957 as reported in the second quarter of FY 2012. The higher prior year charge mainly resulted from the UK tax payable on the St. Georges Healthcare NHS Trust project which was substantially completed in the quarter ended November 30, 2011.

For the six months ended November 30, 2012, income tax recovery was $92,463, compared with a charge of $163,304 for the same period of the previous year, due to current year to date losses compared with a profit for the first half of last year.

Net loss for second quarter of FY 2013 was $786,907 compared to net income of $458,455 in the same quarter of the previous year.

Net loss for the six months ended November 30, 2012 was $1,634,234 compared to net income of $142,926 for the six months ended November 30, 2011.

Comprehensive loss was $706,088 for the second quarter of FY 2013 compared to comprehensive income of $487,671 for the second quarter of FY 2012.

For the six months ended November 30, 2012, comprehensive loss was $1,628,709, compared with comprehensive income of $167,705 for the same period of the previous year.

Liquidity & Capital Resources

The working capital was $1,043,728 at November 30, 2012 compared to working capital of $2,567,447 at May 31, 2012 – a decrease of $1,523,719, with the Company's net cash position (Cash and cash equivalents less Bank loans) decreasing by $848,867 from $1,371,951 at May 31, 2012 to $523,084 as at November 30, 2012.

The Company's working capital position over the last eight quarters can be summarized as follows:

	Feb 28, 2011 $	May 31, 2011 $	Aug 31, 2011 $	Nov 30, 2011 $	Feb 29, 2012 $	May 31, 2012 $	Aug 31, 2012 $	Nov 30, 2012 $
Current Assets	3,717,578	3,898,346	4,371,855	5,813,077	5,345,538	5,758,086	4,534,637	3,814,265
Current Liabilities	1,930,687	2,017,259	2,695,481	3,500,526	2,942,432	3,190,639	2,800,733	2,770,537
Working Capital	1,786,891	1,881,087	1,676,374	2,312,551	2,403,106	2,567,447	1,733,904	1,043,728

Q2 FY 2013 Changes

Current assets decreased in the current quarter by $720,372 to $3,814,265. This was mainly due to a decrease in trade receivables of $438,939, a decrease in cash balances of $71,249 and a decrease in the finance lease receivable of $167,700. Current liabilities meanwhile also decreased by $30,196 to $2,770,537. Increases in trade payables of $58,808 and deferred revenue of $95,332 due to deposits paid by customers for heat recovery projects in the UK, were offset by a decrease in accrued liabilities due mainly to August accruals relating to the Fibrek project now being billed by suppliers.

As at November 30, 2012, $645,281 (44%) of the Company's trade receivables balance was over 90 days past due. Of this balance, $386,239 has subsequently been received by the Company. None of the remaining overdue balance is considered impaired as at November 30, 2012.

Cash outflow from operations (defined as net loss attributable to the owners of the parent, plus items not involving cash, plus lease payments received) for the quarter ended November 30, 2012 was $536,159. After adjusting this for $461,603 of positive changes in non-cash working capital items and foreign exchange adjustments and adding $3,954 for net proceeds of buying and selling fixed assets and deducting $647 to allow for the effect of exchange rate fluctuations on cash and cash equivalents, the net cash outflow was $71,249, decreasing the net cash balance as at November 30, 2012 to $523,084 from $594,333 as at August 31, 2012.

In addition to its net cash balance of $523,084 as at November 30, 2012 the Company also had an estimated $285,000 of unused borrowing capacity under its bank loans.

With cash balances and unused borrowing capacity of approximately $808,084, management believes that it has sufficient capital resources to fund existing operations and anticipated capital requirements in the remainder of FY 2013. Order backlog as at November 30, 2012 was approximately $2.1 million compared to $4.8 million at the same time last year, which included $3.8 million regarding Fibrek and $0.4 million for the St. George NHS Trust project in the UK. As at January 29, 2013, the Company had $3.1 million in purchase orders that had not yet been reflected as revenue in the Company's published quarterly financial statements.

