SECOND QUARTER REPORT
Period ended November 30, 2013

MANAGEMENT'S DISCUSSION & ANALYSIS

This Management Discussion and Analysis (MD&A) 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 2014, ended November 30, 2013. The condensed consolidated interim financial statements and accompanying notes constitute an integral part of the discussion and should be read in conjunction with this MD&A. During the period ended November 30, 2013, 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.

The Board of Directors, on recommendation of the Audit Committee, approved the content of this MD&A on January 28, 2014. Disclosure contained in this document is current to this date, unless otherwise stated.

Description of Business

Thermal Energy, established in 1991, is an innovative cleantech company and a global provider of proprietary and proven energy and water efficiency, emission reduction, and bioenergy products and solutions to the industrial, commercial and institutional markets. The Company is headquartered in Ottawa, Canada, with offices in the U.K. 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 $4,014,145 in the quarter ended November 30, 2013, an increase of 219% compared to revenue of $1,259,984 for the quarter ended November 30, 2012. Sales of GEM® Condensate return systems increased by $170,531 (14.5%) over the same period in the previous year, while sales of heat recovery systems increased by $2,583,630 (3,006%).

GEM® Condensate return system sales were driven by strong broad based sales growth in North America and the partial fulfilment of an order received from a major food and beverage manufacturer, as announced July 3, 2013. These sales gains were partially offset by reduced sales to a major pharmaceutical company as the multi-year agreement with this company is nearing the end of its life. Also, although the current and prior year second quarters each included one hospital conversion, the current period sale was to a smaller hospital.

Heat recovery systems revenue for the quarter ended November, 2013 was bolstered by the commencement of projects at two sites of a major Fortune 500 food and beverage company, as announced September 16, 2013, the installation at a major pulp and paper company as announced June 3, 2013, and the substantial installation at a major hospital as announced June 13, 2013. Heat recovery systems revenue in the quarter ended November 30, 2012 totalled just $86,123 as a number of projects had been completed with no new ones commencing in the quarter.

For the six months ended November 30, 2013, revenues were up 161% to $5,536,268 compared to $2,122,061 for the same period of last year. Revenues from the sale of heat recovery systems increased by $2,891,662 from $237,031 in the previous period, due predominantly to the projects mentioned above, while GEM® Condensate return systems sales increased by 28% to $2,407,575 from $1,885,030 also for the reasons noted above.

The gross profit of $1,874,869 in the quarter ended November 30, 2013 represented an increase of $1,075,152, or 134.4%, over the $799,717 achieved in the quarter ended November 30, 2012. These results expressed as a percentage of sales were 46.7% in the second quarter of FY 2014 compared with 63.5% in the second quarter of FY 2013. Although the gross profit was greater than the previous period, the margins were lower due to the product split.

For the six months ended November 30, 2013, gross profit of $2,844,881 represented an increase of $1,520,201, or 114.7%, from the $1,324,680 achieved in the six months ended November 30, 2012. These results expressed as a percentage of sales were 51.4% in the first half of FY 2014 compared with 62.4% in the first half of FY 2013.

Expenses

Sales and Marketing and General and Administrative expenses in the quarter ended November 30, 2013 totalled $1,581,233 compared with $1,448,303 in the quarter ended November 30, 2012. The increase of $132,930 was the result of increased commissions of around $200,000 on the increased revenues being partially offset by reduced investor relations costs, legal costs and amortization of intangible assets, which were fully amortized in July 2013. The cost of additional sales and technical staff was offset by the allocation of staff costs to cost of sales due to the increased activity in heat recovery projects.

For the six months ended November 30, 2013, Sales and Marketing and General and Administrative expenses totalled $2,866,863 compared to $2,956,220 for the six months ended November 30, 2012, a decrease of $89,357. Increased commission payable was more than offset by the allocation of staff costs relating to chargeable projects to cost of sales, plus reductions in investor relations costs, legal costs and amortization of intangible assets.

