Fiscal Year 2006

THERMAL ENERGY
INTERNATIONAL INC.

Annual Report to Shareholders

Thermal Energy is an innovative technology company providing custom energy and emission reduction solutions

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Chairman's Message to Shareholders

Fiscal 2006 was a tremendous year of change and rebuilding for Thermal Energy. The plans and strategies developed at the Board of Directors level have now been fully implemented and we are just starting to see the results of our hard work. The first full year with our new management and engineering "Teams" have demonstrated breakthrough performance in many areas and our impressive sales pipeline is starting to bring forth sustainable growth.

Composition of the Board

The constant focus of the Thermal Energy Board has been to increase shareholder value through unique and innovative technologies combined with controlled growth. Our vision for success has a defined set of metrics that are combined with the execution of a distinctive set of strategic principles and operational rules. The Board has three active Committees that monitor company financials, ethics, governance, compensation and most importantly, the Board structure itself. We have attracted talented individuals from both the U.S. and Canada who bring excellence and knowledge from areas of taxation, finance and banking, international markets, governance and compliance, technology, and research and development. The Board is self-regulating and has attained the highest levels of integrity and accountability.

Leadership Principles

The Board of Directors acknowledges that we could accomplish nothing without the skill, commitment and dedication of our management and employees. Given the ever-escalating expectations from our clients, we continue to meet and exceed their expectations for quality, innovation and service. The initiative calls for intense focus on management development at all levels in order to realize the desired outcome. It is an acknowledgment that at the end of the day - business is all about people!

Driving Results

We believe strongly in the Thermal Energy "Game Plan." Our strategies are clear and we are working hard to improve on their execution. Together, they enable us to outperform the markets we serve, and create economic value for stockholders.

It remains the foundation from which to improve the Company's financial performance, and a review of its principles will provide insight to better understand the strength of our Company, and why we think our best days are still ahead.

Governance

During 2005 and 2006, we worked hard to achieve compliance with the requirements of the TSX-V and other regulatory bodies. Through the formation of the Ethics, Governance and Compliance (EGC) Committee this effort has been successfully completed, and will remain in focus as we work to simplify ongoing compliance procedures and improve overall effectiveness.

We are also fortunate to have a Board of Directors that understands the importance of responsible corporate governance. Other than our President and CEO Tim Angus, all of our Directors are deemed independent, and they bring a wealth of knowledge and experience to the Company. The Board also helps to set the right "tone at the top," one that emphasizes the importance of early identification of issues, open and honest communication and integrity. They serve as great role models for our management team.

The Future

Thermal Energy is a far different, stronger company than it was three years ago, and we are very confident in our future. We have great core businesses serving strong markets and our business is in better shape competitively than it has ever been. We believe our increasing project revenue and sizeable work and sales backlog demonstrates that the execution of our Plan is effective, and underscores our absolute commitment to shareholders.

I am very grateful for the dedication and hard work of our Board members, senior management and employees during 2006. It is their efforts that have generated our impressive results. I congratulate each and every one of our Board and staff. More importantly, I would also like to thank all of our Shareholders for their continued support and dedication. Our future rests with our continued commitment to growth and success of Thermal Energy and I am confident that together we can reach our full potential.

Sincerely,

John R. Parker
Chairman

President's Message to Shareholders

It is my pleasure to report to you following my first full year as president and chief executive officer. Tremendous progress has been made in reshaping Thermal Energy and positioning our exciting company as a driving force in providing energy and emission reduction solutions, and as a solid player in the rapidly growing renewable and bioenergy field.

Fiscal Year 2006 was a great year for Thermal Energy on many fronts. We achieved record revenue of $2.85 million and closed the year on a high note with our first $1 million revenue quarter. The bulk of our revenue for the year came from our breakthrough project through our relationship with Johnson Controls at the Minas Basin Pulp and Power Co. in Nova Scotia. Our largest FLU-ACE® waste heat recovery project to date, Minas Basin also provides a strong foothold in the important pulp and paper sector. This project garnered attention throughout the sector and received strong media coverage in trade journals in Canada and the U.S.