Net Investment In Lease

The Company's net investment in lease includes the following:

	November 30, 2012 $	May 31, 2012 $
Total estimated minimum lease payments receivable	212,606	530,779
Less: unearned income	(769)	(18,283)
	211,837	512,496
Less: current portion	(72,307)	(512,496)
	139,530	-

The estimated minimum lease payments receivable in this lease represent the estimated monthly energy outputs of the leased asset and are based on assumptions regarding the efficiency of the asset, the operations of the plant in which it is located and penalty payments resulting from temporary plant shut-downs. The lease expires December 31, 2012. On November 27, 2012 an agreement was signed whereby the customer agrees to purchase the recovered energy for a further two years, after which the customer has the option to renew for an additional 24 months on substantially the same terms or purchase the asset from the Company.

Future estimated minimum lease payments receivable, and expected residual value of equipment at the end of the lease, under the sales-type lease are as follows:

	$
FY 2013	247,258
Residual value of equipment	139,530
	386,788

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

Related Party Transactions

Options outstanding for Directors (excluding the CEO) as at November 30, 2012 were 1,500,000 of which 166,666 were exercisable. There were no warrants outstanding for Directors.

Options outstanding for Officers (including the CEO) as at November 30, 2012 were 5,430,000 of which 1,900,000 were exercisable. There were no warrants outstanding for Officers.

Officer and Director Compensation

During the second quarter ended November 30, 2012 compensation arrangements for directors was as follows:

Before October 26, 2012:

$20,000 per annum per Director plus an additional $12,000 per annum payable to the Chairman of the Board, $8,000 per annum payable to individual committee chairpersons of the Audit Committee and the Ethics, Governance and Compliance Committee, and $1,000 payable for each in-person meeting.

After October 26, 2012:

$15,000 per annum per Director plus an additional $9,000 per annum payable to the Chairman of the Board, $6,000 per annum payable to the chairperson of the Audit Committee and $1,000 payable for each in-person meeting.

During the second quarter ended November 30, 2012 Directors fees paid were $24,006. Fees to the Chairperson of the Audit Committee were $1,802; fees to the Chairperson of the Ethics, Governance and Compliance Committee were $1,205; fees paid to the Chairman were $2,701; and a total of $9,000 was paid for in-person meetings.

Compensation paid to directors and officers during the second quarter ended November 30, 2012 (inclusive of the amounts described above) was as follows:

	Salaries and fees		**Commissions / incentives**		**Total**	
	2012 **$**	2011 $	**2012** **$**	2011 $	**2012** **$**	2011 $
Directors						
M. Williams	**7,304**	9,000	**-**	-	**7,304**	9,000
J. Ansell	**4,214**	9,000	**-**	-	**4,214**	9,000
J. Kelly	**9,204**	10,000	**-**	-	**9,204**	10,000
D. Gibbs	**6,503**	7,000	**-**	-	**6,503**	7,000
W. Ollerhead	**6,503**	3,083	**-**	-	**6,503**	3,083
B. Linton	**2,493**	-	**-**	-	**2,493**	-
J. Schoenmakers	**2,493**	-	**-**	-	**2,493**	-
Total	**38,714**	38,083	**-**	-	**38,714**	38,083
Officers						
W. Crossland	**60,000**	60,000	**-**	-	**60,000**	60,000
J. Flynn	**31,847**	31,259	**-**	-	**31,847**	31,259
R. Triebe	**35,775**	33,750	**-**	-	**35,775**	33,750
Total	**127,622**	125,009	**-**	-	**127,622**	125,009

Segmented Information

In the quarters and six month periods ended November 30, 2012 and 2011, the Company operated in the energy efficiency industry in North America, Europe, China and Rest of the World. The Company markets, sells, engineers, fabricates, constructs, installs and supports two technology lines – heat recovery solutions and condensate return system solutions. The Company is also developing a third technology line - low temperature biomass drying systems. Assets are located in Canada, Europe and China.

Management reporting comprises analysis of revenue and gross profit 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 Bristol, United Kingdom, covering Europe and the rest of the world. These areas are determined by proximity of the region to the reporting unit, plus the location of the contracts in existence with agents and distributors in the respective areas and the historical relationships with those agents and distributors. Corporate costs that cannot easily be attributed to either of the two reporting units are included in reconciling items. The chief operating decision maker focuses on revenues and costs by geographical segments, but manages assets and liabilities on a global basis.