Research and development costs of $66,176 in the second quarter of FY 2014 compared to $112,672 in the second quarter of FY 2013. Both quarters include 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. The second quarter of the prior year included some earlier costs which were re-allocated to Research and development costs for clearer identification, hence the larger expense in that period. 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 $135,450 for the six months ended November 30, 2013 compared to $112,672 for the six months ended November 2012. 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 2014 of $38,982 compared to $6,482 in the second quarter of FY 2013. The increase follows the extension of the lease agreement in December 2012 for an additional two years. The interest rate implicit in the lease of 14% is applied against the reducing finance lease receivable balance, hence there will be lower finance revenues as the term of the agreement progresses.

For the six months ended November 30, 2013, finance revenue was $83,407, compared with $17,515 for the six months ended November 2012.

Income before income taxes for the quarter ended November 30, 2013 was $266,442 compared to a loss of $754,776 in the same quarter of the previous year. The increase of $1,021,218 was almost entirely due to the increase in gross profit resulting from increased heat recovery revenues during the quarter.

For the six months ended November 30, 2013, loss before income taxes was $74,025, compared to $1,726,697 for the six months ended November 30, 2012. Again, this was predominantly the result of the increase in heat recovery activity in the first half of FY 2014 compared to the first half of FY 2013, plus increased GEM® revenues.

Income tax charge in the second quarter of FY 2014 was $28,363, compared to $32,131 as reported in the second quarter of FY 2013. Income taxes are payable on profits of the wholly owned U.K. subsidiary.

For the six months ended November 30, 2013, income tax charge was $46,654, compared with income tax recovery of $92,463 for the same period of the previous year, which resulted from losses generated by the U.K. subsidiary in the first half of FY 2013.

Net income for second quarter of FY 2014 was $238,079 compared to a net loss of $786,907 in the same quarter of the previous year.

Net loss for the six months ended November 30, 2013 was $120,679 compared to net income of $1,634,234 for the six months ended November 30, 2012.

Comprehensive income was $391,956 for the second quarter of FY 2014 compared to a comprehensive loss of $706,088 for the second quarter of FY 2013. Exchange gains arising on translation of overseas operations were higher than in prior years due to the weakening of the Canadian Dollar against the Pound Sterling.

For the six months ended November 30, 2013, comprehensive income was $113,849, compared with a comprehensive loss of $1,628,709 for the same period of the previous year.

Liquidity & Capital Resources

The working capital was $1,823,897 at November 30, 2013 compared to working capital of $1,552,021 at May 31, 2013 – an improvement of $271,876, while the Company's net cash position (Cash and cash equivalents less Bank loans) increased by $1,164,283 from $1,304,395 at May 31, 2013 to $2,468,678 as at November 30, 2013.

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

	Feb 29, 2012 $	May 31, 2012 $	Aug 31, 2012 $	Nov 30, 2012 $	Feb 28, 2013 $	May 31, 2013 $	Aug 31, 2013 $	Nov 30, 2013 $
Current Assets	5,345,538	5,758,086	4,534,637	3,814,265	4,537,306	3,642,680	3,604,594	6,184,899
Current Liabilities	2,942,432	3,190,639	2,800,733	2,770,537	2,761,564	2,090,659	2,199,528	4,361,002
Working Capital	2,403,106	2,567,447	1,733,904	1,043,728	1,775,742	1,552,021	1,405,066	1,823,897

Q2 FY 2014 Changes

Current assets increased in the current quarter by $2,580,305 to $6,184,899. This was mainly due to increases in cash balances of $1,390,236 plus trade receivables of $1,094,443, resulting mainly from billings on current heat recovery projects, as well as an increase in prepayments of $44,170 due to payments made on account for heat recovery projects. Current liabilities meanwhile also increased by $2,161,474 to $4,361,002, again mainly due to current heat recovery projects, which gave rise to an increase in deferred revenue of $1,075,536, and in trade payables of $768,202. Accrued liabilities also increased due to commissions payable as well as $78,645 payable for repurchased shares at the end of November for which payment was due at the end of the following month.

As at November 30, 2013, $136,335 (6.6%) of the Company's trade receivables balance was over 90 days past due. None of the remaining overdue balance is considered impaired as at November 30, 2013.

