THIRD QUARTER REPORT
Period ended February 28, 2014

MANAGEMENT'S DISCUSSION & ANALYSIS

This Management Discussion and Analysis (MD&A) explains the material changes in Thermal Energy International Inc.'s ("Thermal Energy" or the "Company") financial condition and results of operations for the third quarter of Fiscal Year 2014, ended February 28, 2014. The condensed consolidated interim financial statements and accompanying notes constitute an integral part of the discussion and should be read in conjunction with this MD&A. During the period ended February 28, 2014, the Company's critical accounting estimates, significant accounting policies and risk factors have remained substantially unchanged. This discussion and analysis of the financial condition and results of operations may contain forward-looking statements. These statements are not guarantees of future performance and are subject to risks and uncertainties that could cause actual results to differ materially from those in the forward-looking statements. Additional information relating to the Company is available on SEDAR at www.sedar.com. All financial information in this report is stated in Canadian Dollars, which is both the presentation and functional currency of the Company.

The Board of Directors, on recommendation of the Audit Committee, approved the content of this MD&A on April 22, 2014. Disclosure contained in this document is current to this date, unless otherwise stated.

Description of Business

Thermal Energy, established in 1991, is an innovative cleantech company and a global provider of proprietary and proven energy and water efficiency, emission reduction, and bioenergy products and solutions to the industrial, commercial and institutional markets. The Company is headquartered in Ottawa, Canada, with offices in the U.K., U.S., 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 $2,897,535 in the quarter ended February 28, 2014, a decrease of $1,311,188, or 31.2% compared to $4,208,723 in the quarter ended February 28, 2013. Sales of GEM® Condensate return systems increased by $93,610 (9.2%) over the same period in the previous year, while sales of heat recovery systems decreased by $1,404,798 (44.0%).

Within GEM® Condensate return system sales was the partial fulfilment of orders received from a major food and beverage manufacturer, as announced July 3, 2013 and a global premium beer company, as announced February 10, 2014. These sales gains were partially offset by reduced sales to hospitals as, although the current and prior year third quarters each included one hospital conversion, the current period sale was to a smaller hospital.

Heat recovery systems sales for the third quarter of the previous year included $1,546,318 resulting from the extension of the Greenpower Purchase Agreement with Fortress Specialty Cellulose, as announced November 29, 2012. Revenues in the current quarter from projects at two sites of a major Fortune 500 food and beverage company, as announced September 16, 2013, plus the installation at a major pulp and paper company as announced June 3, 2013, offset a reduction in revenues from hospitals. The current quarter saw the commencement of projects at two major hospitals, as announced September 10, 2013 and November 14, 2013 respectively, compared with the substantial completion of an installation at a major hospital in the same period of the prior year.

For the nine months ended February 28, 2014, revenues were $8,433,803 compared to $6,330,784 for the same period of the previous year, an increase of $2,103,019, or 33.2%. GEM® condensate return systems sales increased by $616,156 (21.2%), due mainly to the two orders mentioned above plus the continued growth within North America. Revenues from the sale of heat recovery systems increased by $1,486,863 (43.4%) despite the same period of the previous year containing the Greenpower Purchase Agreement extension, due to the projects mentioned above.

The gross profit of $1,391,171 in the quarter ended February 28, 2014 represented a decrease of $1,515,243, or 52.1%, from the $2,906,414 achieved in the quarter ended February 28, 2013. This decrease was almost entirely the result of the Greenpower Purchase Agreement extension in the previous year, which served to increase revenues with minimal additional cost. These results expressed as a percentage of sales were 48.0% in the third quarter of FY 2014 compared with 69.1% in the third quarter of FY 2013.

For the nine months ended February 28, 2014, gross profit of $4,236,052 represented an increase of $4,958, or 0.1%, from the $4,231,094 achieved in the nine months ended February 28, 2013. The gross profit achieved from the Greenpower Purchase Agreement extension with Fortress Specialty Cellulose in the first three quarters of FY 2013 was matched by gross profit generated by the increase in both heat recovery systems and GEM® condensate return systems sales in the current year. These results expressed as a percentage of sales were 50.2% in the nine months ended February 28, 2014 compared with 66.8% in the same period of 2013.