Segment information for the quarter ended November 30, 2012 and the comparative period are detailed in the table below.

	North America and China		Europe and Rest of World		Reconciling items		Total	
	2012	2011	**2012**	2011	**2012**	2011	**2012**	2011
	$	$	**$**	$	**$**	$	**$**	$
Total revenue	**391,989**	2,190,922	**867,995**	2,485,400	**-**	-	**1,259,984**	4,676,322
Cost of sales	**(198,069)**	(1,532,828)	**(262,198)**	(1,019,807)	**-**	-	**(460,267)**	(2,552,635)
Gross profit	**193,920**	658,094	**605,797**	1,465,593	**-**	-	**799,717**	2,123,687
Amortization of intangible assets	**-**	-	**(24,735)**	(25,008)	**-**	-	**(24,735)**	(25,008)
Other expenses	**(502,094)**	(450,128)	**(650,334)**	(635,310)	**(383,812)**	(422,330)	**(1,536,240)**	(1,507,768)
Finance revenue	**6,482**	31,501	**-**	-	**-**	-	**6,482**	31,501
Profit (loss) before taxation	**(301,692)**	239,467	**(69,272)**	805,275	**(383,812)**	(422,330)	**(754,776)**	622,412
Taxation	**-**	-	**(39,422)**	(192,999)	**7,291**	29,042	**(32,131)**	(163,957)
Profit (loss) after taxation	**(301,692)**	239,467	**(108,694)**	612,276	**(376,521)**	(393,288)	**(786,907)**	458,455
Attributable to:								
Owners of the parent	**(293,473)**	242,798	**(108,017)**	610,269	**(376,521)**	(393,288)	**(778,011)**	459,779
Non-controlling interest	**(8,219)**	(3,331)	**(677)**	2,007	**-**	-	**(8,896)**	(1,324)

Segment information for the six months ended November 30, 2012 and the comparative period are detailed in the table below.

	North America and China		Europe and Rest of World		Reconciling items		Total	
	2012	2011	**2012**	2011	**2012**	2011	**2012**	2011
	$	$	**$**	$	**$**	$	**$**	$
Total revenue	**713,399**	2,491,776	**1,408,662**	3,616,232	**-**	-	**2,122,061**	6,108,008
Cost of sales	**(292,553)**	(1,675,724)	**(504,828)**	(1,505,585)	**-**	-	**(797,381)**	(3,181,309)
Gross profit	**420,846**	816,052	**903,834**	2,110,647	**-**	-	**1,324,680**	2,926,699
Amortization of intangible assets	**-**	-	**(49,381)**	(49,631)	**-**	-	**(49,381)**	(49,631)
Other expenses	**(1,082,092)**	(838,422)	**(1,233,564)**	(1,155,821)	**(703,855)**	(639,175)	**(3,019,511)**	(2,633,418)
Finance revenue	**17,515**	62,580	**-**	-	**-**	-	**17,515**	62,580
Profit (loss) before taxation	**(643,731)**	40,210	**(379,111)**	905,195	**(703,855)**	(639,175)	**(1,726,697)**	306,230
Taxation	**-**	-	**50,381**	(212,480)	**42,082**	49,176	**92,463**	(163,304)
Profit (loss) after taxation	**(643,731)**	40,210	**(328,730)**	692,715	**(661,773)**	(589,999)	**(1,634,234)**	142,926
Attributable to:								
Owners of the parent	**(625,432)**	53,732	**(329,205)**	687,550	**(661,773)**	(589,999)	**(1,616,410)**	151,283
Non-controlling interest	**(18,299)**	(13,522)	**475**	5,165	**-**	-	**(17,824)**	(8,357)

Reconciling items comprise the following:

	Three months ended November 30		Six months ended November 30	
	2012	2011	**2012**	2011
	$	$	**$**	$
Corporate admin costs	**247,692**	214,435	**441,806**	377,750
Stock-based compensation	**33,689**	16,838	**68,082**	32,384
Professional fees	**73,492**	144,972	**127,014**	171,220
Depreciation of property, plant and equipment	**12,431**	11,420	**23,058**	21,929
Bank charges and interest	**9,168**	11,303	**19,474**	22,930
Foreign exchange differences	**7,340**	23,362	**24,421**	12,962
Total	**383,812**	422,330	**703,855**	639,175

During the quarter ended November 30, 2012 the company had one customer in Europe and rest of world that accounted for 20% of total revenue for the period.

