THIRD QUARTER REPORT
Period ended February 28, 2013

MANAGEMENT'S DISCUSSION & ANALYSIS

This discussion is dated as of April 29, 2013 and explains the material changes in Thermal Energy International Inc.'s ("Thermal Energy" or the "Company") financial condition and results of operations for the third quarter of Fiscal Year 2013, ended February 28, 2013. The condensed consolidated interim financial statements and accompanying notes constitute an integral part of the discussion and should be read in conjunction with these comments. During the period ended February 28, 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.

Description of Business

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

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

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

Discussion of Operations and Financial Conditions

Revenues and Gross Profits

Revenues were $4,208,723 in the quarter ended February 28, 2013, an increase of $624,922, or 17.4% compared to $3,583,801 in the quarter ended February 29, 2012. Sales of GEM® Condensate return systems increased by $183,641 (22.0%) over the same period in the previous year, while sales of heat recovery systems increased by $441,281 (16.1%).

Within GEM® condensate return systems sales, sales to two large hospitals totaling $417,455 were partially offset by fewer orders from a major pharmaceutical manufacturer and reduced sales to Europe, which continues to suffer from a prolonged recession.

Heat recovery systems revenue of $3,190,228 in the quarter ended February 28, 2013 includes $1,546,318 resulting from the extension of the Greenpower Purchase Agreement with Fortress Specialty Cellulose, as announced November 29, 2012, plus $1,295,113 from sales to two large hospitals and $285,016 from sales to a major food manufacturer. The majority of the heat recovery systems revenue in the same period of the previous year related to the $5.8 million contract with Fibrek, announced June 16, 2011.

For the nine months ended February 28, 2013, revenues were $6,330,784 compared to $9,691,809 for the same period of the previous year. Revenues from the sale of heat recovery systems decreased by $3,756,729 from $7,183,989, due to three main factors: the Fibrek project which produced $4,128,446 more revenue in the first nine months of last year; decreased revenues from sales to hospitals of $1,314,792, due mainly to the St. Georges Healthcare NHS Trust project in FY 2012 which was a larger than average project; and, offsetting these two decreases, the Greenpower Purchase Agreement extension which produced an additional $1,546,318. GEM® condensate return systems sales increased by $395,704 to $2,903,524 from $2,507,820, despite a decrease in revenues from sales to a major food manufacturer of $229,414 from the prior period, due to sales to two major hospitals and continued growth within North America.

The gross profit of $2,906,414 in the quarter ended February 28, 2013 represented an increase of $1,493,149, or 105.6%, from the $1,413,265 achieved in the quarter ended February 29, 2012. This increase was almost entirely the result of the Greenpower Purchase Agreement extension, which served to increase revenues with minimal additional cost. These results expressed as a percentage of sales were 69.1% in the third quarter of FY 2013 compared with 39.4% in the third quarter of FY 2012.

For the nine months ended February 28, 2013, gross profit of $4,231,094 represented a decrease of $108,870, or 2.5%, from the $4,339,964 achieved in the nine months ended February 29, 2012. The reduction resulting from reduced revenues was countered by the gross profit achieved from the Greenpower Purchase Agreement extension with Fortress

Specialty Cellulose. These results expressed as a percentage of sales were 66.8% in the nine months ended February 28, 2013 compared with 44.8% in the same period of 2012.

Expenses

Sales and Marketing and General and Administrative expenses in the quarter ended February 28, 2013 totaled $1,398,644 compared with $1,471,759 in the quarter ended February 29, 2012.

Staff costs within Sales and Marketing and General and Administrative expenses increased in the quarter ended February 28, 2013 over the same period of the previous year due to the addition of two sales staff plus two technical staff, plus increased commissions payable. Other cost increases include the retainer paid to the investor relations firm, as announced April 19, 2012. These cost increases were offset by reductions in legal fees from the same period of the previous year as well as lower audit fees in the quarter due to the timing of invoices.

For the nine months ended February 28, 2013, Sales and Marketing and General and Administrative expenses totalled $4,354,864, compared to $4,147,764 for the nine months ended February 29, 2012, an increase of $207,100. This was predominantly the result of the additional staff in the first nine months of FY 2013 plus the increased investor relations costs.