We continue to work very closely with Johnson Controls who provide excellent opportunities for Thermal Energy. We will see continued revenue growth through this highly beneficial relationship as Johnson Controls leverages our technology solutions to bring value to their customers across North America and as we seek opportunities to broaden the relationship.

$40M Pipeline

Throughout the year we saw great interest in our solutions which has resulted in a growing pipeline of potential sales opportunities. The key to sustained growth and success is to continually increase the number and size of qualified sales opportunities and to translate these into secured revenues. This remains our number one focus and as such, we continue to tackle this with great intensity. At year end, this pipeline stood at $40 million of potential projects each at various stages in our sales process. As we head into this year's annual meeting, we are continuing the process of growing and further developing these opportunities with the intent of translating these into booked revenues. This pipeline produced Thermal's first major U.S. contract - a FLU-ACE® heat recovery project in the food and beverage sector with a Fortune 500 company, in excess of $1.4 million. We fully expect this is the first of a number of new projects which will result in a strong second half for Fiscal 2007.

New Solutions

Considerable effort throughout the year went into developing a new business plan for Thermal Energy. Prior to this fiscal year, Thermal Energy's business was predominantly conducted in Canada and was focused on developing projects for FLU-ACE®, the company's lone, proprietary heat recovery technology. Our new go-to-market strategy places emphasis on delivering customized, turnkey, multi-technology solutions based on a suite of offerings. We sought out a number of complementary technologies and solutions which provide us multiple entry points into the $200 billion-a-year waste heat market in North America. They also provide a way to break into the rapidly growing renewable bioenergy based market.

We will continue to actively pursue this strategy in FY 2007. Our most exciting expansion through the recent acquisition of the Dry-Rex™ low temperature drying technology is a perfect partner for our FLU-ACE® waste heat recovery technology. Dry-Rex™ provides a prime gateway for many industries to convert, or improve the value of, wet biomass into a highly-efficient alternative fuel source.

In the few months since our acquisition, we are already in the advanced discussions and development on a number of opportunities for Dry-Rex™ in the pulp and paper sector. We see Dry-Rex™ as a catalyst to much more substantial growth by enabling us to provide solutions which reach to the heart of our customers energy issues - providing them with clean, dependable renewable energy.

We are also undertaking exploratory work to determine other markets, such as ethanol production and Biomass power plants where our combined Flu-Ace® and Dry-Rex™ technologies will provide innovative benefits.

Thermal Energy also acquired the exclusive license to the exciting GEM® Condensate Return System across Canada and in the primary industrial markets in the U.S. GEM® is a revolutionary no-fail system of steam traps with a 10-year warranty. Already in use by Fortune 500 companies throughout Europe, Thermal Energy is in the process of implementing a number of trial installations in multiple sectors.

During the year we also licensed ozone generation technology and went to market with THERMALOZOMAX™ which can be used in a wide variety of commercial and industrial applications such as waste water treatment, treatment of air streams and incorporated with waste heat recovery for various water-based processes in the hospitality industry. We have commenced a pilot project at a major Caribbean resort chain and are hoping that the pilot will lead to projects at a number of the chain's facilities.

Our quest to expand our solution offerings portfolio for our customers has just begun. We are currently in the process of evaluating other strategically complementary technologies offerings focused on the growing renewable energy and biofuels sector. Pending successful results of this strategic evaluation process further expansions to our solution offerings can be expected. These select additional offerings may be either through acquisition or partnering arrangements.

We have also had a productive year on the research and development front with our THERMALONOx™ solution to remove nitrogen oxides (NOx) from flue gas streams such as those at coal-fired power generating stations. Thermal Energy filed a provisional patent in March 2006 on new technology developed by our Chief Scientist Dr. Raymond Belanger, which produces the ozone required. Initial bench tests show a high success rate in both generating a significant source of ozone and achieving the desired chemical reaction to remove NOx. Economic analysis of the potential of this new approach is underway, and movement to larger scale testing is in progress.

Alternative Utility Delivery

This year also saw the development and roll-out to customers of an exciting new commercial offering we have named the Thermal "Alternate Utility Delivery" program. This program provides customers an opportunity to monetize the economic and environmental benefits of our solutions through unique financial approaches including a "Off Balance Sheet" project financing. This lets customers focus their capital expenditures on their core business activities.

