SECOND QUARTER REPORT
Period ended February 29, 2012

MANAGEMENT'S DISCUSSION & ANALYSIS

This discussion is dated as of April 30, 2012 and explains the material changes in Thermal Energy International Inc.'s ("Thermal Energy" or the "Company") financial condition and results of operations for the third quarter of Fiscal Year 2012, ended February 29, 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. The condensed consolidated interim financial statements are prepared in accordance with International Financial Reporting Standards ("IFRS") and comparative periods have been restated in accordance with IFRS, where applicable. During the period ended February 29, 2012, the Company's critical accounting estimates, significant accounting policies and risk factors have remained substantially unchanged. Unless otherwise indicated, all amounts presented in this discussion are in Canadian dollars. This discussion and analysis of the financial condition and results of operations may contain forward-looking statements. These statements are not guarantees of future performance and are subject to risks and uncertainties that could cause actual results to differ materially from those in the forward-looking statements. Additional information relating to the Company is available on SEDAR at www.sedar.com.

Description of Business

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

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

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

Discussion of Operations and Financial Conditions

Revenues and Gross Profits

Revenues were $3,583,801 in the quarter ended February 29, 2012; an increase of 92.3% compared to $1,863,635 in the quarter ended February 28, 2011. Sales of GEM® Condensate return systems decreased by $421,725 (33.6%) over the same period in the previous year, while sales of heat recovery systems increased by $2,141,891 (352.8%).

Of the decrease in GEM® Condensate return systems sales, $317,925 was the result of reduced sales to a major UK food manufacturer which in the previous year saw a number of site conversions, and $132,665 was due to decreased sales to the NHS in the UK in the current quarter.

Heat recovery systems revenue of $2,748,947 in the quarter ended February 29, 2012 included $2,181,815 from the $5.8 million contract with Fibrek, announced June 16, 2011 and $332,464 relating to St. Georges Healthcare NHS Trust in the U.K. announced August 5, 2011.

For the nine months ended February 29, 2012, revenues were $9,691,809 compared to $7,787,433 for the same period of the previous year. Revenues from the sale of heat recovery systems increased to $7,158,379 from $4,698,118 in the previous period, due to the progress of the two projects mentioned above compared to just one significant project in the prior year, while GEM® Condensate return systems sales decreased to $2,533,430 from $3,089,315, due mainly to the decrease in orders from a major pharmaceutical company.

The gross profit of $1,413,265 in the quarter ended February 29, 2012 represented an increase of $273,188, or 24.0%, on the $1,140,077 achieved in the quarter ended February 29, 2011. These results expressed as a percentage of sales were 39.4% in the third quarter of FY 2012 compared with 61.1% in the third quarter of FY 2011. The higher gross margin in the previous period was a result of a higher proportion of sales generated from the GEM® product.

For the nine months ended February 29, 2012, gross profit of $4,339,964 represented an increase of $720,383, or 19.9%, on the $3,619,581 achieved in the nine months ended February 28, 2011. These results expressed as a percentage of sales were 44.8% in the first three quarters of FY 2012 compared with 46.5% in the first three quarters of FY 2011.

Expenses

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

Administration and Selling, Marketing and Business Development expenses in the quarter ended February 29, 2012 totalled $1,471,759 compared with $1,141,424 in the quarter ended February 28, 2011.

Increases within general administration, selling, marketing and business development costs for the quarter ended February 29, 2012 over the same period of the previous year include additional commission payable on the increased revenues, stock based compensation, salaries for two additional heat recovery and one additional GEM sales staff, one additional finance staff and a marketing and sales co-ordinator, and increased training costs relating to distributorships in the U.S. In addition, audit fees increased by $67,571, predominantly due to the timing of invoices relating to the annual audit of the financial statements for the year ended May 31, 2011, and assistance with the transition to IFRS reporting, plus legal costs increased due to activities related to the statement of claim filed against the Company by a past president.

For the nine months ended February 29, 2012, Administration and Selling, Marketing and Business Development expenses totalled $4,147,764, compared to $3,723,034 for the nine months ended February 28, 2011, an increase of $424,730. In addition to the increases described above, other material variances on the year to date costs over the previous year to date include a reduction in legal fees of $41,451, mainly due to fees paid in the first quarter of FY 2010 relating to the TSX Venture Exchange review.