Research and development costs of 51,851 in the third quarter of FY 2013 compared to $1,411 in the third quarter of FY 2012. The current quarter includes costs relating to the product development project targeting the Chinese petrochemical market, for which the Company had previously received an offer of government funding through ISTP Canada, as announced February 8, 2012. The funding agreement was signed by both parties on January 21, 2013. Funding will be credited to research and development costs when it is received. Research and development costs also include time spent on the development of sundry ancillary products relating to the GEM product range.

Year to date research and development costs totaled $164,523 for the nine months ended February 28, 2013 and $8,455 for the nine months ended November 29, 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 third quarter of FY 2013 of $39,489 compared to $23,461 recognized in the third quarter of FY 2012. The current quarter finance revenue is the result of the extended Greenpower Purchase Agreement with Fortress Specialty Cellulose, which commenced on December 1, 2012.

For the nine months ended February 28, 2013, finance revenue was $57,004, compared with $86,041 for the nine months ended February 29, 2012. The interest rate implicit in the lease of 14% is applied against the reducing finance lease receivable balance, hence lower finance revenues as the term of the agreement progresses.

Income before income taxes for the quarter ended February 29, 2013 was $1,495,408 compared to a loss of $36,444 in the same quarter of the previous year. The increase of $1,531,852 was due to the increase in gross profit, with little net change to other costs in the current quarter from the same quarter of the previous year.

For the nine months ended February 28, 2013, loss before income taxes was $231,289, compared with income of $269,786 for the nine months ended February 29, 2012. This was the result of the decrease in heat recovery activity in the first three quarters of FY 2013 compared to the first three quarters of FY 2012, plus the increased staff and investor relations costs mentioned above.

Income tax charge in the third quarter of FY 2013 was $23,440, compared to a credit of $4,590 in the third quarter of FY 2012. The higher charge in the current quarter is the result of increased sales in the quarter within the UK compared to the third quarter of FY 2012.

For the nine months ended February 28, 2013, income tax recovery was $69,023, compared with a charge of $158,714 for the same period of the previous year, due to current year to date losses of the UK entity compared with a profit for the same period of last year.

Net income for third quarter of FY 2013 was $1,471,968 compared to a net loss of $31,854 in the same quarter of the previous year.

Net loss for the nine months ended February 28, 2013 was $162,226 compared to net income of $111,072 for the nine months ended February 29, 2012.

Comprehensive income was $1,388,907 for the third quarter of FY 2013 compared to a comprehensive loss of $121,479 for the third quarter of FY 2012.

For the nine months ended February 28, 2013, comprehensive loss was $239,802, compared with comprehensive income of $46,226 for the same period of the previous year. In both the quarter and nine months ended February 28, 2013 and February 29, 2012 respectively, Sterling weakened against the Canadian dollar, resulting in an exchange loss on translation of overseas operations.

Liquidity & Capital Resources

The working capital was $1,775,742 at February 28, 2013 compared to working capital of $2,567,447 at May 31, 2012 – a decrease of $791,705, with the Company's net cash position (Cash and cash equivalents less Bank loans) decreasing by $671,247 from $1,371,951 at May 31, 2012 to $700,704 as at February 28, 2013.

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

	May 31, 2011 $	Aug 31, 2011 $	Nov 30, 2011 $	Feb 29, 2012 $	May 31, 2012 $	Aug 31, 2012 $	Nov 30, 2012 $	Feb 28, 2013 $
Current Assets	3,898,346	4,371,855	5,813,077	5,345,538	5,758,086	4,534,637	3,814,265	4,537,306
Current Liabilities	2,017,259	2,695,481	3,500,526	2,942,432	3,190,639	2,800,733	2,770,537	2,761,564
Working Capital	1,881,087	1,676,374	2,312,551	2,403,106	2,567,447	1,733,904	1,043,728	1,775,742

Q3 FY 2013 Changes

Current assets increased in the current quarter by $723,041 to $4,537,306. The majority of this increase was the result of the Greenpower Purchase Agreement extension, which added $520,662 to the current element of the finance lease receivable. In addition, the cash balance increased by $177,620. Current liabilities meanwhile decreased by $8,973 to $2,761,564. A decrease in trade payables of $197,484 was offset by an increase in accrued liabilities of $222,447, with little movement in other liabilities. The increase in accrued liabilities represents accrued commissions payable on UK sales which occurred in the last month of the quarter, plus unpaid directors' fees and increased expense claims at month end.