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

During the six months ended November 30, 2012 the company had one customer in Europe and rest of world that accounted for 12% of total revenue for the period.

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

Further geographical analysis:

	Revenues for the six months ended		Property, plant and equipment as at		Goodwill and other intangibles assets as at		Finance lease receivable as at	
	November 30							
	2012	2011	**November 30, 2012**	May 31, 2012	**November 30, 2012**	May 31, 2012	**November 30, 2012**	May 31, 2012
	$	$	**$**	$	**$**	$	**$**	$
Canada	**212,527**	2,120,674	**28,565**	28,448	**-**	-	**211,837**	512,496
U.S.A.	**489,537**	345,011	**-**	-	**-**	-	**-**	-
U.K.	**901,920**	3,160,487	**34,305**	40,512	**4,103,644**	4,145,745	**-**	-
Italy	**119,285**	213,965	**-**	-	**-**	-	**-**	-
Netherlands	**85,962**	44,023	**-**	-	**-**	-	**-**	-
Ireland	**74,746**	71,725	**-**	-	**-**	-	**-**	-
Rest of Europe	**22,566**	39,507	**-**	-	**-**	-	**-**	-
India	**117,479**	11,838						
Kenya	**44,311**	2,140						
China	**11,335**	26,091	**628**	1,364	**-**	-	**-**	-
Singapore	**4,005**	54,996	**-**	-	**-**	-	**-**	-
Rest of world	**38,388**	17,551	**-**	-	**-**	-	**-**	-
Total	**2,122,061**	6,108,008	**63,498**	70,324	**4,103,644**	4,145,745	**211,837**	512,496

Material Segmentation Variances

Revenue

North America and China: revenue for the second quarter ended November 30, 2012 was $391,989 compared to $2,190,922 for the same period of the previous year. Heat recovery revenue decreased by $1,911,598, mainly due to the Fibrek project being substantially completed in the previous year. Revenue from sales of GEM products increased by $112,665, the majority of which was the result of a site conversion of a major pharmaceutical company in South America.
For the six months ended November 30, 2012, revenue decreased to $713,399 from $2,491,776 for the same period of the previous year. The decrease of $1,778,377 represents a decrease in heat recovery revenue of $2,031,941, due mainly to the Fibrek project in FY 2012, with an increase in GEM revenue of $253,564, resulting from the site conversion at the major pharmaceutical company plus a general increase in US revenues following the addition of a sales person to the region in the second half of FY 2012.

Europe and rest of world: revenue for the second quarter ended November 30, 2012 was $867,995 compared to $2,485,400 for the same period of the previous year. Heat recovery revenue decreased by $1,909,631, mainly due to the St. George's Hospital project plus two smaller hospitals being substantially completed in the previous year, with no similar projects in the current quarter. Revenue from sales of GEM products increased by $292,226, mainly from an increase in UK sales plus increased sales to distributors in both India and Kenya.
For the six months ended November 30, 2012, revenue decreased to $1,408,662 from $3,616,232 for the same period of the previous year. The decrease of $2,207,570 represents a decrease in heat recovery revenue of $2,166,069, due to the lack of current projects within UK hospitals, compared to the previous year, plus a decrease in GEM revenue of $41,501. Decreases in sales to a major food manufacturer as part of a division wide conversion plus sales to a major pharmaceutical company were partially replaced in the first half of FY 2013 with increased sales to hospitals in the UK as well as tea plants and rubber manufacturers in the rest of the world.