Expenses

Sales and Marketing and General and Administrative expenses in the quarter ended February 28, 2014 totaled $1,360,367 compared with $1,398,644 in the quarter ended February 28, 2013, a decrease of $38,277.

Increased staff costs in the quarter ended February 28, 2014 over the same period of the previous year resulting from two additional sales staff were offset by reductions in commissions payable and amortization of intangible assets, which were fully amortized in July 2013, as well as foreign exchange gains arising from the strengthening of Sterling against the Canadian Dollar.

For the nine months ended February 28, 2014, Sales and Marketing and General and Administrative expenses totaled $4,227,230, compared to $4,354,864 for the nine months ended February 28, 2013, a decrease of $127,634. Increased commission payable and additional sales salaries were more than offset by the allocation of staff costs relating to chargeable projects to cost of sales, plus reductions in investor relations costs, legal costs and amortization of intangible assets, as well as foreign exchange gains resulting from the strengthening of Sterling against the Canadian Dollar.

A Research and development net credit of $35,079 in the third quarter of FY 2014 compared to costs of $51,851 in the third quarter of FY 2013. Although costs had increased over the same quarter of the previous year, the current quarter saw the receipt of a SR&ED credit relating to a previous period plus a credit relating to government funding through ISTP Canada. 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 is credited to research and development costs when it is received.

Year to date research and development costs totaled $100,371 for the nine months ended February 28, 2014 compared to $164,523 for the nine months ended February 28, 2013. As mentioned above, this reduction is due to increased credits being received for previous research and development accumulated costs.

Finance revenue in the third quarter of FY 2014 of $20,566 compared to $39,489 recognized in the third quarter of FY 2013.

For the nine months ended February 28, 2014, finance revenue was $103,973, compared with $57,004 for the nine months ended February 28, 2013. The increase in the current year is due to the extension of the lease during the third quarter of last year. 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 28, 2014 was $86,449 compared to income of $1,495,408 in the same quarter of the previous year. The decrease of $1,408,959 was predominantly due to the lease extension in the same quarter of the previous year.

For the nine months ended February 28, 2014, income before income taxes was $12,424, compared with a loss of $231,289 for the nine months ended February 28, 2013. The gross profit realized from the lease extension in the previous year was matched by gross profit from additional revenues in the current year. Increased finance revenue following the lease extension plus the cost savings mentioned above resulted in the improvement of $243,713.

Income tax charge in the third quarter of FY 2014 was $29,145, compared to $23,440 in the third quarter of FY 2013.

For the nine months ended February 28, 2014, income tax charge was $75,799, compared with a recovery of $69,023 for the same period of the previous year, due mainly to current year to date profits of the UK entity compared with losses for the same period of last year.

Net income for third quarter of FY 2014 was $57,304 compared to $1,471,968 in the same quarter of the previous year.

Net loss for the nine months ended February 28, 2014 was $63,375 compared to $162,226 for the nine months ended February 28, 2013.

Comprehensive income was $216,376 for the third quarter of FY 2014 compared to $1,388,907 for the third quarter of FY 2013.

For the nine months ended February 28, 2014, comprehensive income was $330,225, compared with a comprehensive loss of $239,802 for the same period of the previous year. In both the quarter and nine months ended February 28, 2014 Sterling strengthened against the Canadian Dollar, resulting in an exchange gain on translation of overseas operations. In contrast, the same periods of the previous year saw a weakening of Sterling, resulting in exchange losses arising from the translation of overseas operations.

Liquidity & Capital Resources

The working capital was $1,829,495 at February 28, 2014 compared to working capital of $1,552,021 at May 31, 2013 – an increase of $277,474, with the Company's net cash position (Cash and cash equivalents less Bank loans) increasing by $1,341,839 from $1,304,395 at May 31, 2013 to $2,646,234 as at February 28, 2014.