Cash inflow 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, 2013 was $455,144. After adjusting this for $962,935 of positive changes in non-cash working capital items, foreign exchange adjustments and other non-cash equity items, and deducting $16,114 for the purchase of fixed assets, $1,229 to allow for the effect of exchange rate fluctuations on cash and cash equivalents, and $10,500 used for the repurchase of Class A common shares the net cash inflow was $1,390,236, increasing the net cash balance as at November 30, 2013 to $2,468,678 from $1,078,442 as at August 31, 2013.

In addition to its net cash balance of $2,468,678 as at November 30, 2013 the Company also had an estimated $310,000 of unused borrowing capacity under its bank loans. With cash balances and unused borrowing capacity of approximately $2,778,678, management believes that it has sufficient capital resources to fund existing operations and anticipated capital requirements in the remainder of FY 2014. Order backlog as at November 30, 2013 was approximately $6.5 million compared to $2.1 million at the same time last year. As at January 28, 2014, the Company had $7.1 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, 2013 $	May 31, 2013 $
Total estimated minimum lease payments receivable	1,126,140	1,507,952
Less: unearned income	(77,944)	(161,131)
	1,048,196	1,346,601
Less: current portion	(822,010)	(761,404)
	226,186	585,197

On December 31, 2012, the lease with Fortress Specialty Cellulose, as signed on June 29, 2010, expired. On November 27, 2012 an agreement was signed whereby the customer agreed to purchase the recovered energy for a further two years, after which the customer has the option to renew for an additional 24 months on substantially the same terms or purchase the asset from the Company. This new agreement was recorded in accordance with the previous lease, resulting in an increase to net investment in lease, plus associated revenue relating to the capitalization of the lease during the year ended May 31, 2013 of $1,546,318. In subsequent periods until the expiry of the new lease on December 31, 2014, finance revenue will be recognized within the income statement at the interest rate implicit in the lease. The estimated minimum lease payments receivable in this lease represent the estimated monthly energy outputs of the leased asset and are based on assumptions regarding the efficiency of the asset and the operations of the plant in which it is located.

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

	$
Less than one year	898,921
Between two and five years	87,689
Residual value of equipment	139,530
	1,126,140

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, 2013 were 1,500,000 of which 666,666 were exercisable. There were no warrants outstanding for Directors.

Options outstanding for Officers (including the CEO) as at November 30, 2013 were 6,340,000 of which 3,376,667 were exercisable. There were no warrants outstanding for Officers.

Officer and Director Compensation

During the second quarter ended November 30, 2013 compensation arrangements for directors was as follows:

$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, 2013 Directors fees paid were $22,500. Fees to the Chairperson of the Audit Committee were $1,500; fees paid to the Chairman were $2,250; and a total of $10,000 was paid for in-person meetings.

Compensation paid to directors and officers during the second quarter ended November 30, 2013 (inclusive of the amounts described above) was as follows:

	Salaries and fees		**Commissions / incentives**		**Total**	
	2013 $	2012 $	**2013 $**	2012 $	**2013 $**	2012 $
Directors						
M. Williams	**7,250**	7,304	**-**	-	**7,250**	7,304
J. Ansell	**-**	4,214	**-**	-	**-**	4,214
J. Kelly	**8,000**	9,204	**-**	-	**8,000**	9,204
D. Gibbs	**4,750**	6,503	**-**	-	**4,750**	6,503
W. Ollerhead	**4,750**	6,503	**-**	-	**4,750**	6,503
B. Linton	**5,750**	2,493	**-**	-	**5,750**	2,493
J. Schoenmakers	**5,750**	2,493	**-**	-	**5,750**	2,493
Total	**36,250**	38,714	**-**	-	**36,250**	38,714
Officers						
W. Crossland	**60,000**	60,000	**-**	-	**60,000**	60,000
J. Flynn	**34,486**	31,847	**-**	-	**34,486**	31,847
R. Triebe	**37,305**	35,775	**-**	-	**37,305**	35,775
Total	**131,791**	127,622	**-**	-	**131,791**	127,622

Normal Course Issuer Bid

On October 28, 2013, the Company announced its intent to conduct a Normal Course Issuer Bid ("NCIB"). NCIB was approved by TSX Venture Exchange on October 30, 2013. During the 12-month period commencing October 31, 2013 and ending October 31, 2014, the Company may purchase on the TSX up to 13,513,869 common shares, representing approximately 10% of the then issued and outstanding common shares. The actual number of common shares purchased, if any, and the timing of such purchases will be determined by the Company by considering market conditions, share prices, its cash position, and other factors.