As at February 28, 2013, $367,151 (31.7%) of the Company's trade receivables balance was over 90 days past due. Of this balance, $209,610 has subsequently been received by the Company. Of the remainder, $135,916 relates to a balance with a major food manufacturer in the UK, with whom the Company is currently working to address technical issues which, once settled, will result in the release of payments by the customer. None of the remaining overdue balance is considered impaired as at February 28, 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 February 28, 2013 was $185,249. After adjusting this for $7,368 of negative changes in non-cash working capital items and foreign exchange adjustments and deducting $729 for net cash outflow of buying and selling fixed assets and adding $468 to allow for the effect of exchange rate fluctuations on cash and cash equivalents, the net cash inflow was $177,620, increasing the net cash balance as at February 28, 2013 to $700,704 from $523,084 as at November 30, 2012.

In addition to its net cash balance of $700,704 as at February 28, 2013 the Company had an estimated $116,000 of unused borrowing capacity available against certain authorized UK accounts receivable balances, under its bank loans. The facility provides up to approximately $780,000 dependent upon the level of authorized accounts receivable balances at any given time. As at February 28, 2013, the Company had no borrowings against the facility.

With cash balances and unused borrowing capacity of approximately $816,704, management believes that it has sufficient capital resources to fund existing operations and anticipated capital requirements in the remainder of FY 2013. Order backlog as at February 28, 2013 was approximately $1.9 million compared to $2.9 million at the same time last year, which included $1.5 million regarding Fibrek and $0.8 million regarding heat recovery solutions sales to a major food manufacturer. As at April 29, 2013, the Company had $2.3 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:

	February 28, 2013	May 31, 2012
	$	$
Total estimated minimum lease payments receivable	1,765,187	530,779
Less: unearned income	(212,804)	(18,283)
	1,552,383	512,496
Less: current portion	(732,499)	(512,496)
	819,884	-

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 has been recorded in accordance with the previous lease, resulting in an increase to net investment in 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	726,736
Residual value of equipment	139,530
	1,765,187

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 February 28, 2013 were 1,500,000 of which 333,334 were exercisable. There were no warrants outstanding for Directors.

Options outstanding for Officers (including the CEO) as at February 28, 2013 were 5,430,000 of which 2,330,000 were exercisable. There were no warrants outstanding for Officers.

Officer and Director Compensation

During the third quarter ended February 28, 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 third quarter ended February 28, 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 $6,000 was paid for in-person meetings.

Compensation paid to directors and officers during the third quarter ended February 28, (inclusive of the amounts described above) was as follows:

	Salaries and fees		**Commissions / incentives**		**Total**	
	2013 **$**	2012 $	**2013** **$**	2012 $	**2013** **$**	2012 $
Directors						
M. Williams	**6,250**	9,000	**-**	-	**6,250**	9,000
J. Ansell	**-**	9,000	**-**	-	**-**	9,000
J. Kelly	**7,000**	10,000	**-**	-	**7,000**	10,000
D. Gibbs	**4,750**	7,000	**-**	-	**4,750**	7,000
W. Ollerhead	**4,750**	7,000	**-**	-	**4,750**	7,000
B. Linton	**4,750**	-	**-**	-	**4,750**	-
J. Schoenmakers	**4,750**	-	**-**	-	**4,750**	-
Total	**32,250**	42,000	**-**	-	**32,250**	42,000
Officers						
W. Crossland	**60,000**	60,000	**-**	-	**60,000**	60,000
J. Flynn	**31,755**	29,858	**-**	-	**31,755**	29,858
R. Triebe	**34,763**	33,750	**-**	-	**34,763**	33,750
Total	**126,518**	125,009	**-**	-	**126,518**	125,009