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

	May 31, 2012 $	Aug 31, 2012 $	Nov 30, 2012 $	Feb 28, 2013 $	May 31, 2013 $	Aug 31, 2013 $	Nov 30, 2013 $	Feb 28, 2014 $
Current Assets	5,758,086	4,534,637	3,814,265	4,537,306	3,642,680	3,604,594	6,184,899	5,729,213
Current Liabilities	3,190,639	2,800,733	2,770,537	2,761,564	2,090,659	2,199,528	4,361,002	3,899,718
Working Capital	2,567,447	1,733,904	1,043,728	1,775,742	1,552,021	1,405,066	1,823,897	1,829,495

Q3 FY 2014 Changes

Current assets decreased in the current quarter by $455,686 to $5,729,213. While trade receivables decreased by $720,981 due mainly to payment of invoices relating to the projects at two sites of a major Fortune 500 food and beverage company during the quarter, cash increased by $177,556 and prepayments increased by $118,451 due to deposits made relating to equipment for heat recovery projects in the UK. Current liabilities meanwhile decreased by $461,284 to $3,899,718, mainly due to decreases in trade payables of $162,322 and deferred revenue of $132,734 relating to heat recovery projects plus the payment of previously accrued sales commissions.

As at February 28, 2014, $114,459 (8.9%) of the Company's trade receivables balance was over 90 days past due. None of the remaining overdue balance is considered impaired as at February 28, 2014.

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, 2014 was $61,934. After adjusting this for $209,302 of positive changes in non-cash working capital items, foreign exchange adjustments and other non-cash equity items, and deducting $9,473 for the purchase of fixed assets, $1,175 to allow for the effect of exchange rate fluctuations on cash and cash equivalents, and $83,032 used for the repurchase of Class A common shares the net cash inflow was $177,556, increasing the net cash balance as at February 28, 2014 to $2,646,234 from $2,468,678 as at November 30, 2013.

In addition to its net cash balance of $2,646,234 as at February 28, 2014 the Company also had an estimated $248,000 of unused borrowing capacity under its bank loans. With cash balances and unused borrowing capacity of approximately $2,894,234, management believes that it has sufficient capital resources to fund existing operations and anticipated capital requirements in the remainder of FY 2014 and into FY 2015. Order backlog as at February 28, 2014 was approximately $4.9 million compared to $1.9 million at the same time last year. As at April 22, 2014, the Company had $5.3 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, 2014 $	May 31, 2013 $
Total estimated minimum lease payments receivable	1,193,435	1,507,952
Less: unearned income	(86,940)	(161,131)
	1,106,495	1,346,601
Less: current portion	(746,698)	(761,404)
	359,797	585,197

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

On December 22, 2013 the site commenced a market downtime for a period of ten weeks, following the recent imposition of an interim duty in China on the import of Canadian dissolving pulp. On April 11, 2014 an amendment was made to the agreement further extending the existing lease beyond the current expiry date by up to 131 days in order to secure both continued savings for the customer and total payments to the Company as defined within the previous extension. The net effect of this extension is an immaterial impairment to net investment in lease, representing the time value of money arising from the assumed implicit rate of interest of 14.3% per annum. This impairment will be accounted for at the end of the lease following discussions with Fortress Specialty Cellulose regarding their future options to further lease or purchase outright the equipment.

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	829,891
Between two and five years	224,014
Residual value of equipment	139,530
	1,193,435

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, 2014 were 1,500,000 of which 833,333 were exercisable. There were no warrants outstanding for Directors.

Options outstanding for Officers (including the CEO) as at February 28, 2014 were 6,430,000 of which 3,806,667 were exercisable. There were no warrants outstanding for Officers.