200,000 Class A common shares were purchased for cancellation by the Company on November 28, 2013 for a purchase price of $10,500. These shares were cancelled and payment for this purchase was made at the quarter-end.

1,498,000 Class A common shares were purchased for cancellation by the Company on November 29, 2013 for a purchase price of $78,645.These shares were cancelled and payment for this purchase was made subsequent to the quarter-end.

Segmented Information

In the quarters and six month periods ended November 30, 2013 and 2012, 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 three months ended November 30, 2013 and the comparative period are detailed in the table below:

	North America and China		Europe and Rest of World		Reconciling Items		Total	
	2013 $	2012 $	**2013 $**	2012 $	**2013 $**	2012 $	**2013 $**	2012 $
Sales	**2,560,758**	391,989	**1,453,387**	867,995	**-**	-	**4,014,145**	1,259,984
Cost of sales	**(1,555,971)**	(198,069)	**(583,305)**	(262,198)	**-**	-	**(2,139,276)**	(460,267)
Gross profit	**1,004,787**	193,920	**870,082**	605,797	**-**	-	**1,874,869**	799,717
Amortization of intangible assets	**-**	-	**-**	(24,735)	**-**	-	**-**	(24,735)
Other expenses	**(616,499)**	(502,094)	**(706,822)**	(650,334)	**(324,088)**	(383,812)	**(1,647,409)**	(1,536,240)
Finance revenue	**38,982**	6,482	**-**	-	**-**	-	**38,982**	6,482
Profit (loss) before taxes	**427,270**	(301,692)	**163,260**	(69,272)	**(324,088)**	(383,812)	**266,442**	(754,776)
Tax (expense) recovery	**(10,300)**	-	**(19,555)**	(39,422)	**1,492**	7,291	**(28,363)**	(32,131)
Net income(loss)	**416,970**	(301,692)	**143,705**	(108,694)	**(322,596)**	(376,521)	**238,079**	(786,907)
Attributable to:								
Owners of the parent	**422,303**	(293,473)	**140,522**	(108,017)	**(322,596)**	(376,521)	**240,229**	(778,011)
Non-controlling interest	**(5,333)**	(8,219)	**3,183**	(677)	**-**	-	**(2,150)**	(8,896)

Segment information for the six months ended November 30, 2013 and the comparative period are detailed in the table below:

	North America and China		Europe and Rest of World		Reconciling Items		Total	
	2013 $	2012 $	**2013 $**	2012 $	**2013 $**	2012 $	**2013 $**	2012 $
Sales	**2,945,937**	713,399	**2,590,331**	1,408,662	**-**	-	**5,536,268**	2,122,061
Cost of sales	**(1,737,300)**	(292,553)	**(954,087)**	(504,828)	**-**	-	**(2,691,387)**	(797,381)
Gross profit	**1,208,637**	420,846	**1,636,244**	903,834	**-**	-	**2,844,881**	1,324,680
Amortization of intangible assets	**-**	-	**(8,303)**	(49,381)	**-**	-	**(8,303)**	(49,381)
Other expenses	**(1,078,435)**	(1,082,092)	**(1,302,459)**	(1,233,564)	**(613,116)**	(703,855)	**(2,994,010)**	(3,019,511)
Finance revenue	**83,407**	17,515	**-**	-	**-**	-	**83,407**	17,515
Profit (loss) before taxes	**213,609**	(643,731)	**325,482**	(379,111)	**(613,116)**	(703,855)	**(74,025)**	(1,726,697)
Tax (expense) recovery	**(12,561)**	-	**(41,607)**	50,381	**7,514**	42,082	**(46,654)**	92,463
Net income(loss)	**201,048**	(643,731)	**283,875**	(328,730)	**(605,602)**	(661,773)	**(120,679)**	(1,634,234)
Attributable to:								
Owners of the parent	**196,602**	(625,432)	**277,908**	(329,205)	**(605,602)**	(661,773)	**(131,092)**	(1,616,410)
Non-controlling interest	**4,446**	(18,299)	**5,967**	475	**-**	-	**10,413**	(17,824)