Research and development costs of $1,411 in the third quarter of FY 2012 compared to $nil in the third quarter of FY 2011. Year to date research and development costs totaled $8,455 for the nine months ended February 29, 2012 and $1,913 for the nine months ended February 28, 2011. Current focus continues to be on increasing revenues from existing product lines, rather than developing new products.

Finance revenue in the third quarter of FY 2012 of $23,461 compared to $47,892 recognized in the third quarter of FY 2011.

For the nine months ended February 29, 2012, finance revenue was $86,041, compared with $125,148 for the nine months ended February 29, 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 February 29, 2012 was $36,444 compared to a profit of $46,545 in the same quarter of the previous year. The increase in gross profit over the same period of the previous year was more than consumed by increased costs. Other than the legal and audit costs mentioned above, the increase in expenses is mainly a result of increased staff required to build up the business.

For the nine months ended February 2012, income before income taxes was $269,786, compared with $19,782 for the nine months ended February 28, 2011.

Income taxes in the third quarter of FY 2012 were a credit of $4,590, compared to a charge of $100,156 in the third quarter of FY 2011. A nominal charge relating to the Company's wholly owned subsidiary Gardner Energy Management Ltd in the UK was more than offset by a sundry credit reflecting the reduction in the future tax liability related to intangible assets in the quarter ended February 29, 2012. The charge in the same quarter of the previous year reflected higher profits from the UK subsidiary.

For the nine months ended February 29, 2012, income taxes were $158,714, compared with $106,036 for the same period of the previous year.

Net loss for third quarter of FY 2012 was $31,854 compared to a loss of $53,611 in the same quarter of the previous year.

Net income for the nine months ended February 29, 2012 was $111,072 compared to a loss of $86,254 for the nine months ended February 28, 2011.

Comprehensive loss was $121,479 for the third quarter of FY 2012 compared to comprehensive income of $91,412 for the third quarter of FY 2011.

For the nine months ended February 29, 2012, comprehensive income was $46,226, compared with $98,412 for the same period of the previous year.

Liquidity & Capital Resources

The working capital was $2,393,077 at February 29, 2012 compared to working capital of $1,870,934 at May 31, 2011 – an increase of $522,143, with the Company's net cash position (Cash and cash equivalents less Bank loans) increasing by $911,839 from $972,163 at May 31, 2011 to $1,884,002 as at February 29, 2012.

Cash flow from operations (defined as net income (loss), plus items not involving cash, plus lease payments received) for the quarter ended February 29, 2012 was $236,363 and for the nine months ended February 29, 2012 was $696,962.

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

	May 31, 2010 $	Aug 31, 2010 $	Nov 30, 2010 $	Feb 28, 2011 $	May 31, 2011 $	Aug 31, 2011 $	Nov 30, 2011 $	Feb 29, 2012 $
Current Assets	3,281,721	3,491,058	3,955,487	3,717,578	3,898,346	4,371,855	5,813,077	5,345,538
Current Liabilities	2,132,235	2,092,165	2,344,370	1,943,063	2,027,408	2,705,623	3,510,727	2,952,461
Working Capital	1,149,486	1,398,893	1,611,117	1,774,515	1,870,938	1,666,232	2,302,350	2,393,077

Current assets decreased by $467,539 over the third quarter of FY 2012 to $5,345,538. A decrease in trade and other receivables of $900,356, due predominantly to a November invoice raised regarding the St George heat recovery project being settled in the current period, and a decrease in the finance lease receivable of $120,842 due to the expiry date now being within less than one year, was partially offset by an increase in cash of $558,307. Current liabilities meanwhile decreased by $558,266 to $2,952,461. Accounts payable decreased by $887,903, due to payments of November invoices related to equipment purchases for the Fibrek project, current tax liabilities were reduced by $123,319 due mainly to the payment of the prior year tax charge of the UK subsidiary, while deferred revenue increased by $408,637 due predominantly to deposit invoices raised to customers for two heat recovery projects in the UK.

After adjusting cash flow from operations for the quarter ended February 29, 2012 of $236,363 for $340,797 of positive changes in non-cash working capital items, and deducting $18,853 to allow for the effect of exchange rate fluctuations on cash and cash equivalents, the net cash flow was $558,307, increasing the net cash balance as at February 29, 2012 to $1,884,002 from $1,325,695 as at November 30, 2011.

In addition to its net cash balance of $1,884,002 as at February 29, 2012 the Company also had an estimated $200,000 of unused borrowing capacity under its bank loans.