Officer and Director Compensation

During the third quarter ended February 28, 2014 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, 2014 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 $3,000 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**	
	2014 **$**	2013 $	**2014** **$**	2013 $	**2014** **$**	2013 $
Directors						
M. Williams	**6,250**	6,250	**-**	-	**6,250**	6,250
J. Ansell	**-**	-	**-**	-	**-**	-
J. Kelly	**7,000**	7,000	**-**	-	**7,000**	7,000
D. Gibbs	**3,750**	4,750	**-**	-	**3,750**	4,750
W. Ollerhead	**4,750**	4,750	**-**	-	**4,750**	4,750
B. Linton	**3,750**	4,750	**-**	-	**3,750**	4,750
J. Schoenmakers	**3,750**	4,750	**-**	-	**3,750**	4,750
Total	**29,250**	32,250	**-**	-	**29,250**	32,250
Officers						
W. Crossland	**60,000**	60,000	**-**	-	**60,000**	60,000
J. Flynn	**37,065**	31,755	**-**	-	**37,065**	31,755
R. Triebe	**37,305**	34,763	**-**	-	**37,305**	34,763
Total	**134,370**	126,518	**-**	-	**134,370**	126,518

Normal Course Issuer Bid

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

In the nine months ended February 28, 2014 the Company purchased 1,775,000 common shares for a total purchase price of $93,532.

Segmented Information

In the quarters and nine month periods ended February 28, 2014 and February 28, 2013, 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, 2014 and the comparative period are detailed in the table below.

	North America and China		Europe and Rest of World		Reconciling Items		Total	
	2014	2013	**2014**	2013	**2014**	2013	**2014**	2013
	$	$	**$**	$	**$**	$	**$**	$
Total revenue from external customers	**1,750,205**	1,824,828	**1,147,330**	2,383,895	**-**	-	**2,897,535**	4,208,723
Cost of sales	**(1,119,754)**	(119,830)	**(386,610)**	(1,182,479)	**-**	-	**(1,506,364)**	(1,302,309)
Gross profit	**630,451**	1,704,998	**760,720**	1,201,416	**-**	-	**1,391,171**	2,906,414
Amortization of intangible assets	**-**	-	**-**	(24,664)	**-**	-	**-**	(24,664)
Other expenses	**(481,731)**	(482,869)	**(630,117)**	(679,854)	**(213,440)**	(263,108)	**(1,325,288)**	(1,425,831)
Finance revenue	**20,566**	39,489	**-**	-	**-**	-	**20,566**	39,489
Profit (loss) before taxes	**169,286**	1,261,618	**130,603**	496,898	**(213,440)**	(263,108)	**86,449**	1,495,408
Tax (expense) recovery	**10,300**	-	**(13,202)**	(18,778)	**(26,243)**	(4,662)	**(29,145)**	(23,440)
Net income (loss)	**179,586**	1,261,618	**117,401**	478,120	**(239,683)**	(267,770)	**57,304**	1,471,968
Attributable to:								
Owners of the parent	**182,012**	1,269,339	**114,953**	475,245	**(239,683)**	(267,770)	**57,282**	1,476,814
Non-controlling interest	**(2,426)**	(7,721)	**2,448**	2,875	**-**	-	**22**	(4,846)

Segment information for the nine months ended February 28, 2014 and the comparative period are detailed in the table below:

	North America and China		Europe and Rest of World		Reconciling Items		Total	
	2014	2013	**2014**	2013	**2014**	2013	**2014**	2013
	$	$	**$**	$	**$**	$	**$**	$
Total revenue from external customers	**4,696,142**	2,538,227	**3,737,661**	3,792,557	**-**	-	**8,433,803**	6,330,784
Cost of sales	**(2,857,055)**	(412,384)	**(1,340,696)**	(1,687,306)	**-**	-	**(4,197,751)**	(2,099,690)
Gross profit	**1,839,087**	2,125,843	**2,396,965**	2,105,251	**-**	-	**4,236,052**	4,231,094
Amortization of intangible assets	**-**	-	**(8,303)**	(74,044)	**-**	-	**(8,303)**	(74,044)
Other expenses	**(1,560,166)**	(1,564,139)	**(1,932,576)**	(1,914,241)	**(826,556)**	(966,963)	**(4,319,298)**	(4,445,343)
Finance revenue	**103,973**	57,004	**-**	-	**-**	-	**103,973**	57,004
Profit (loss) before taxes	**382,894**	618,708	**456,086**	116,966	**(826,556)**	(966,963)	**12,424**	(231,289)
Tax (expense) recovery	**(2,261)**	-	**(54,808)**	31,603	**(18,730)**	37,420	**(75,799)**	69,023
Net income (loss)	**380,633**	618,708	**401,278**	148,569	**(845,286)**	(929,543)	**(63,375)**	(162,266)
Attributable to:								
Owners of the parent	**378,613**	644,729	**392,863**	145,218	**(845,286)**	(929,543)	**(73,810)**	(139,596)
Non-controlling interest	**2,020**	(26,021)	**8,415**	3,351	**-**	-	**10,435**	(22,670)