Under this approach Thermal becomes the builder/owner of assets generating stable, long-term revenue. We then engage the customer under various forms of long term utility contracting structures for renewable energy in the form of waste heat, drying output or even biofuel production. We have worked very hard with lending groups to put together this program and have secured several sources of project funding as opportunities become available. This program is very exciting and will form another key building block required to build the intrinsic value of our company.

The year was not without its challenges. While the revenue milestones we achieved prove we are on the right track for significant growth, we absorbed the final negative effects of some legacy projects. We worked extremely hard to resolve these issues, especially where they involved customers. I am pleased to say that our management and project teams resolved these issues successfully. More importantly, we have worked hard to implement new procedures, project management and oversight to prevent these problems from occurring in the future.

While we were pleased with 2006 revenue, as you can imagine, we understand the requirement to improve the bottom line. We recognized upon commencing the restructuring of the company that we must grow our revenues considerably if we are to see profitability. We have made tremendous progress in that regard and Thermal Energy now has the largest force of sales representatives in its history. They are continually delivering high quality prospects to us for discussions, project development and eventually contracts. We will also explore on a case-by-case basis, opportunities that present themselves outside of core North American markets, including the growth markets of Asia and Latin America.

Thermal Energy is active at tradeshows and meeting prospective customers delivering the message that our solutions provide tremendous energy cost savings, environmental benefits and increase competitiveness and efficiency.

Objectives Achieved

Overall, we were able to achieve many of our objectives in Fiscal 2006. I am certain that this hard work will continue to result in the growth and success we are looking for through Fiscal 2007 and beyond. Throughout FY 2007 we intend to share this exciting growth story with the investment community in Canada and the U.S. in an effort to expand support and our base of shareholders beyond the retail level.

We will also increase our marketing efforts by telling the Thermal Energy story at more trade shows in the U.S. and adding to the excellent coverage we received in major trade media in 2006, particularly those which target our key markets such as pulp and paper, food and beverage and other major manufacturing sectors, as well as various energy and environmental forums.

I also must take this opportunity to recognize the pillar of our future success, which is the talent and dedication of our employees. The single and most significant successful building block we have achieved in re-shaping this company has been our ability to attract and bring on board some of the most talented people in the industry. This is clearly recognized by our customers who continue to remark on this fact and pay compliment to our talents and abilities. I thank them for their hard work and dedication. They share the same vision as our shareholders and take great pride in the wonderful work we do. As we move into FY 2007 and beyond, continuing to attract top talent and building our world class team will play a key strategic role in ensuring our future success.

Thank Shareholders

Finally, I sincerely want to thank you, our valued shareholders, for your trust and patience, and also for sharing our vision of the great company Thermal Energy is and for the potential of the results that the company can and will achieve.

We believe tremendously exciting times lie ahead as we continue to convert this vision to reality. Our technologies and services bring to the marketplace a lasting long term positive impact on the financial well being of our shareholders and customers we work with. They also provide significantly noticeable benefits to the environment we all share. We thank you for enabling us to bring these benefits to market and commend you for continued support and investment in a company which can truly make a difference.

Sincerely,

Tim Angus

Tim Angus
President & CEO

Thermal Energy's Products and Solutions

Thermal Energy International Inc. (TEI) provides customers with solutions to optimize their consumption of fossil or biofuels, significantly reducing costs while increasing productivity and performance at the plant or factory level. We go beyond the realm of single application-focused or single-product competitors.

TEI employs a unique mix of process, energy, environmental, mechanical and other expertise, combined with an offering of best technologies and solutions. Clients see a typical payback of 1-2 years.

TEI's solutions have an excellent record of longevity and proven reliability. These solutions provide energy cost savings of up to 30% with commensurate reductions in greenhouse gases and other emissions.

FLU-ACE®

TEI's proprietary FLU-ACE® heat recovery technology is state of the art in waste heat recovery from large industrial, institutional and commercial energy sources. Displacing existing purchased fuel with the "free" FLU-ACE® heat results in 15% to 30%+ savings in energy purchase costs.

FLU-ACE® also provides other financial and sustainable benefits such as generating credits for greenhouse gas and other emissions such as carbon dioxide (CO_2), nitrogen oxides (NOx), and sulphur oxides (SOx) through reduced emissions.