With cash balances and unused borrowing capacity of approximately $2,084,002, management believes that it has sufficient capital resources to fund existing operations and anticipated capital requirements in the remainder of FY 2012. Order backlog as at February 29, 2012 was approximately $2.9 million compared to $1.6 million at the same time last year. As at April 30, 2012 the Company had approximately $4.4 million in purchase orders that had not yet been reflected as revenue in the Company's published quarterly financial statements.

Finance Lease Receivable

The Company's finance lease receivable includes the following:

	Feb 29, 2012 $	Feb 29, 2011 $
Total estimated minimum lease payments receivable	745,137	1,435,159
Less: unearned income	(35,199)	(161,343)
	709,938	1,273,816
Less: current portion	(570,408)	(632,322)
	139,530	641,494

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

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

The estimated minimum lease payments receivable in this new lease represent the estimated monthly energy outputs of the leased asset and are based on assumptions regarding the efficiency of the asset, the operations of the plant in which it is located and penalty payments resulting from temporary plant shut-downs. The lease expires December 31, 2012, at which time the customer has the option to purchase the asset for $1,000,000 or extend the lease term for a further 24 months with a 15% reduction in the purchase price of the asset to $850,000 at the end of the extended term.

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

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

	$
FY 2012	214,356
FY 2013	391,251
	605,607
Residual value of equipment	139,530
	745,137

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

Dry-Rex™ Agreement

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

Related Party Transactions

Options outstanding for Directors (excluding the CEO) as at February 29, 2012 were 1,250,000 of which none were exercisable. There were no warrants outstanding for Directors.

Options outstanding for Officers (including the CEO) as at February 29, 2012 were 4,140,000 of which 1,283,333 were exercisable. There were no warrants outstanding for Officers.

Loans outstanding to shareholders, including accrued interest, to enable the exercise of options and purchase of shares at February 29, 2012 totalled $nil ($122,275 at May 31, 2011).

Officer and Director Compensation

During the third quarter ended February 29, 2012 compensation arrangements for directors was as follows:

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

During the third quarter ended February 29, 2012, Directors fees paid were $25,000. Fees to the Chairperson of the Audit Committee were $2,000; fees to the Chairperson of the Ethics, Governance and Compliance Committee were $2,000; fees paid to the Chairman were $3,000; and a total of $10,000 was paid for in-person meetings.

Compensation paid to directors and officers during the third quarter ended February 29, 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	**9,000**	8,000	**-**	-	**9,000**	8,000
J. Ansell	**9,000**	8,000	**-**	-	**9,000**	8,000
J. Kelly	**10,000**	9,000	**-**	-	**10,000**	9,000
D. Gibbs	**7,000**	-	**-**	-	**7,000**	-
W. Ollerhead	**7,000**	-	**-**	-	**7,000**	-
Total	**42,000**	25,000	**-**	-	**42,000**	25,000
Officers						
W. Crossland	**60,000**	60,000	**-**	-	**60,000**	60,000
J. Flynn	**30,830**	29,858	**-**	-	**30,830**	29,858
R. Triebe	**33,750**	33,750	**-**	-	**33,750**	33,750
Total	**124,580**	123,608	**-**	-	**124,580**	123,608

Chinese Joint Venture

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

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

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

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

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

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

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

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

Sales in China through TEI (Guangzhou) Ltd came to a virtual halt during the last three quarters of FY 2011, pending resolution of management and staffing changes. Expenses incurred are related to the maintenance of the office plus technical and administrative staff. Management has now established a stable team to recommence the distribution of the Company's range of products in China. There was no revenue from the Chinese operation in either the first, second or third quarters of FY 2012, with expenses relating to office rental and three employees of $22,645 in the quarter ended August 31, 2011, a net loss in the quarter ended November 2011 of $7,402, representing costs of $10,728 less the recovery of a previously written off bad debt of $3,326, plus a net loss in the third quarter ended February 29, 2012 of $15,578, predominantly all staff related costs.

Segmented Information

In the three quarters and nine month periods ended February 29, 2012 and February 28, 2011, the Company operated in the energy conservation industry in North America, Europe, China and Rest of the World. Within this business segment, the Corporation markets, sells, engineers, fabricates, constructs, installs and supports three technology lines – heat recovery solutions, condensate return system solutions and low temperature biomass drying systems. Assets are located in Canada, Europe and China.