Reconciling items comprise the following:

	Three months ended February 28		Nine months ended February 28	
	2014	2013	**2014**	2013
	$	$	**$**	$
Corporate admin costs	**198,884**	205,644	**589,267**	647,451
Stock-based compensation	**47,835**	40,559	**117,318**	108,641
Professional fees	**5,286**	7,806	**134,990**	134,819
Depreciation of property, plant and equipment	**9,273**	11,848	**28,422**	34,906
Bank charges and interest	**11,178**	11,133	**33,980**	30,606
Foreign exchange differences	**(59,016)**	(13,882)	**(77,421)**	10,540
Total	**213,440**	263,108	**826,556**	966,963

During the three months ended February 28, 2014, the company had two customers in North America and China that accounted for 32% and 22% respectively; and one customer in Europe and Rest of World that accounted for 11% of total revenue for the period.

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 nine months ended February 28, 2014, the company had two customers in North America and China that accounted for 27% and 18% respectively 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.

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 (non-current) as at	
	February 28, 2014	2013	**February 28, 2014**	May 31, 2013	**February 28, 2014**	May 31, 2013	**February 28, 2014**	May 31, 2013
	$	$	**$**	$	**$**	$	**$**	$
Canada	**2,335,776**	1,814,729	**47,901**	22,301	**-**	-	**359,797**	585,197
U.S.A.	**2,339,390**	685,395	**-**	-	**-**	-	**-**	-
U.K.	**3,146,453**	3,142,397	**16,571**	23,169	**1,999,160**	1,706,449	**-**	-
Italy	**215,371**	180,232	**-**	-	**-**	-	**-**	-
Netherlands	**84,043**	91,683	**-**	-	**-**	-	**-**	-
Ireland	**36,723**	94,037	**-**	-	**-**	-	**-**	-
Germany	**43,485**	11,588	**-**	-	**-**	-	**-**	-
Rest of Europe	**13,694**	26,612	**-**	-	**-**	-	**-**	-
India	**150,397**	140,773	**-**	-	**-**	-	**-**	-
Kenya	**36,816**	44,311	**-**	-	**-**	-	**-**	-
China	**20,976**	37,679	**-**	-	**-**	-	**-**	-
Turkey	**-**	23,531	**-**	-	**-**	-	**-**	-
Pakistan	**-**	22,874	**-**	-	**-**	-	**-**	-
Singapore	**-**	4,005	**-**	-	**-**	-	**-**	-
Rest of world	**10,679**	10,938	**-**	-	**-**	-	**-**	-
Total	**8,433,803**	6,330,784	**64,472**	45,470	**1,999,160**	1,706,449	**359,797**	585,197

Material Segmentation Variances

Revenue

North America and China: revenue for the third quarter ended February 28, 2014 was $1,750,205 compared to $1,824,828 for the same period of the previous year. Heat recovery revenue decreased by just $14,655 despite the same period of the previous year containing $1,546,318 relating to the Greenpower Purchase Agreement extension signed on November 29, 2012. The current period includes revenue from projects at two sites of a major Fortune 500 food and beverage company, as announced September 16, 2013, plus the installation at a major pulp and paper company as announced June 3, 2013. Revenue from sales of GEM® products meanwhile, decreased by $59,968 from the third quarter of FY 2013.

For the nine months ended February 28, 2014, revenue increased to $4,696,142 from $2,538,227 for the same period of the previous year. The increase of $2,157,915 represents an increase in heat recovery revenue of $2,125,955, due mainly to the projects at two sites of a major Fortune 500 food and beverage company plus the installation at a major pulp and paper company more than offsetting the revenues produced by the Greenpower Purchase Agreement extension in the previous year, with an increase in GEM® revenue of $31,960, resulting from a general increase in US revenues.