Segmented Information

In the quarters and nine month periods ended February 28, 2013 and February 29, 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 quarter ended February 28, 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
	$	$	**$**	$	**$**	$	**$**	$
Total revenue from external customers	**1,824,828**	2,693,482	**2,383,895**	890,319	**-**	-	**4,208,723**	3,583,801
Cost of sales	**(119,830)**	(1,915,835)	**(1,182,479)**	(254,701)	**-**	-	**(1,302,309)**	(2,170,536)
Gross profit	**1,704,998**	777,647	**1,201,416**	635,618	**-**	-	**2,906,414**	1,413,265
Amortization of intangible assets	**-**	-	**(24,664)**	(24,664)	**-**	-	**(24,664)**	(24,664)
Other expenses	**(482,869)**	(526,043)	**(679,854)**	(523,809)	**(263,108)**	(398,654)	**(1,425,831)**	(1,448,506)
Finance revenue	**39,489**	23,461	**-**	-	**-**	-	**39,489**	23,461
Profit (loss) before taxation	**1,261,618**	275,065	**496,898**	87,145	**(263,108)**	(398,654)	**1,495,408**	(36,444)
Tax (expense) recovery	**-**	-	**(18,778)**	(18,640)	**(4,662)**	23,230	**(23,440)**	4,590
Profit (loss) after taxation	**1,261,618**	275,065	**478,120**	68,505	**(267,770)**	(375,424)	**1,471,968**	(31,854)
Attributable to:								
Owners of the parent	**1,269,339**	282,074	**475,245**	64,437	**(267,770)**	(375,424)	**1,476,814**	(28,913)
Non-controlling interest	**(7,721)**	(7,009)	**2,875**	4,068	**-**	-	**(4,846)**	(2,941)

Segment information for the nine months ended February 28, 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
	$	$	**$**	$	**$**	$	**$**	$
Total revenue from external customers	**2,538,227**	5,185,258	**3,792,557**	4,506,551	**-**	-	**6,330,784**	9,691,809
Cost of sales	**(412,384)**	(3,591,558)	**(1,687,306)**	(1,760,287)	**-**	-	**(2,099,690)**	(5,351,845)
Gross profit	**2,125,843**	1,593,700	**2,105,251**	2,746,264	**-**	-	**4,231,094**	4,339,964
Amortization of intangible assets	**-**	-	**(74,044)**	(74,295)	**-**	-	**(74,044)**	(74,295)
Other expenses	**(1,564,139)**	(1,364,465)	**(1,914,241)**	(1,679,630)	**(966,963)**	(1,037,829)	**(4,445,343)**	(4,081,924)
Finance revenue	**57,004**	86,041	**-**	-	**-**	-	**57,004**	86,041
Income (loss) before taxation	**618,708**	315,276	**116,966**	992,339	**(966,963)**	(1,037,829)	**(231,289)**	269,786
Tax (expense) recovery	**-**	-	**31,603**	(231,120)	**37,420**	72,406	**69,023**	(158,714)
Profit (loss) after taxation	**618,708**	315,276	**148,569**	761,219	**(929,543)**	(965,423)	**(162,266)**	111,072
Attributable to:								
Owners of the parent	**644,729**	335,807	**145,218**	751,986	**(929,543)**	(965,423)	**(139,596)**	122,370
Non-controlling interest	**(26,021)**	(20,531)	**3,351**	9,233	**-**	-	**(22,670)**	(11,298)

Reconciling items comprise the following:

	Three months ended February 28		Nine months ended February 28	
	2013	2012	**2013**	2012
	$	$	**$**	$
Corporate admin costs	**205,644**	202,621	**647,451**	580,370
Stock-based compensation	**40,559**	44,170	**108,641**	76,554
Professional fees	**7,806**	109,652	**134,819**	280,872
Depreciation of property, plant and equipment	**11,848**	11,084	**34,906**	33,014
Bank charges and interest	**11,133**	11,091	**30,606**	34,021
Foreign exchange differences	**(13,882)**	20,036	**10,540**	32,998
Total	**263,108**	398,654	**966,963**	1,037,829

During the three months ended February 28, 2013, the company had one customer in Europe and Rest of World that accounted for 33%; and one customer in North America and China that accounted for 37% of total revenue for the period.