Segment loss before tax

North America and China: as a result of the decreased revenue in the second quarter FY 2013 compared to FY 2012, gross profit fell by $464,174. This decrease, coupled with increased costs of $51,966 (mainly staff increases, tempered by a reduction in incentive provision) and reduced finance revenue of $25,019, as the lease nears its completion date, resulted in a segment loss before tax of $301,692 compared to a profit of $239,467 in the same period of the previous year.
For the six months ended November 30, 2012, gross profit fell by $395,206 from the same period of the previous year. Added to increased costs (mainly staff related) of $243,670 plus a reduction in finance revenue of $45,065, this led to a loss of $643,731 compared to a profit of $40,210 in the first half of FY 2012.

Europe and rest of world: gross profit fell in the quarter ended November, 2012 by $859,796 from the quarter ended November, 2011, as a result of the reduction in revenue. Staff cost increases were more or less countered by a reduction in incentive provision for the quarter, giving a net pre-tax loss of $69,272 compared to a net income of $805,275 for the same period of the prior year.

The first half of FY 2013 saw a reduction in gross profit for the Europe and rest of world region of $1,206,813 due to the lack of heat recovery projects in progress in the first six months of the year. Coupled with additional costs (mainly staff related) of $77,743 this gave rise to a decrease in net income before tax of $1,284,306.

Other expenses within Reconciling items, which incorporates all costs not specifically attributable to either regional operational center, decreased in the second quarter of FY 2013 over the same period of the prior year by $38,518. A decrease in professional fees of $71,480 was partially offset by an increase in stock based compensation plus corporate admin costs, following the appointment of the investor relations firm, as announced April 19, 2012.
For the six months ended November 30, other expenses within reconciling items increased from $639,175 in 2011 to $703,855 in 2012. Stock based compensation and investor relations both contributed to this increase.

Supplementary financial information

Quarterly financial information (unaudited)
For the eight quarters ended November 30, 2012

Quarter ended	30-Nov-12 $	31-Aug-12 $	31-May-12 $	29-Feb-12 $
Revenue	1,259,984	862,077	3,460,878	3,583,801
Gross Profit	799,717	524,963	1,308,407	1,413,265
Gross Profit Percentage	63.5%	60.9%	37.8%	39.4%
EBITDAS(1)	(682,929)	(901,104)	(61,525)	44,242
Total net income (loss)	(778,011)	(838,399)	(20,941)	(28,913)
Income (loss) per share, basic and diluted	(0.005)	(0.005)	0.000	0.000
Net operating cash flow(2)	(536,159)	(668,914)	216,353	236,363

Quarter ended	30-Nov-11 $	31-Aug-11 $	31-May-11 $	28-Feb-11 $
Revenue	4,676,322	1,431,686	1,913,163	1,863,635
Gross Profit	2,123,687	803,012	1,055,037	1,140,077
Gross Profit Percentage	45.4%	56.1%	55.1%	61.2%
EBITDAS(1)	731,191	(264,766)	(79,562)	78,638
Total net income (loss)	459,779	(308,496)	(50,794)	(53,842)
Income (loss) per share, basic and diluted	0.003	(0.002)	0.000	0.000
Net operating cash flow(2)	609,587	(158,988)	86,776	167,807

(1) EBITDAS represents earnings before interest, taxation, depreciation, amortization, share-based compensation expense and net write down of lease.

(2) Net operating cash flow represents net income (loss) plus items not involving cash, plus lease payments received.

Trend Analysis:

Revenues increased in the second quarter of FY 2013 by $397,907 over the previous quarter. A slight decrease in heat recovery revenues was more than compensated for by an increase in GEM revenues, mainly due to an increase in revenues from sales to the NHS in the UK, plus increased sales within the rest of the world. The effect of this revenue increase on gross profit was an additional $274,754 over the previous quarter. EBITDAS saw an improvement of $218,175 - $56,579 less than the gross profit increase, mainly due to costs in the second quarter relating to the AGM, as well as increased commissions on the increased GEM sales plus the receipt of invoices relating to the audit of the FY 2012 financial statements. The decrease in net loss of $60,388 was less than the EBITDAS improvement as a result of UK tax losses being absorbed in the first quarter, allowing for no further tax credit from previous years despite losses incurred in the current year.