Europe and rest of world: revenue for the third quarter ended February 28, 2014 was $1,147,330 compared to $2,383,895 for the same period of the previous year. Heat recovery revenue decreased by $1,390,143, due to the current quarter seeing the commencement of two hospital conversions compared with one complete and one partial hospital site conversion in the equivalent quarter of the previous year, plus the completion of an installation at a site of a major food manufacturer in the previous year. Revenue from sales of GEM® products increased by $153,578, representing an increase in sales from the partial fulfilment of orders received from a major food and beverage manufacturer and a global premium beer company. These sales gains were partially offset by reduced sales to hospitals as, although the current and prior year third quarters each included one hospital conversion, the current period sale was to a smaller hospital.

For the nine months ended February 28, 2014, revenue decreased to $3,737,661 from $3,792,557 for the same period of the previous year. The decrease of $54,896 represents a decrease in heat recovery revenue of $639,092 and an increase in GEM® revenue of $584,196. Heat recovery revenue in the nine months ended February 28, 2014 was lower than the previous year to date total due partly to installations at a site of a major food manufacturer being substantially complete in the prior year plus one hospital project in the previous year being of a higher value compared to the current year's complete hospital conversion. The majority of the increase in GEM® revenue came from the order from a major food and beverage manufacturer, as announced July 3, 2013.

Segment loss before tax

North America and China: Gross profit decreased by $1,074,547 in the third quarter of FY 2014 compared with the same period of the previous year, as 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 in FY 2013. Other expenses remained at a similar level, with finance revenue decreasing by $18,923, resulting in segment income before tax of $169,286 compared to $1,261,618 in the same period of the previous year.

For the nine months ended February 28, 2014, gross profit fell by $286,756 from the same period of the previous year. Again, other expenses remained fairly constant while finance revenue increased by $46,969, leading to income before tax of $382,894 compared to $618,708 in the nine months ended February 28, 2013.

Europe and rest of world: gross profit decreased in the quarter ended February 28, 2014 over the same quarter of the previous year by $440,696, as a result of the decreased revenue. Reduced commissions contributed to a decrease in other expenses of $49,737 plus the full amortization of intangible assets in the previous year meant no charge in the current period, compared with $24,664 in the nine months ended February 28, 2013. The resulting pre-tax profit of $130,603 compared to $496,898 for the same period of the prior year.

The first three quarters of FY 2014 saw an increase in gross profit for the Europe and rest of world region of $291,714 due to the increase in GEM® revenues. Other costs remained at a similar level to the first nine months of FY 2013, while amortization of intangible assets fell by $65,741, giving rise to an increase in net income before tax of $339,120
Other expenses within Reconciling items, which incorporates all costs not specifically attributable to either regional operational center, decreased in the third quarter of FY 2014 over the same period of the prior year by $49,668, due predominantly to a higher net exchange gain in the current quarter compared with the previous year.

For the nine months ended February 28, 2014 other expenses within reconciling items decreased by $140,407, again predominantly due to exchange gains resulting from the strengthening of Sterling against the Canadian Dollar, plus reduced investor relations costs.

Supplementary financial information

Quarterly financial information (unaudited)
For the eight quarters ended February 28, 2014

Quarter ended	28-Feb-14 $	30-Nov-13 $	31-Aug-13 $	31-May-13 $
Revenue	2,897,535	4,014,145	1,522,123	1,879,450
Gross Profit	1,391,171	1,874,869	970,012	746,358
Gross Profit Percentage	48.3%	46.7%	63.7%	39.7%
EBITDAS(1)	144,664	311,366	(286,423)	(424,414)
Total net income (loss)	57,304	238,079	(358,758)	(2,685,427)
Income (loss) per share, basic and diluted	0.000	0.001	(0.002)	(0.016)
Net operating cash flow(2)	61,934	455,144	(176,528)	(223,741)

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)	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