During the three months ended February 28, 2012, the company had one customer in North America and China that accounted for 61% of total revenue for the period.

During the nine months ended February 28, 2013, the company had one customer in Europe and Rest of World that accounted for 22%; and one customer in North America and China that accounted for 25% of total revenue for the period.

During the nine months ended February 28, 2012, the company had one customer in North America and China that accounted for 43%; and one customer in Europe and Rest of World that accounted for 20% of total revenue for the period.

Further geographical analysis:

	Revenues for the nine months ended		Property, plant and equipment as at		Goodwill and other intangibles assets as at		Finance lease receivable as at	
	February 28, 2013 $	February 28, 2012 $	**February 28, 2013 $**	May 31, 2012 $	**February 28, 2013 $**	May 31, 2012 $	**February 28, 2013 $**	May 31, 2012 $
Canada	**1,814,729**	4,370,839	**21,181**	28,448	**-**	-	**1,552,383**	512,496
U.S.A.	**685,395**	763,840	**-**	-	**-**	-	**-**	-
U.K.	**3,142,397**	3,660,149	**29,049**	40,512	**3,969,556**	4,145,745	**-**	-
Italy	**180,232**	482,679	**-**	-	**-**	-	**-**	-
Netherlands	**91,683**	74,918	**-**	-	**-**	-	**-**	-
Ireland	**94,037**	72,474	**-**	-	**-**	-	**-**	-
Germany	**11,588**	29,810						
Rest of Europe	**26,612**	27,714	**-**	-	**-**	-	**-**	-
India	**140,773**	13,571						
Kenya	**44,311**	2,140						
China	**37,679**	50,579	**282**	1,364	**-**	-	**-**	-
Turkey	**23,531**	6,647						
Pakistan	**22,874**	19,427						
Singapore	**4,005**	63,316	**-**	-	**-**	-	**-**	-
Rest of world	**10,938**	53,706	**-**	-	**-**	-	**-**	-
Total	**6,330,784**	9,691,809	**50,512**	70,324	**3,969,556**	4,145,745	**1,552,383**	512,496

Material Segmentation Variances

Revenue

North America and China: revenue for the third quarter ended February 28, 2013 was $1,824,828 compared to $2,693,482 for the same period of the previous year. Heat recovery revenue decreased by $809,644, mainly representing $2,181,815 relating to the Fibrek project, which was substantially completed in the previous year, partially offset by $1,546,318 relating to the Greenpower Purchase Agreement extension signed on November 29, 2012. Revenue from sales of GEM products, meanwhile, decreased by $59,010.

For the nine months ended February 28, 2013, revenue decreased to $2,538,227 from $5,185,258 for the same period of the previous year. The decrease of $2,647,031 represents a decrease in heat recovery revenue of $2,841,585, due mainly to the Fibrek project in FY 2012 offset by the Greenpower Purchase Agreement extension, with an increase in GEM revenue of $194,554, resulting from the site conversion at the major pharmaceutical company plus a general increase in US revenues following the addition of a sales person to the region in the second half of FY 2012.

Europe and rest of world: revenue for the third quarter ended February 28, 2013 was $2,383,895 compared to $890,319 for the same period of the previous year. Heat recovery revenue increased by $1,250,925, due to one complete and one partial hospital site conversion in the UK. Revenue from sales of GEM products increased by $242,651, representing an increase in sales within the National Health Service in the UK of $415,193, less reductions in sales elsewhere, mainly within Europe as a result of the continuing recession.

For the nine months ended February 28, 2013, revenue decreased to $3,792,557 from $4,506,551 for the same period of the previous year. The decrease of $713,994 represents a decrease in heat recovery revenue of $915,144 and an increase in GEM revenue of $201,150. Heat recovery revenue in the nine months ended February 29, 2012 was higher than the current year due to the St George's project. Decreases in sales to a major food manufacturer as part of a division wide conversion plus decreased sales to a major pharmaceutical company and within Europe were more than offset in the nine months ended February 28, 2013 by increased sales to the National Health Service in the UK as well as tea plants and rubber manufacturers in the rest of the world.