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

Segment information for the quarter ended February 29, 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	2,693,482	313,138	890,319	1,550,497			3,583,801	1,863,635
Cost of sales	1,915,835	164,631	254,701	558,927	-	-	2,170,536	723,558
Gross profit	777,647	148,507	635,618	991,570	-	-	1,413,265	1,140,077
Amortization of intangible assets			24,664	10,610			24,664	10,610
Other expenses	526,043	380,105	523,809	527,872	398,654	222,837	1,448,506	1,130,814
Finance revenue	23,461	47,892					23,461	47,892
Profit (loss) before taxation	275,065	(183,706)	87,145	453,088	(398,654)	(222,837)	(36,444)	46,545
Taxation	-	-	(18,640)	(114,750)	23,230	14,594	(4,590)	(100,156)
Profit (loss) after taxation	275,065	(183,706)	68,505	338,338	(375,424)	(208,243)	(31,854)	(53,611)
Attributable to:								
Owners of the parent	282,074	(179,913)	64,437	334,314	(375,424)	(208,243)	(28,913)	(53,842)
Non-controlling interests	(7,009)	(3,793)	4,068	4,024	-	-	(2,941)	231

Segment information for nine months ended February 29, 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	5,185,258	4,312,202	4,506,551	3,475,231			9,691,809	7,787,433
Cost of sales	3,591,558	2,959,110	1,760,287	1,208,742	-	-	5,351,845	4,167,852
Gross profit	1,593,700	1,353,092	2,746,264	2,266,489	-	-	4,339,964	3,619,581
Amortization of intangible assets			74,295	78,652			74,295	78,652
Other expenses	1,,364,465	1,141,077	1,679,630	1,564,630	1,037,829	940,588	4,081,924	3,646,295
Finance revenue	86,041	125,148					86,041	125,148
Profit (loss) before taxation	315,276	337,163	992,339	623,207	(1,037,829)	(940,588)	269,786	19,782
Taxation	-	-	(231,120)	(153,610)	72,406	47,574	(158,714)	(106,036)
Profit (loss) after taxation	315,276	337,163	761,219	469,597	(965,423)	(893,014)	111,072	(86,254)
Attributable to:								
Owners of the parent	335,807	342,973	751,986	458,253	(965,423)	(893,014)	122,370	(91,788)
Non-controlling interests	(20,531)	(5,810)	9,233	11,344	-	-	(11,298)	5,534

During the quarter ended February 29, 2012 the company had one customer in North America and China that accounted for 61% of total revenue for the period.

For the quarter ended February 29, 2011 the company had two customers that accounted for 21% and 17% respectively of total revenue for the period. Both customers were based in the Europe and rest of World geographical segment.

During the nine months ended February 29, 2012 the company had one customer in North America and China that accounted for 43%, and one customer in in Europe and rest of world that accounted for 20% of total revenue for the period.

During the nine months ended February 29, 2011 the company had one customer that accounted for 45% of total revenue for the period, based in the North America and China geographical segment.

Further geographical analysis:

	Revenues for the 9 months ended Feb 29/28		Property, plant and equipment		Goodwill and intangibles		Sales-type lease	
	2012	2011	**Feb 29, 2012**	May 31, 2011	**Feb 29, 2012**	May 31, 2011	**Feb 29, 2012**	May 31, 2011
	$	$	**$**	$	**$**	$	**$**	$
Canada	**4,370,839**	3,805,367	**27,536**	20,115	**-**	-	**709,938**	1,121,330
U.S.A.	**763,840**	347,149	**-**	-	**-**	-	**-**	-
U.K.	**3,660,149**	2,371,543	**40,591**	51,824	**4,131,163**	4,258,567	**-**	-
Italy	**482,679**	267,354	**-**	-	**-**	-	**-**	-
Germany	**29,810**	109,079	**-**	-	**-**	-	**-**	-
Eire	**72,474**	106,400						
Rest of Europe	**102,632**	255,139	**-**	-	**-**	-	**-**	-
China	**50,579**	159,686	**1,666**	2,588	**-**	-	**-**	-
Malaysia	**4,484**	128,274	**-**	-	**-**	-	**-**	-
Singapore	**63,316**	5,471	**-**	-	**-**	-	**-**	-
Turkey	**6,647**	109,149						
Rest of world	**84,360**	122,822	**-**	-	**-**	-	**-**	-
Total	**9,691,809**	7,787,433	**69,793**	74,527	**4,131,163**	4,258,567	**709,938**	1,121,330