The typical pay back period on FLU-ACE® is currently two years and less for industrial applications. This translates into a return on investment that exceeds the threshold required by the North American industry.

The FLU-ACE® waste heat recovery technology has been demonstrated through numerous installations at hospitals, food and beverage manufacturing facilities and other industrial facilities over a 15-year period. Virtually all systems installed continue to operate with full efficiency and minimal maintenance, delivering increasing savings to clients as energy prices continue to rise. One major food and beverage company installed a FLU-ACE® system 10 years ago for annual fuel savings at that time of $350,000. Today, that same FLU-ACE® system performs flawlessly and saves the company more than $1 million a year!

In 2006, the Company completed two breakthrough FLU-ACE® installations in new markets; pulp and paper, and industrial coatings (appliance and automotive painting). Both projects are showcase venues and will drive market expansion. In 2007, the first FLU-ACE® systems will be installed in the U.S. at Fortune 500 companies.

MINAS BASIN PULP AND POWER CO.

Thermal Energy completed its largest FLU-ACE waste heat recovery project to date for Johnson Controls Inc. at Minas Basin Pulp and Power Co. in 2006 saving the mill an estimated $1.5 million in energy cost using waste heat from the mill's No. 6 paper machine.

DRY-REX™

Dry-Rex ™ is an exciting new patented bioenergy system, which utilizes low grade waste heat to dry bark, pulp and paper sludge and other waste products so that they may be burned as biomass at higher efficiencies. TEI acquired the patented Dry-Rex™ technology in FY 2006 and we view it as our second flagship technology which will greatly increase penetration into the rapidly growing and exciting field of true biomass "green energy."

Dry-Rex™ is the perfect complement to the FLU-ACE® system making ideal use of captured waste heat. It enables industry to replace non-renewable fossil fuels with wood waste and other biomass, substantially reducing greenhouse gas emissions. After passing through Dry-Rex™, dry residual is more efficiently incinerated, improving energy efficiency.

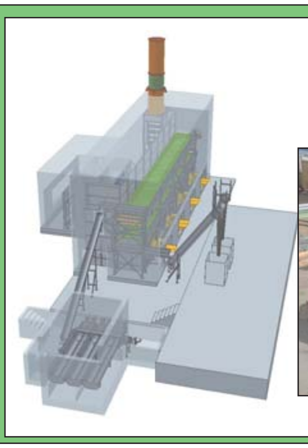
Today, many pulp and paper mills derive 50% or more of their energy from consuming biomass. The Dry-Rex™ provides a considerable cost advantage to mills in reducing the amount of energy needed to transform biomass into a viable fuel source. Especially when used to dry

THERMALONOx™ NITROGEN OXIDE (NOx) REDUCTION

Thermal Energy filed a provisional patent in Q3 FY2006 for a new technology to reduce nitrogen oxides emissions from coal-fired power plants and other industrial and commercial applications which will be marketed under the THERMALONOx™ name.

This is a new technology developed by the Company's Chief Scientist Dr. Raymond Belanger who has a strong background in chemical analysis and an extensive career in alternative and sustainable energy research and development. He possesses a wealth of practical knowledge of phosphorous and nitrogen compounds, and the associated chemistry, all fundamental to the success of THERMALONOx™.

THERMALONOx™ was originally proposed as an economical way to remove nitrogen oxides from the flue gas of coal-fired power plants through a chemical reaction with ozone created from a chemical process developed by Dr. Belanger. Initial bench tests show a high success rate in achieving the desired chemical



The Dry-Rex™ low temperature drying system was acquired in 2006 and is an excellent solution for turning biomass into high-efficiency biofuels at pulp and paper mills and other industries.

sludge as a fuel source, Dry-Rex™ also alleviates a mill's costly landfill and environmental remediation issues.

GEM® CONDENSATE RETURN SYSTEM

Thermal Energy acquired the exclusive rights in March 2006 in key U.S. industrial markets including Michigan and Ohio and in Canada, to the GEM® Condensate Return System. The GEM® system involves a series of state-of-the art steam traps. Steam traps are designed to maintain steam system energy efficiency for performing specific tasks such as heating a building or maintaining heat for process use.