Segment loss before tax

North America and China: despite the decreased revenue in the third quarter of FY 2013 compared to the same period of FY 2012, gross profit increased by $927,351. This was a result of the revenue recognized on commencement of the two year extension to the Greenpower Purchase Agreement with Fortress Specialty Cellulose, which carried little cost. A net decrease in other expenses resulted from increased staff costs being more than offset by decreased training expenditure in the current quarter, commissions on reduced revenues and no repeat of the lease write off experienced in the third quarter of FY 2012. With an increase in finance revenue of $16,028 these positive changes resulted in segment income before tax of $1,261,618 compared to $275,065 in the same period of the previous year.

For the nine months ended February 28, 2013, gross profit rose by $532,143 from the same period of the previous year. Added to increased costs (mainly staff related) of $199,674 plus a reduction in finance revenue of $29,037, this led to income of $618,708 compared to $315,276 in the nine months ended February 29, 2012.

Europe and rest of world: gross profit increased in the quarter ended February 28, 2013 over the same quarter of the previous year by $565,798, as a result of the increase in revenue. Staff cost increases plus commissions on the higher revenues contributed to an increase in other expenses of $156,045. The resulting pre-tax profit of $496,898 compared to a net income of $87,145 for the same period of the prior year.

The first three quarters of FY 2013 saw a reduction in gross profit for the Europe and rest of world region of $641,013 due mainly to the lower project values of heat recovery projects in progress in the first nine months of the current year. Coupled with additional costs (mainly staff related) of $234,611 this gave rise to a decrease in net income before tax of $875,373.

Other expenses within Reconciling items, which incorporates all costs not specifically attributable to either regional operational center, decreased in the third quarter of FY 2013 over the same period of the prior year by $135,546, due to a decrease in professional fees of $101,847, being $40,751 legal fees and $61,096 timing-related audit fees, and a net exchange gain in the current quarter compared with a loss in the previous year. The additional cost of the investor relations firm, as announced April 19, 2012 was partially offset by a reduction in directors fees.

For the nine months ended February 28, 2013 other expenses within reconciling items decreased by $70,866. Increases relating to investor relations and stock based compensation were more than offset by a combination of decreases in directors fees, legal fees, audit fees (with the prior period including additional costs relating to the transition to reporting in accordance with International Financial Reporting Standards) and reduced foreign exchange differences.

Supplementary financial information

Quarterly financial information (unaudited)
For the eight quarters ended February 28, 2013

Quarter ended	28-Feb-13 $	30-Nov-12 $	31-Aug-12 $	31-May-12 $
Revenue	4,208,723	1,259,984	862,077	3,460,878
Gross Profit	2,906,414	799,717	524,963	1,308,407
Gross Profit Percentage	69.1%	63.5%	60.9%	37.8%
EBITDAS(1)	1,573,398	(682,929)	(901,104)	(61,525)
Total net income (loss) attributable to owners of the parent	1,476,814	(778,011)	(838,399)	(20,941)
Income (loss) per share, basic and diluted	0.009	(0.005)	(0.005)	0.000
Net operating cash flow(2)	185,249	(536,159)	(668,914)	216,353

Quarter ended	29-Feb-12 $	30-Nov-11 $	31-Aug-11 $	31-May-11 $
Revenue	3,583,801	4,676,322	1,431,686	1,913,163
Gross Profit	1,413,265	2,123,687	803,012	1,055,037
Gross Profit Percentage	39.4%	45.4%	56.1%	55.1%
EBITDAS(1)	44,242	731,191	(264,766)	(79,562)
Total net income (loss) attributable to owners of the parent	(28,913)	459,779	(308,496)	(50,794)
Income (loss) per share, basic and diluted	0.000	0.003	(0.002)	0.000
Net operating cash flow(2)	236,363	609,587	(158,988)	86,776

(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:

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 UK food manufacturer and $1,295,113 relating to sales to the National Health Service in the UK. 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 UK, plus increased sales within the rest of the world. The effect of this revenue increase on gross profit was an additional $274,754 over the previous quarter. EBITDAS saw an improvement of $218,175 - $56,579 less than the gross profit increase, mainly due to costs in the second quarter relating to the AGM, as well as increased commissions on the increased GEM sales plus the receipt of invoices relating to the audit of the FY 2012 financial statements. The decrease in net loss of $60,388 was less than the EBITDAS improvement as a result of

UK tax losses being absorbed in the first quarter, allowing for no further tax credit from previous years despite losses incurred in the current year.