Supplementary financial information

Quarterly financial information (unaudited)
For the eight quarters ended February 29, 2012

	2010	2011				2012		
	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Sales	1,636,644	2,985,667	2,938,131	1,863,635	1,913,163	1,431,686	4,676,322	3,583,801
Net profit (loss)	(843,849)	(34,760)	(3,186)	(53,842)	(50,794)	(308,496)	459,779	(31,854)
Net profit (loss) per share basic and diluted	(0.005)	(0.000)	(0.000)	(0.000)	(0.000)	(0.002)	0.003	(0.000)

Material Segmentation Variances

Revenue

Revenue within North America and China increased by $2,380,344 in the quarter ended February 29, 2012 over the same quarter of the previous year. The quarter ended February 29, 2012 included revenue from the Fibrek project of $2,181,815, whereas the quarter ended February 28, 2011 did not include any comparative revenue.

Europe and rest of world revenue decreased by $720,178 in the quarter ended February 29, 2012 compared with the same quarter of the previous year. This was the mostly due to decreased sales to both the UK based food manufacturer and the NHS.

Geographical segment profit (loss) before tax:

North America and China realized a pre-tax income of $275,065 in the third quarter of FY 2012, compared with a loss of $183,706 in the same period of the preceding year. This was predominantly a result of the increased gross profit resulting from the Fibrek revenues in the current quarter, however costs also increased mainly from the addition of staff plus increased training of distributors in North America.

Europe and rest of the world income before tax decreased by $365,943 in the quarter ended February 29, 2012 compared with the same period of the previous year, due almost entirely to the drop in sales. There were no other significant changes.

Trend Analysis:

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

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

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

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

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

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

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

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.

Business Update:

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

2. On April 11, 2011 the Company announced it had received a purchase order for approximately £246 thousand (approximately CDN $386 thousand) from Salisbury District Hospital Trust, a

major hospital in South West England, to install a heat recovery system for use on its heating and hot water system. This system was largely completed in the first quarter of fiscal 2012.

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

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

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

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

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

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

9. 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.

10. The Company's order backlog as at February 29, 2012 was approximately $2.9 million compared to $1.6 million at the same time last year. As at April 30, 2012 the Company had approximately $4.4 million in purchase orders that had not yet been reflected as revenue in the Company's published quarterly financial statements.

Critical Accounting Estimates

On October 25, 2005, the Company was served with a statement of claim from its past President. Among other things, the lawsuit alleges that the former president was wrongfully dismissed from his employment. Damages are claimed in the approximate amount of $4 million, plus an as yet undetermined value of share options, interest and legal costs. The Company has filed a statement of defence in response and has counterclaimed for approximately $5 million in damages plus interest and costs.

Two attempts have been made at a mediated settlement. Neither attempt has been successful. Although the lawsuit was commenced in October, 2005, the plaintiff has yet to take the proceeding to the point of oral examinations for discovery.

In May, 2010, the plaintiff brought a motion for summary judgment, seeking judgment in the amount of $1,105,047 plus interest and costs. This amount is comprised of: i) $398,737 allegedly owing as a result of wrongful dismissal and calculated as 24 months of salary, commissions, and related benefits; ii) $618,810 in alleged unpaid loans and advances; and iii) $87,500 in stock options which are alleged to have vested. The motion was heard on September 6 and 7, 2011 and on October 18, 2011 a decision was rendered. In its decision on the motion for summary judgment the court: i) Allowed the plaintiff's claim for wrongful dismissal assessing the damages for the plaintiff's wrongful dismissal at the equivalent of 18 months of pay in lieu of notice of termination; ii) Dismissed the plaintiff's claim for alleged unpaid loans and advances; iii) Permitted the remainder of the parties' claims and counterclaims to proceed to trial; iv) Declined to fix the amount of the damages for pay in lieu of notice of termination, suggesting instead that the parties try to agree on the amount; v) Stated that in the absence of the parties' agreement on the amount of damages for pay in lieu of notice of termination, the issue is to be referred to a Master; and vi) Stayed the execution of the partial summary judgment pending the determination of the outstanding claims at trial. The plaintiff has been awarded approximately $37, 000 in costs but to date and the Company has paid this amount. The parties have not yet discussed or agreed on the amount of the damages for wrongful dismissal, and there has, as yet, been no reference to a Master.