Reconciling items comprise the following:

	Three months ended November 30		Six months ended November 30	
	2013 $	2012 $	**2013 $**	2012 $
Corporate admin costs	**217,439**	247,692	**390,383**	441,806
Stock-based compensation	**34,036**	33,689	**69,483**	68,082
Professional fees	**59,843**	73,492	**129,704**	127,014
Depreciation of property, plant and equipment	**9,729**	12,431	**19,149**	23,058
Bank charges and interest	**10,892**	9,168	**22,802**	19,474
Foreign exchange losses (gains)	**(7,851)**	7,340	**(18,405)**	24,421
Total	**324,088**	383,812	**613,116**	703,855

During the three months ended November 30, 2013, the Company had one customer in North America and China that accounted for 35% of total revenue and another customer in Europe and Rest of World that accounted for 16% of total revenue for the period.

During the three months 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 six months ended November 30, 2013, the Company had one customer in North America and China that accounted for 29% of total revenue and another customer in Europe and Rest of World that accounted for 12% 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.

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 (non-current) as at	
	November 30		**November 30,**	May 31,	**November 30,**	May 31,	**November 30,**	May 31,
	2013	2012	**2013**	2013	**2013**	2013	**2013**	2013
	$	$	**$**	$	**$**	$	**$**	$
Canada	**1,681,568**	**212,527**	**43,100**	22,301	**-**	-	**226,186**	585,197
U.S.A.	**1,243,393**	**489,537**	**-**	-	**-**	-	**-**	-
U.K.	**2,143,781**	**901,920**	**19,998**	23,169	**1,874,098**	1,706,449	**-**	-
Italy	**207,268**	**119,285**	**-**	-	**-**	-	**-**	-
Netherlands	**66,931**	**85,962**	**-**	-	**-**	-	**-**	-
Germany	**41,881**	**8,478**	**-**	-	**-**	-	**-**	-
Ireland	**13,589**	**74,746**	**-**	-	**-**	-	**-**	-
Rest of Europe	**14,128**	**14,088**	**-**	-	**-**	-	**-**	-
India	**54,114**	**117,479**	**-**	-	**-**	-	**-**	-
Kenya	**12,606**	**44,311**	**-**	-	**-**	-	**-**	-
China	**20,976**	**11,335**	**-**	-	**-**	-	**-**	-
New Zealand	**31,837**	**-**	**-**	-	**-**	-	**-**	-
Rest of world	**4,196**	**42,393**	**-**	-	**-**	-	**-**	-
Total	**5,536,268**	**2,122,061**	**63,098**	45,470	**1,874,098**	1,706,449	**226,186**	585,197

Material Segmentation Variances

Revenue

North America and China: revenue for the second quarter ended November 30, 2013 was $2,560,758 compared to $391,989 for the same period of the previous year. Heat recovery revenue increased by $1,944,532 from just $31,683, with $1,409,553 coming from the major pulp and paper company, as announced June 3, 2013 and $563,273 from the two sites for which we had received orders from a major food and beverage company, as announced September 16, 2013. Revenue from sales of GEM products increased by $224,237, despite the lack of revenues from a site conversion of a major pharmaceutical company in South America, which in the prior year contributed $85,854.

For the six months ended November 30, 2013, revenue increased to $2,945,937 from $713,399 for the same period of the previous year. This increase of $2,232,538 represents an increase in heat recovery revenue of $2,150,456, due mainly to the projects mentioned above, with an increase in GEM revenue of $82,082, despite the lack of revenues from a site conversion of a major pharmaceutical company in South America, which in the prior year contributed $85,854.

Europe and rest of world: revenue for the second quarter ended November 30, 2013 was $1,453,387 compared to $867,995 for the same period of the previous year. Heat recovery revenue increased by $639,098, mainly due to the substantial completion of a major hospital in the current quarter, with no similar projects in the same quarter of the previous year. Revenue from sales of GEM products meanwhile decreased by $53,706, mainly due to a drop in sales to hospitals in the quarter plus a general reduction across the rest of the world being partially offset by revenue from a major food and beverage company, in partial fulfilment of an order as announced July 3, 2013.