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

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

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

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

The first quarter of Fiscal Year 2012 experienced a drop in revenue of $481,477 over the previous quarter to $1,431,686. Of this revenue, $913,665 related to sales of GEM® product, representing a decrease from the previous quarter of $574,088. $309,189 of this decrease was due to a significant proportion of the sales to the major food manufacturer in the UK being recognized in Q4 of Fiscal 2011, $191,246 related to sales to the NHS in the UK, with one hospital order in the quarter ended February 28, 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 February 28, 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 Qinchunbao of $159,972 in the previous quarter, but the decrease of other smaller projects served to reduce the overall increase. These reductions in overall revenue of $481,477 resulted in a decreased gross profit from the previous quarter of $252,025. Net loss increased in the first quarter of FY 2012 over the previous quarter by $257,702, due to the decrease in gross profit, plus $26,248 audit fees paid in the first quarter. There were no other large fluctuations in costs during the quarter.

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

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 February 28, 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. The first three quarters of FY 2013, however, has produced a loss before tax of $162,266, resulting from diminished revenues and increasing costs. The increased costs predominantly relate to increased staff numbers, which management believes are vital to maintain and build on the record revenues of FY 2012. A dip in profitability was expected while new staff additions become accustomed to their roles and the strategy of the Company.

As reported last year, on June 29th, 2010 the Company signed an arm's length Greenpower Purchase Agreement with Fortress Specialty Cellulose Inc. ("Fortress Specialty"). The agreement 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 waste energy expected to be recovered, this agreement was expected to provide the Company approximately $720,000 of additional cash flow per year between now and December 31, 2012, 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 waste energy 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 has been recorded in the financial statements as an increase to the net investment in lease. The revenue for the nine months ended February 28, 2013 therefore includes the capital element of the total expected payments over the 24 month period of the extension, totaling $1,546,318. The interest element of the lease will be recorded as finance revenue over the period of the lease.

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 Outlook

- As reported previously, on December 17, 2010 the Company signed a Letter of Intent with a major North American pulp and paper company outlining the two parties' intent to develop and, subject to financing and approval by the pulp and paper company's board of directors, implement on an exclusive basis heat recovery projects at three of the customer's locations. A project has been developed for the first site and is awaiting approval by the customer. The second site did not support a viable project and further development work is not currently being conducted at this site. The final site is still under consideration.

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

- In June 2012, the Company received another purchase order for approximately $249,000 from the same major food manufacturer for a heat recovery solution at one of its sites. This order is expected to be substantially completed by the first quarter 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 is expected to be substantially completed by the first quarter of FY 2014..

- 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 is expected to be substantially completed by the end of FY 2013. Thermal Energy is working on a number of additional sites within the company.

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

- The company is currently developing energy efficiency projects on a paid or exclusive basis at 13 different sites for 7 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 February 28, 2013, was approximately $1.9 million. As at April 29, 2013, the Company had an order backlog of approximately $2.3 million. 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

163,336,616 class A common shares.

Options

Number of Options outstanding	Number of Options Exercisable	Exercise Price Per Share $	Expiry Date
2,750,000	2,166,667	0.10	May 4,2015
2,562,500	854,167	0.10	May 10, 2016
500,000	166,666	0.10	July 12, 2016
4,940,000	1,646,667	0.10	December 1, 2016
5,480,000	-	0.10	November 23, 2017
16,232,500	4,834,167		

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

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

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

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

Thermal Energy's external auditors, Raymond Chabot Grant Thornton LLP, conducted an independent audit of the consolidated financial statements for the year ended May 31, 2012 in accordance with IFRS, performing such tests and other procedures as they consider necessary to express an audit opinion. The condensed consolidated financial statements for the quarter ended February 28, 2013, prepared in accordance with IFRS, have not been audited.