The technology of steam traps had improved little since the 1800s until the invention of the GEM® steam trap. Unlike regular steam traps which have valves opening and closing millions of times a year and are prone to failure, GEM® steam traps have no trap valves, no moving parts to wear out or jam. The GEM® Condensate Return System is guaranteed for 10 years, which is unprecedented.

GEM® typically provides 12% to 55% energy savings iin steam production with corresponding air emission reductions, complete elimination of steam trap repair costs, significant maintenance cost reductions vs. industry standard equipment having a two to five year life expectancy. A 2004 independent study at Queen's University, Belfast, determined that the GEM® Condensate Return System has the lowest steam loss compared to other types of steam traps on the market.

The GEM® system has been installed throughout Europe at facilities owned by Dow Corning, Shell, Total Oil, Exxon, BASF, Coca Cola, Dupont, GlaxoSmithKline, Michelin, Pfizer and McCain's. GEM® technology has already been installed at some of these customers' North American sites and as such will provide Thermal with an immediate addressable customer base to focus on providing these and other solutions.

Other implementations include hospitals, textile and paper manufacturing, and the pharmaceutical sector. TEI has entered into pilot project agreements for GEM® with Big Three automakers and several other large U.S. clients.

Chief Scientist Dr. Raymond Belanger conducts bench tests on the new ozone-generating process for our THERMALONOx™ solution to reduce nitrogen oxides at coal-fired powerplants. A new patent was filed in March 2006 and development is progressing toward pilot stage testing.

reaction. In fact, initial results in our chemical reaction process are positive and are generating a significant source of ozone. Thus,

TEI has extended the provisional patent to now encapsulate an invention which is for a high output chemical based ozone generation technology.

The Company hopes to move to a pilot project phase in 2007-2008, contingent upon raising sufficient capital to accelerate R&D efforts.

THERMALOZOMAX™OZONE GENERATING SYSTEMS

Thermal Energy's new THERMALOZOMAx™ solution is based on Ozomax's successful and effective ozone generation technology. THERMALOZOMAx™ can be used in a wide variety of commercial & industrial applications including large scale water purification, all forms of waste water treatment, and treatment of air streams including hazardous air pollutants.

Potential customers include pulp and paper mills, municipal potable water and waste water treatment plants, petrochemical plants, the mining industry, food and beverage manufacturers, hospitals, laundries, hotels and resort complexes.

TEI has submitted the first proposal for its newly branded THERMALOZOMAx™ ozone treatment systems to a major hospitality client in the Caribbean. This solution dramatically reduces energy and water consumption while increasing sterilization and decontamination treatment.

Financial Information

MANAGEMENT'S DISCUSSION & ANALYSIS - 2006

Overview

This discussion explains the material changes in the Company's financial condition and results of operations for the fiscal year ended May 31, 2006 (or FY 2006), and compares the FY 2006 financial results to the previous year ended May 31, 2005 (or FY 2005). The consolidated financial statements, and notes to the consolidated financial statements constitute an integral part of the discussion and should be read in conjunction with these comments. 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.

Thermal Energy has established itself since 1991 as a leading provider of cost-effective energy conservation and environmental compliance (air) products and solutions. Thermal Energy is providing its integrated turnkey solutions for customers to economically reduce multiple air pollutant emissions while deriving substantial energy savings benefits through advanced heat recycling. Thermal Energy's innovative abilities and unique technologies have ensured that the implemented solutions met or exceeded the air pollution control performance expectations, while at the same time generated sufficient renewable energy and operating cost savings to produce an attractive return on investment ("ROI"), thereby causing the solution to be self-financing.

Thermal Energy has developed cost-effective energy conservation and air compliance solutions for efficiently removing and reducing multiple air pollutant emissions including: Nitrogen Oxides (NOx) "Smog", Sulfur Oxides (SOx) "Acid Rain", Carbon Dioxide (CO2) "Greenhouse Gas", Fine Particulate Matter (PM2.5) "Lung Irritants", Heavy Metals (HM) including Mercury (Hg) "Carcinogenic Bio-accumulators", Toxic Organic Compounds (TOC) "Poisonous", and Volatile Organic Compounds (VOC) "Odorous or Toxic".