For the six months ended November 30, 2013, revenue increased by $1,181,669 from $1,408,662 for the same period of the previous year. This increase represents an increase in heat recovery revenue of $978,237, due predominantly to the substantial completion of two projects within U.K. hospitals, compared to none in the previous year, plus an increase in GEM revenue of $203,432 resulting from revenue from sales to the major food and beverage company mentioned above of $379,086 with decreases across Europe and the rest of the world.

Segment loss before tax

North America and China: as a result of the increased revenue in the second quarter FY 2014 compared to FY 2013, gross profit rose by $810,867. With increased costs of $114,405 (mainly commission payable on the increased revenue) and increased finance revenue of $32,500 following the extension of the lease, the resulting income before tax of $427,270 compared to a loss before tax of $301,692 in the same period of the previous year.

For the six months ended November 30, 2013, gross profit rose by $787,791 from the same period of the previous year. With costs remaining at a similar level (with increased commissions being offset by reduced staff costs which were reallocated to heat recovery projects) plus an increase in finance revenue of $65,892, this led to an income before tax of $213,609 compared to a loss of $643,731 in the first half of FY 2013.

Europe and rest of world: gross profit rose in the quarter ended November, 2013 by $264,285 over the quarter ended November 30, 2012, as a result of the increase in revenue. Cost increases of $56,488 were predominantly sales commission resulting from increased revenues, while amortization of intangible assets fell to zero from $24,735 as the Company's intangible assets (other than trade names and trademarks) were fully amortized in the first month of FY 2014. This gave rise to a net pre-tax income of $163,260 compared to a net pre-tax loss of $69,272 for the same period of the prior year.

The first half of FY 2014 saw a rise in gross profit for the Europe and rest of world region of $732,410 due to the increased revenues in the first six months of the year. Increased commission payable was the main contributor to increased costs of $68,895, while amortization of intangible assets fell by $41,078. The resulting net profit before tax for the first half of FY 2014 was $325,482 compared to a loss of $379,111 in the same period of the previous year.

Other expenses within Reconciling items, which incorporates all costs not specifically attributable to either regional operational centre, decreased in the second quarter of FY 2014 over the same period of the prior year by $59,724, mainly due to a decrease in professional fees of $27,536 plus lesser reductions in costs relating to investor relations and the AGM.

For the six months ended November 30, 2013 other expenses within reconciling items decreased by $90,739 from the six months ended November 30, 2012, mainly due to reduced legal costs, investor relations costs and the AGM.

Supplementary financial information

Quarterly financial information (unaudited)
For the eight quarters ended November 30, 2013

Quarter ended	30-Nov-13 $	31-Aug-13 $	31-May-13 $	29-Feb-13 $
Revenue	4,014,145	1,522,123	1,879,450	4,208,723
Gross Profit	1,874,869	970,012	746,358	2,906,414
Gross Profit Percentage	46.7%	63.7%	39.7%	69.1%
EBITDAS(1)	311,366	(286,423)	(424,414)	1,573,398
Total net income (loss)	238,079	(358,758)	(2,685,427)	1,476,814
Income (loss) per share, basic and diluted	0.001	(0.002)	(0.016)	0.009
Net operating cash flow(2)	455,144	(176,528)	(223,741)	185,249

Quarter ended	30-Nov-12 $	31-Aug-12 $	31-May-12 $	28-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

(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:

Revenue of $4,014,145 in the second quarter of FY 2014 represented an increase of $2,492,022 over the $1,522,123 recorded in the previous quarter. Heat recovery revenue increased by $2,210,453, with the commencement of projects at two sites of a major food and beverage company in the quarter, alongside the continuance of work at a major pulp and paper company. In addition, one hospital was virtually completed within the second quarter, whereas the first quarter saw the completion of a hospital which has started in the last quarter of FY 2013. GEM Revenues increased in the current quarter over the previous quarter by $281,569. With revenue from hospitals and the major food company order, as announced July 3, 2013, remaining fairly constant, the majority of the increase is attributable to North America. These increases in revenue gave rise to an increase in gross profit over the prior quarter of $904,857. Increased costs of $292,505 were mainly attributable to sales commission, plus the AGM which was held in the second quarter, along with tradeshow costs, and combined with the improved gross profit and a slight fall in finance revenue of $5,443, plus an increase in tax charge for the quarter of $10,072 resulted in an improved total net income improvement of $596,837 over the first quarter of FY 2014.