The past President has appealed from the dismissal of his claims for unpaid loans and advances. The hearing for the appeal is scheduled for May 10, 2012. The Company has not appealed the October 18, 2011 decision.

Until the remaining issues are determined, it is unclear what the net balance payable between the parties will be and to which party it is to be paid and the ultimate net impact of the partial judgment on Thermal Energy remains unknown at present. While the Company is confident in the merits of its own case, there is much that is still unknown about the former president's case. In November 2009, the Company recorded a charge of $190,000 in its financial statements. This charge remains unchanged and is intended to account for possible future net liabilities resulting from the claim and the counterclaim.

Disclaimer

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

Business Risks

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

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

- The Company's history of operating losses and uncertainty of future profitability;
- The ability to grow sales through the establishment of new cooperative partnerships and strategic alliances;
- The ability to grow sales through the licensing of the corporation's technologies;
- The ability to secure and maintain the required outside working capital financing;
- The ability to achieve profitable operations through increased sales,
- Reliance on third party collaborations and license arrangements;
- Reliance on proprietary technology;
- Competition in the energy conservation and environmental compliance solutions;
- Product liability claims and insurance;
- Reliance on key personnel;
- The ongoing litigation with its former President & CEO;

- The ability to control costs and achieve a positive gross margin on projects; and,
- The effect of a prolonged recession in Canada, USA and Europe to the financial markets in securing project financing and in particular to industrial and commercial customers in committing capital to projects.

Management's addressing of the risks:

The management of the Company realizes that the operating losses in FY 2010, FY 2011 and the first quarter of FY 2012 display a consistent pattern of losses as in previous years. However the operating losses in FY 2010 were partly attributed to $963,213 in one-time provisions and write-offs. FY 2011 also resulted in a loss, however this was much reduced from previous years' losses due to achieving a larger number of both heat recovery projects and GEM sales, along with improved cost controls. The loss suffered in the first quarter of FY 2012 was due to the lack of revenue from heat recovery projects, which was recovered in the second quarter, as both the Fibrek project and St. Georges Healthcare NHS Trust project, announced August 5, 2011, progressed, producing a profit for the quarter and for the six months ended November 30, 2011. Although the third quarter saw a reduction in revenues, resulting in a small loss, the year to date period to February 29, 2012 still shows a net income.

In addition on June 29th, 2010 the Company signed an arm's length Greenpower Purchase Agreement with Fortress Specialty Cellulose Inc. ("Fortress Specialty"). The agreement is to supply recovered energy to the Fortress Specialty mill in Thurso, Quebec from a FLU-ACE® Waste Heat Recovery System installed at the site. Based on the amount of heat expected to be recovered, this agreement is expected to provide the Company approximately $605,000 of additional cash flow per year between now and December 31, 2012.

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

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

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

INTERNATIONAL FINANCIAL REPORTING STANDARDS

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

The significant accounting policies adopted under IFRS are included in note 3 to the unaudited condensed consolidated interim financial statements for the quarter ended February 29, 2012. These accounting policies have been applied consistently to all periods presented in the financial statements. They also have been applied in preparing an opening IFRS statement of financial position as at June 1, 2010, the Company's transition date, as required by IFRS 1. The accounting policies have been selected to be consistent with IFRS as is expected to be effective on May 31, 2012, the Company's first annual IFRS reporting date. The standards and interpretations within IFRS are subject to change and accordingly, the accounting policies for the annual period that are relevant to these unaudited condensed consolidated interim financial statements will be finalized only when the first full IFRS financial statements are prepared for the year ending May 31, 2012.

Reconciliations and descriptions of the effect of the transition from Canadian GAAP to IFRS are included in note 27 to the unaudited condensed consolidated interim financial statements for the quarter ended February 29, 2012.

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

Summary of Outstanding Shares and Dilutive Instruments

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

Shares

163,336,616 class A common shares.

Options

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

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

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

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

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

Thermal Energy's external auditors, Raymond Chabot Grant Thornton LLP, conducted an independent audit of the consolidated financial statements for the year ended May 31, 2011 in accordance with Canadian generally accepted auditing standards, performing such tests and other procedures as they consider necessary to express an audit opinion. The condensed consolidated financial statements for the quarter and nine months ended February 29, 2012, prepared in accordance with IFRS, have not been audited.