More information on Thermal Energy can be found at www.thermalenergy.com. FLU-ACE®, THERMALONOx™ and THERMALOZOMAx™ are registered trademarks of Thermal Energy. Common shares of Thermal Energy are traded on the TSX Venture Exchange under the symbol TMG.

Environmental Compliance and Energy Conservation Market Trends

World market demand is increasing for innovative environmental protection and renewable energy solutions for sustainable economic growth. North America today is faced with the growing challenge of reducing and controlling air pollution emissions that cause serious health risk to human beings, cross international borders, and impact the environment. Furthermore, as the USA, Europe ("EU") and Canada strive to grow their economies and increase their economic outputs, this causes increased demand and consumption of fossil fuels. Therefore, the more successful a country becomes, the larger the task and costs are for the reduction and the control of multiple air pollutant emissions from fossil fuel consumption. In addition, the costs of oil and natural gas fossil fuel energy sources have been rising substantially both due to the increasing demand for their utilization, and due to the decreasing fossil fuel reserves and sources which are available for consumption. Thermal Energy has developed and commercialized proprietary air compliance and waste heat recovery technologies and solutions, designed specifically to cost-effectively meet or exceed both the current and future anticipated US and EU air pollution emissions regulations.

Thermal Energy is well positioned to provide the US, EU and Canada with the best available products, technologies, and solutions to most economically meet both the medium-term and longer-term air compliance and energy conservation objectives. In addition to having cost effective environmental compliance and energy conservation solutions, Thermal Energy continues to grow and work through strategic alliances, cooperative partnerships, and synergistic sales development associations with USA and Canadian companies in order to sell, market, and implement retrofit solutions in North America. In the future, the Corporation plans to establish new strategic alliances and cooperative relationships with European and Asian based companies to further improve the Corporation's competitive access to global markets.

Through unique energy conservation and self-financing solutions, Thermal Energy is economically assisting in meeting Canadian, and soon US, and EU environment protection policies, strategies and goals to achieve cost effective environmental compliance.

Energy Conservation and Environmental Compliance Solutions Business

Thermal's technologies have widespread industrial, utility, commercial and institutional applications for environmental compliance, self-funding energy retrofits and infrastructure upgrades to plant operations. Specifically the technologies can be applied to process modifications and retrofit solutions for primary metal processing, automotive manufacturing, coal-fired power utilities, petrochemical, pulp & paper, and food processing industries as well as for sewage treatment, central or district heating, commercial building, and institutional facilities. In addition, Thermal Energy has developed leading edge energy-from-waste solutions for combustion of solid and liquid waste via incineration and thermal destruction facilities.

The Corporation delivers superior proprietary and patented environmental compliance and energy conservation technologies coupled with comprehensive engineering and implementation services. The Corporation has two main product lines, the first of which is the proven FLU-ACE® condensing reactive exhaust gas scrubbing technology, and the second is the patented THERMALONOx™ and OPTINOx™ technologies under development to reduce nitrogen oxide emissions for coal-fired utilities and heavy industry. Hybrid Multi-Air Pollutant FLU-ACE® is the only known multi air pollutant removal system on the market to effectively combine efficient energy recovery with air pollution control into one easy solution. The unique benefits of combined energy savings and air pollution control give the FLU-ACE® family of products and integrated systems solutions a large competitive advantage in the marketplace. More information on the Corporation's products, technologies and solutions may be found by visiting the website at www.thermalenergy.com.

Throughout FY 2006, the Corporation maintained its strategic cooperation agreement with Johnson Controls L.P. ("JCLP") for developing combined energy conservation and air pollution control solutions for their selected Canadian customers. However, although JCLP accounted for all of the sales in FY 2004, FY 2005 and FY 2006 this does not imply the existence of an economic dependence to JCLP as the Corporation is working aggressively with other new and potential partners to attract to new customers. Management is confident that the Corporation would continue in the absence of contracts with JCLP.