The first quarter of FY 2014 saw a decrease in heat recovery revenue from the previous quarter with the completion of the major hospital project which had commenced in the last quarter of FY 2013 and revenue from the major pulp and paper company as announced June 3, 2013 not matching the substantial completion of the three projects in the prior quarter. This decrease of $831,611 was partially offset by an increase in GEM® revenues of $474,283. A decrease in revenues from a major food and beverage manufacturer of $110,139 was more than offset by revenues from another food and beverage manufacturer plus a major hospital. GEM® sales within North America were down from the prior quarter, although orders were received awaiting sizing information, while revenues within Europe more than doubled, mostly within the U.K. and Italy, through directly employed sales personnel. Despite a drop in revenues, gross profit increased by $223,654 as a result of the product mix. Increased commission from increased gross profit plus audit fees billed in the first quarter of the year ate up some of the increased gross profit, resulting in an improvement in EBITDAS of $137,991 from the last quarter of FY 2013.

The final quarter of FY 2013, ended May 31, 2013, experienced a drop in revenue of $2,329,273 from the previous quarter, which had seen the Fortress Greenpower Purchase Agreement extension plus the completion of the installation of a heat recovery system at a major hospital, providing a combined revenue of $2,600,072. This decrease in heat recovery systems revenue was offset by $700,574 coming from other heat recovery projects, including the commencement of a further major hospital conversion plus the completion of installations at two major food and beverage manufacturers. GEM® sales meanwhile fell by $429,775 from the third quarter due to the third quarter including a full site conversion at the major hospital at which the heat recovery system was also installed in Q3. The impairment charge which resulted from the annual testing for impairment of both goodwill and other intangible assets was recorded in the final quarter of FY 2013. This charge is a non-cash item and therefore did not adversely affect either the cash balance or EBITDAS. As other expenses remained at a similar level to the third quarter, other than commission payable, the resulting reduction in EBITDAS was directly related to the reduction in revenue. Due to the U.K. subsidiary making a loss in the final quarter, the change in total net loss/income was eased by a provision for recoverable income tax.

The third quarter of FY 2013 produced $2,948,739 more revenue than the second quarter. Heat recovery revenues increased by $3,094,436, with $1,546,318 relating to the Fortress Greenpower Purchase Agreement extension, $230,757 relating to the sale of equipment to a major U.K. food manufacturer and $1,295,113 relating to sales to the National Health Service in the U.K.. GEM® sales fell in the quarter by $145,697, despite an increase in sales to the National Health Service, due to unusually higher sales within the rest of the world plus a site conversion to a major pharmaceutical manufacturer in the second quarter. As a result of these increased revenues, in particular the Greenpower Purchase Agreement extension, gross profit rose in the third quarter by $2,106,697 over the previous quarter. EBITDAS increased by $2,256,327, slightly better than the gross profit increase due to the prior quarter expenses including invoices relating to the audit of the FY 2012 financial statements and the AGM. Net income of $1,476,814 in the third quarter represented an improvement of $2,254,825 over the second quarter.

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 U.K., 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 U.K. 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 U.K. 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 U.K. 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 U.K. entity, there was a reversal of tax charge. In addition, a reduction in the U.K. 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 U.K., which was substantially completed in the second quarter. The majority of the GEM® related increase came from general U.K. 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.

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, 2013, 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. FY 2013, however, produced an operating loss of $844,328, resulting from diminished revenues and increasing costs. The first half has also generated a loss but orders received to date which have yet to be recorded as revenue are stronger than in the prior year and indicate that the prior years' investment is starting to pay off. A dip in profitability was expected while new staff additions become accustomed to their roles and the strategy of the Company. Management is constantly monitoring the effectiveness of this strategy.