In the first quarter of FY 2013, revenues fell from the last quarter of FY 2012 by $2,598,801, representing mainly heat recovery revenue from Fibrek and GEM revenues from UK sites of a major food manufacturer realized in the quarter ended May 31, 2012. The consequent reduction in gross profit of $783,444 along with a slight increase in other expenses net of finance revenue of $34,014, resulted in an increased loss of $817,458 over the previous quarter. Historically, the first quarter of the year has relatively lower GEM sales than in other quarters due to summer vacations, and management had forecast a significant loss in this quarter.

Revenues in the quarter ended May 31, 2012 decreased again from the quarter ended February 29, 2012 by $122,923. 74% of the revenue in this quarter came from heat recovery systems sales; mainly Fibrek and two UK sites of a major food manufacturer. GEM® revenues increased by $71,065 over the previous quarter. Although expenses remained fairly constant from the third to the fourth quarter, due to less revenue being generated in the UK entity, there was a reversal of tax charge. In addition, a reduction in the UK rate of tax served to reduce the value of the future tax liability against intangible assets, thus creating a credit to the tax charge on the fourth quarter, and reducing the effect of the reduction in revenue.

The quarter ended February 29, 2012 experienced a decrease in revenues of $1,092,521 over the previous quarter, represented by a decrease in heat recovery revenues of $1,168,074 and a small increase in GEM® revenues of $75,553. The majority of the heat recovery decrease related to the St. George's project in the UK, which was substantially completed in the second quarter. The majority of the GEM related increase came from general UK and Rest of World sales. Expenses decreased in the third quarter from the previous quarter by $59,606, mostly the result of reduced incentive related to the reduced net income for the period.

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

The first quarter of Fiscal Year 2012 experienced a drop in revenue of $481,477 over the previous quarter to $1,431,686. Of this revenue, $913,665 related to sales of GEM® product, representing a decrease from the previous quarter of $574,088. $309,189 of this decrease was due to a significant proportion of the sales to the major food manufacturer in the UK being recognized in Q4 of Fiscal 2011, $191,246 related to sales to the NHS in the UK, with one hospital order in the quarter ended November 30, 2011 compared with three in the quarter ended May 31, 2011, and other general sales worldwide being down $103,675, except for sales to the major pharmaceutical company which increased by $30,022 over the previous quarter. Revenue from sales of heat recovery solutions in the quarter ended November 30, 2011 increased by $92,611 over the previous quarter. Of the order from Salisbury District Hospital Trust, announced April 11, 2011, $321,752 was recognized as revenue in the first quarter of FY 2012. This more than replaced the revenue from Qincunbao of $159,972 in the previous quarter, but the decrease of other smaller projects served to reduce the overall increase. These reductions in overall revenue of $481,477 resulted in a decreased gross profit from the previous quarter of $252,025. Net loss increased in the first quarter of FY 2012 over the previous quarter by $257,702, due to the decrease in gross profit, plus $26,248 audit fees paid in the first quarter. There were no other large fluctuations in costs during the quarter.

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

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

Disclaimer

The information provided in this document is not intended to be a comprehensive review of all matters concerning the Company. It should be read in conjunction with all other disclosure documents provided. No securities commission or regulatory authority has reviewed the accuracy or adequacy of the information presented herein and, as noted in the condensed consolidated interim financial statements for the quarter ended November 30, 2012, these statements were not subject to an audit.

Business Risks

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

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

- The Company's history of operating losses and uncertainty of future profitability;
- The ability to grow sales through the establishment of new cooperative partnerships and strategic alliances;
- The ability to grow sales through the licensing of the corporation's technologies;
- The ability to secure and maintain the required outside working capital financing;
- The ability to achieve profitable operations through increased sales,

- Reliance on third party collaborations and license arrangements;
- Reliance on proprietary technology;
- Competition in the energy conservation and environmental compliance solutions;
- Product liability claims and insurance;
- Reliance on key personnel;
- The ongoing litigation with its former President & CEO;
- The ability to control costs and achieve a positive gross margin on projects; and,
- The effect of a continuing prolonged recession in Canada, USA and Europe to the financial markets in securing project financing and in particular to industrial and commercial customers in committing capital to projects.