During the past year, the Corporation started and completed the implementation of its second Hybrid FLU-ACE® solution for JCLP at the Minas Basin Pulp and Power Co.'s facility in Nova Scotia, Canada. In addition, it was successful in signing a Project Development Agreement (PDA) to conduct detailed engineering design on a heat recovery project for JCLP's US-based client, (the first such contract in the USA). The Corporation also successfully completed its Hybrid FLU-ACE® solution at Camco Inc.'s Montreal (Quebec) facility. Late in the year the Corporation received a purchase order to install its newly acquired energy saving, GEM® condensate return technology at a "Big Three" automaker's research facility in Detroit, Michigan.

In addition, the Corporation successfully diversified its business development model to initiate direct sales of proven FLU-ACE® solutions to established Fortune 500 customers, while continuing to develop new non-exclusive strategic alliances under a new more cooperative joint venture alliance model.

Financial Information (Cont'd)

During FY 2006, the Corporation cooperated with JCLP to develop and propose many industrial and institutional Standard and Hybrid FLU-ACE® Energy Recovery Solutions to establish a growing multimillion dollar potential sales pipeline in Canada and the USA. While the Corporation was successful in generating $2,845,341 in sales during FY 2006; however, the potential sales pipeline of qualified bids significantly increased to an amount in excess of $40,000,000 and these will carry-over to FY 2007.

The Thermal Energy and JCLP cooperative mission statement can be summarized as follows: to increase sales through existing (JCLP) customer relationships by targeting energy solutions sales opportunities which will result in a faster sales cycle for both companies, while targeting niche industrial and commercial market sectors where Thermal Energy solutions provides a strong competitive advantage.

During FY 2006, the Corporation remained committed to the future product development and commercialization of the patented THERMALONOx™ technology with the filing for a provisional patent on new technology at the core of its THERMALONOx™ solution. Over the past year, the Corporation's chief scientist, Dr. Raymond Belanger, has developed a new system to generate ozone, which is fundamental to the chemical reaction required to remove NOx from flue gas streams and one of several components required for a complete emission reduction solution. Additionally, the Corporation continued to evaluate potential partners in the medium and large electric utility market who could sponsor a large scale demonstration of the technology once it has successfully completed its laboratory testing.

The Corporation was successful in financing its working capital requirements to support its business development efforts, by raising capital through the completion of a non-brokered private placement on April 22, 2006 for gross proceeds of $734,900. The financing consisted of an issuance of 3,867,895 Units at $0.19 per Unit with each Unit comprising one Common Share and one non-transferable Share Purchase Warrant entitling the holder to acquire one additional Common Share at any time within one year of issuance at a price of $0.30 per Share.

In addition, a consultant of the Corporation reaffirmed his confidence and support in the Corporation's business plan by accepting a total of 107,432 flow-through shares representing $23,635 of compensation for his services through to December 2005.

The Corporation incurred a net loss during the year of $2,216,733 compared to $1,421,589 during the previous year and has an accumulated deficit at year-end of $16,270,809. The Company's ability to continue as a going concern will improve significantly by obtaining an appropriate level of financing and by achieving or exceeding targeted gross margins as was the case in the recently completed work at Minas Basin Pulp and Power Co. To this end the Company has completed its Business Plan and is currently negotiating with financiers to secure an investment of $2.25M for the purpose of expanding its R&D work on its new THERMALONOx™ technology solution and to significantly expand sales and marketing throughout North America.

Revenues and Gross Profits

Revenues were $2,845,341 in FY 2006 compared to $668,204 in FY 2005. Revenues significantly increased in FY 2006 as compared to FY 2005 primarily due to the efforts of a transitioning new management team in increasing the sales funnel.

The gross loss of $126,815 in FY 2006 can be compared with a gross profit of $182,730 in FY 2005. These results expressed as a percentage of sales were (4.45%) in FY 2006 compared with 27.3% in FY 2005. The gross loss in FY 2006 compared to a gross profit in FY 2005 was due to additional costs incurred to remedy the design deficiencies at the Valley Regional Hospital and at the Stratford General Hospital. Other contributing factors for the losses were the cost over-runs at the Camco project.

Expenses

Administration expenses in FY 2006 were $556,350 compared with $520,818 in FY 2005. The increase in costs was due to additional services required to meet the demands of the increased business activity of the Company.
Selling, marketing and business development expenses were $737,021 in FY 2006 which increased significantly compared to $574,034 in FY 2005 due to increased sales efforts and traveling expenses throughout North America.