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 was to supply recovered energy to the Fortress Specialty mill in Thurso, Quebec from a FLU-ACE® Waste Heat Recovery System installed at the site. Based on the amount of heat expected to be recovered, this agreement was expected to provide the Company approximately $720,000 of additional cash flow per year between then and December 31, 2012, which it did in fact achieve. 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 heat expected to be recovered, this extension will provide the Company with approximately $898,000 cash per year between January 2013 and December 2014. The extension was recorded in the financial statements as an increase to the net investment in lease in the year ended May 31, 2013 which therefore includes the capital element of the total expected payments over the 24 month period of the extension within revenue for that year, totaling $1,546,318. The interest element of the lease will be recorded as finance revenue over the period of the lease, but the cash inflow will include the capital element.

On December 22, 2013 the site commenced a market downtime for a period of ten weeks, following the recent imposition of an interim duty in China on the import of Canadian dissolving pulp. Management is currently in negotiations with Fortress Specialty Cellulose to further extend the existing lease beyond the current expiry date.

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:

- In June 2012, the Company received another purchase order for approximately $249,000 from a major food manufacturer for a heat recovery solution at one of its sites. This order was partially completed in FY 2013 and is expected to be completed by the end of FY 2014.

- In June 2012, the Company received an order for approximately $562,000 from a publicly owned hospital for a heat recovery solution. This order was partially completed in FY 2013 and the customer is currently deciding on changes it may wish to be made before the project is continued. It is not yet known when this project may be completed.

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

- On June 3, 2013, the Company announced it had received a purchase order valued at approximately $3.6 million for the installation of a heat recovery system at a major North American pulp and paper company. The heat recovery system is expected to be installed and revenue earned by the end of FY 2014.

- On June 13, 2013, the Company announced it had received new GEM® steam trap system and heat recovery system orders totalling approximately $800,000 from a major publicly owned hospital. The GEM® steam trap system was installed and revenue earned in the first quarter and the heat recovery system was substantially installed in the second quarter of FY 2014, with completion expected by the third quarter of FY 2014.

- On July 3, 2013, the Company announced it had received a purchase order valued at approximately $480,000 for GEM® steam traps from a major multinational food and beverage company. The order is to replace the entire steam trap system at one of the company's manufacturing facilities and revenue is expected to be earned by the third quarter of FY 2014. The order is the result of a strategy to target large multinational manufacturers.

- On September 10, 2013, the Company announced it had received orders for both the installation of a heat recovery system and the supply and installation of GEM® steam traps at a large publicly funded hospital, totaling $780,000. The GEM® steam trap system was substantially installed and revenue earned in the quarter ended November 30, 2013 and is expected to be complete and revenue earned by the end of FY 2014, along with the heat recovery installation.

- On September 16, 2013, the Company announced it had received orders totaling approximately $1.7 million for the installation of heat recovery systems at two sites and the supply and installation of GEM® steam traps at one site of a Fortune 500 food and beverage company. Work commenced in the second quarter, generating revenue of $563,273 and is expected to be fully installed and revenue earned by the end of FY 2014..

- The Company is currently developing energy efficiency projects on a paid or exclusive basis at 15 different sites for 10 different customers. This compares to 7 sites for 3 customers during all of FY 2012 and only 1 site and 1 customer in each of FY 2011 and FY2010.

- The Company's order backlog as at November 30, 2013 was approximately $6.5 million. As at January 28, 2014, the Company had an order backlog of approximately $7.1 million, of which approximately $0.5 million is related to long term contracts and is not expected to be reflected in revenue within the next 12 months. The Company includes in "order backlog" any purchase orders that have been received by the Company but have 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

161,638,616 class A common shares.

Options

Number of Options outstanding	Number of Options Exercisable	Exercise Price Per Share $	Expiry Date
2,750,000	2,750,000	0.10	May 4,2015
2,562,500	1,708,333	0.10	May 10, 2016
500,000	333,333	0.10	July 12, 2016
4,820,000	1,607,667	0.10	December 1, 2016
5,300,000	1,766,667	0.10	November 23, 2017
4,004,000	-	0.05	November 18, 2018
19,936,500	8,165,000		

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 International Financial Reporting Standards (IFRS) and in particular with International Accounting Standard 34: Interim Financial Reporting. 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 former external auditors, Raymond Chabot Grant Thornton LLP, conducted an independent audit of the consolidated financial statements for the year ended May 31, 2013 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, 2013, prepared in accordance with IFRS, have not been audited.