(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 2014

The quarter ended February 28, 2014 saw a decrease in revenue from the previous quarter of $1,116,610 to $2,897,535. Heat recovery revenue fell by $884,143 due to the prior quarter including major equipment delivery to the pulp and paper company plus the substantial completion of a hospital conversion. The current quarter included the commencement of projects at two further hospitals for which substantial completion is expected in the final quarter of FY 2014. Also lessening the decrease in revenue in the third quarter was the substantial completion of the projects at two sites of a major food and beverage company. GEM® revenue fell by $232,467 from the second quarter, despite sales to a major beer company and a large hospital, due to the previous quarter including a number of larger sales within the US which were not repeated in the current quarter. These decreases in revenue led to a fall in gross profit from the previous quarter of $483,698, which was partially offset by reductions in total costs of $322,121 including commissions payable, audit fees plus the AGM being held in the previous quarter, plus the receipt of credits from SR&ED and ISTP Canada for research and development activities, as well as positive exchange differences arising from the strengthening of Sterling against the Canadian Dollar. These differences, combined with a decrease in finance revenue from the previous quarter of $18,416 and an increase in incomes taxes of $782 led to a net income reduction of $180,775 from the second quarter of FY 2014.

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

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

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

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

Revenues increased in the second quarter of FY 2013 by $397,907 over the previous quarter. A slight decrease in heat recovery revenues was more than compensated for by an increase in GEM® revenues, mainly due to an increase in revenues from sales to the NHS in the U.K., plus increased sales within the rest of the world. The effect of this revenue increase on gross profit was an additional $274,754 over the previous quarter. EBITDAS saw an improvement of $218,175 - $56,579 less than the gross profit increase, mainly due to costs in the second quarter relating to the AGM, as well as increased commissions on the increased GEM® sales plus the receipt of invoices relating to the audit of the FY 2012 financial statements. The decrease in net loss of $60,388 was less than the EBITDAS improvement as a result of

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

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

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

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, 2014, these statements were not subject to an audit.

Business Risks

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

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

Financial risks and uncertainties of the Corporation include:

- The Company's history of operating losses and uncertainty of future profitability;
- The ability to grow sales through the establishment of new cooperative partnerships and strategic alliances;
- The ability to grow sales through the licensing of the corporation's technologies;
- The ability to secure and maintain the required outside working capital financing;
- The ability to achieve profitable operations through increased sales,
- Reliance on third party collaborations and license arrangements;
- Reliance on proprietary technology;
- Competition in the energy conservation and environmental compliance solutions;
- Product liability claims and insurance;
- Reliance on key personnel;
- The ongoing litigation with its former President & CEO;
- The ability to control costs and achieve a positive gross margin on projects; and,
- The effect of a continuing prolonged recession in Canada, USA and Europe to the financial markets in securing project financing and in particular to industrial and commercial customers in committing capital to projects.

Management's addressing of the risks:

FY 2012 saw the Company's first ever net profit, which was the result of increased revenues and strict cost control. FY 2013, however, produced an operating loss of $844,328, resulting from diminished revenues and increasing costs. The first three quarters of FY 2014 have also generated a small loss but orders received to date which have yet to be recorded as revenue are stronger than in the prior year and indicate that the prior years' investment is starting to pay off. A dip in profitability was expected while new staff additions become accustomed to their roles and the strategy of the Company. Management is constantly monitoring the effectiveness of this strategy.

As reported last year, on June 29th, 2010 the Company signed an arm's length Greenpower Purchase Agreement with Fortress Specialty Cellulose Inc. ("Fortress Specialty"). The agreement was to supply recovered energy to the Fortress Specialty mill in Thurso, Quebec from a FLU-ACE® Waste Heat Recovery System installed at the site. Based on the amount of heat expected to be recovered, this agreement was expected to provide the Company approximately $720,000 of additional cash flow per year between then and December 31, 2012, which it did in fact achieve. On November 27, 2012, both parties signed an amendment to the agreement, extending the term by a further two years. Upon completion of the extended term, Fortress Specialty has an option to further extend for up to a maximum of 24 months on substantially the same terms or purchase the FLU-ACE® Waste Heat Recovery System from Thermal Energy. Based on the amount of heat expected to be recovered, this extension would provide the Company with approximately $898,000 cash per year between January 2013 and December 2014. The extension was recorded in the financial statements as an increase to the net investment in lease in the year ended May 31, 2013 which therefore includes the capital element of the total expected payments over the 24 month period of the extension within revenue for that year, totaling $1,546,318. The interest element of the lease will be recorded as finance revenue over the period of the lease, but the cash inflow will include the capital element.