Management's addressing of the risks:

FY 2012 saw the Company's first ever net profit, which was the result of increased revenues and strict cost control. The first half of FY 2013, however, has produced a loss before tax of $1,726,697, resulting from diminished revenues and increasing costs. The increased costs predominantly relate to increased staff numbers, which management believes are vital to maintain and build on the record revenues of FY 2012. A dip in profitability was expected while new staff additions become accustomed to their roles and the strategy of the Company.

As reported last year, on June 29th, 2010 the Company signed an arm's length Greenpower Purchase Agreement with Fortress Specialty Cellulose Inc. ("Fortress Specialty"). The agreement is to supply recovered energy to the Fortress Specialty mill in Thurso, Quebec from a FLU-ACE® Waste Heat Recovery System installed at the site. Based on the amount of waste energy expected to be recovered, this agreement was expected to provide the Company approximately $720,000 of additional cash flow per year between now and December 31, 2012. To date, it has delivered just that. On November 27, 2012, both parties signed an amendment to the agreement, extending the term by a further two years. Upon completion of the extended term, Fortress Specialty has an option to further extend for up to a maximum of 24 months on substantially the same terms or purchase the FLU-ACE® Waste Heat Recovery System from Thermal Energy. Based on the amount of waste energy expected to be recovered, this extension will provide the Company with approximately $898,000 per year between January 2013 and December 2014.
The Company actively protects its proprietary technology through registered trademarks and confidentiality agreements.

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

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

Business Update:

1. On April 20, 2012, the Company received an order for the value of £316,844 (approximately $500,000) from St. Bartholomew's Hospital in the UK for its heat recovery solutions. This order is expected to be substantially completed by the end of the third quarter of FY 2013.

2. On May 10, 2012, the Company announced it had received a further purchase order for approximately $467 thousand from the major food manufacturer in the U.K. for a heat recovery solution. This order is expected to be completed in FY 2013.

3. On October 16, 2012, the Company announced it had appointed Tim Gardner as Director of Business Development. The inventor of the GEM® steam trap, Mr. Gardner will be responsible for driving sales in the UK, Ireland and Italy. He will be working out of the Bristol office in the UK.

4. On November 27, 2012, the Company announced it had signed an amendment to the Greenpower Purchase Agreement with Fortress Specialty Cellulose Inc. dated June 29, 2010, extending the term by a further two years. Upon completion of the extended term, Fortress Specialty has an option to further extend for up to a maximum of 24 months on substantially the same terms or purchase the FLU-ACE® Waste Heat Recovery System from Thermal Energy.

5. On December 14, 2012, the Company announced it had received a first purchase order totalling approximately $300,000 for the installation of a heat recovery system at a food and beverage company. The project is expected to be substantially completed by the end of FY 2013. Thermal Energy is working on a number of additional sites within the company.

6. On December 18, 2012, the Company announced it had received a purchase order valued at approximately $750,000 for the installation of a heat recovery system at a large publicly funded hospital. The project is expected to be substantially completed by the end of FY 2013.

7. The Company's order backlog as at November 30, 2012 was approximately $2.1 million. As at January 29, 2013 the Company had approximately $3.1 million in purchase orders that had not yet been reflected as revenue in the Company's published quarterly financial statements.

Summary of Outstanding Shares and Dilutive Instruments

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

Shares

163,336,616 class A common shares.

Options

Number of Options outstanding	Number of Options Exercisable	Exercise Price Per Share $	Expiry Date
2,750,000	2,166,667	0.10	May 4,2015
2,562,500	854,167	0.10	May 10, 2016
500,000	166,666	0.10	July 12, 2016
5,190,000	-	0.10	December 1, 2016
5,480,000	-	0.10	November 23, 2017
16,482,500	3,187,500		

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

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

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

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

Thermal Energy's external auditors, Raymond Chabot Grant Thornton LLP, conducted an independent audit of the consolidated financial statements for the year ended May 31, 2012 in accordance with IFRS, performing such tests and other procedures as they consider necessary to express an audit opinion. The condensed consolidated financial statements for the quarter ended November 30, 2012, prepared in accordance with IFRS, have not been audited.