On December 22, 2013 the site commenced a market downtime for a period of ten weeks, following the recent imposition of an interim duty in China on the import of Canadian dissolving pulp. On April 11, 2014 an amendment was made to the agreement further extending the existing lease beyond the current expiry date by up to 131 days in order to secure both continued savings for the customer and total payments to the Company as defined within the previous extension. The net effect of this extension is an immaterial impairment to net investment in lease, representing the time value of money arising from the assumed implicit rate of interest of 14.3% per annum. This impairment will be accounted for at the end of the lease following discussions with Fortress Specialty Cellulose regarding their future options to further lease or purchase outright the equipment.

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

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

- On June 3, 2013, the Company announced it had received a purchase order valued at approximately $3.6 million for the installation of a heat recovery system at a major North American pulp and paper company. The heat recovery system is expected to be installed and revenue earned by the end of FY 2014. As at February 28, 2014, $2.2 million has been recognized as revenue.

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

- On November 14, 2013, the Company announced it had received an order for approximately $1.2 million from a publicly owned hospital for a heat recovery solution. The heat recovery system is expected to be substantially installed and revenue earned by the end of FY 2014.

- On December 13, 2013, the Company announced it had received an order for approximately $200,000 from a global mining and materials company for a heat recovery system. This heat recovery system is an equipment sale with no installation by the Company. It is expected to be fulfilled by the end of FY 2014.

- On February 18, 2014 the Company announced it had received an order for GEM® steam traps from a global diversified healthcare company for approximately $160,000. This order is expected to be fulfilled by the end of FY 2014.

- The Company is currently developing energy efficiency projects on a paid or exclusive basis at 16 different sites for 14 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, 2014 was approximately $4.9 million. As at April 23, 2014, the Company had an order backlog of approximately $5.3 million, of which approximately $0.5 million is related to long term contracts and is not expected to be reflected in revenue within the next 12 months. The Company includes in "order backlog" any purchase orders that have been received by the Company but have not yet been reflected as revenue in the Company's published quarterly financial statements.

Summary of Outstanding Shares and Dilutive Instruments

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

Shares

161,561,616 class A common shares.

Options

Number of Options outstanding	Number of Options Exercisable	Exercise Price Per Share $	Expiry Date
2,450,000	2,450,000	0.10	May 4,2015
2,281,250	1,520,833	0.10	May 10, 2016
500,000	333,333	0.10	July 12, 2016
4,400,000	2,933,333	0.10	December 1, 2016
4,880,000	1,626,667	0.10	November 23, 2017
3,750,000	-	0.05	November 18, 2018
18,261,250	8,864,166		

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

The unaudited condensed consolidated interim financial statements of Thermal Energy and all the information in this interim financial report have been prepared by management, which is solely responsible for the integrity and fairness of the data presented, including the many amounts, which due to necessity, are based on estimates and judgments. The accounting policies followed in the preparation of these unaudited condensed consolidated interim financial statements conform to International Financial Reporting Standards (IFRS) and in particular with International Accounting Standard 34: Interim Financial Reporting. Financial information presented throughout this report is consistent with that in the unaudited condensed consolidated interim financial statements.

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

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

Thermal Energy's former external auditors, Raymond Chabot Grant Thornton LLP, conducted an independent audit of the consolidated financial statements for the year ended May 31, 2013 in accordance with IFRS, performing such tests and other procedures as they consider necessary to express an audit opinion. The condensed consolidated financial statements for the quarter ended February 28, 2014, prepared in accordance with IFRS, have not been audited.