Stock compensation expenses were $431,827 in FY 2006 compared with $397,673 in FY 2005. This is the fourth year of the Company's adoption on a prospective basis, of a new accounting policy for stock-based compensation. The Company now expenses the value of stock options granted to employees and non-employees using the Black-Scholes Statistical Model.

Legal expenses in FY 2006 were $155,950, a significant increase compared to the amount of $52,450 incurred in FY 2005. The increase arose from the Company's litigation against the past President and CEO.

Insurance expenses decreased to $82,166 in FY 2006 compared with $105,694 in FY 2005 due to changes in an insurance policy from one that included for separate errors and omission insurance coverage to one that includes product liability in a comprehensive general liability insurance policy.

Patent and trademark maintenance costs were $16,059 in FY 2006 compared to $22,696 in FY 2005 with respect to countries where patents have been granted. Patent and trademark maintenance costs are expensed as incurred. The decrease in costs year over year was due the Company's decision not to renew the original THERMALONOx™ licences.

Research and Development costs increased significantly in FY 2006 to $89,880 compared to $2,550 in FY 2005. The increase was due to extensive laboratory testing following the Company's decision to resume work in developing its patented THERMALONOx™ technology through laboratory testing. The Company expects with new laboratory supporting data that the timing will be better in the near future for re-engaging and completing the THERMALONOx™ technology development and commercialization program.

Amortization of property, plant and equipment was $18,518 in FY 2006 compared to $9,150 in FY 2005. The increased costs were due primarily to the amortization of leasehold improvements associated with a new office lease and the acquisition of computer equipment.

Other Revenues

Other revenue was $290,214 in FY 2006 compared with $87,906 in FY 2005. The increase was due primarily to an adjustment to the past President's account.

Other Costs

Other costs were $310,096 in FY 2006 compared to $nil in FY 2005. These were additional costs incurred to remedy a design deficiency for the Valley Regional Hospital project and were summarily classified to monitor against a potential insurance recovery claim.

Financial Information (Cont'd)

Net Loss

Net Loss was $2,216,733 in FY 2006 compared to a net loss of $1,421,589 in FY 2005. Contributing factors resulting in the significantly greater loss in 2006 were the cost over-runs at Camco, costs associated with the design deficiency at the Valley Regional Hospital and increased legal fees arising from litigation against the past President and insufficient sales volume to cover the current level of fixed costs in the Company required to produce a net profit. Management continues to work hard to control overhead costs but its main focus at the present time is a dedicated effort to secure much improved sales results.

Liquidity

The working capital deficiency of $414,337 at the end of FY 2006 increased significantly compared to the working capital deficiency of $226,372 at the end of FY 2005. Current assets decreased by $461,960 to $816,391. The major changes were an increase in accounts receivable of $395,236 more than offset by a draw down in short term investments of $800,263. Current liabilities decreased by $273,995 to $1,230,728. The changes were an increase in accounts payable of $535,762 offset by a reduction in accrued liabilities of $151,722, deferred revenue of $375,000 and amounts due to the past President of $283,035. Other cash requirements in FY 2006 were met by a draw down of $800,263 in short term investments, $462,767 from the exercise of warrants into common shares and $238,500 from the exercise of options into common shares. Cash requirements have been adversely affected by over-runs at the Camco project and the additional costs to remedy design flaws on the Valley Regional Hospital and Stratford General Hospital projects and the cost of litigation to defend and counterclaim against the past President.

Management continues to recognize the requirement to further improve liquidity in order to continue as a going concern, and as a result is aggressively working to increase sales and is continuing to develop new cooperative business relationships and exclusive sales distributorships in different, but complementary, product lines. In addition, the Company has completed a non-brokered private placement in the fourth quarter of 2006 with gross proceeds of $734,900.

Additionally the Company is actively exploring opportunities to structure a multi-million dollar financing of its new Business Plan. The proceeds raised would be used for expanded sales and marketing efforts, strategic acquisitions and R&D activities with THERMALONOx™.

Related Party Transactions

In FY 2006, officers were paid fees for services of $187,000. A combination of a debt settlement comprising a cash payment to the past President and a small debt payment made on behalf of the past President reduced the amount due to the past President to $17,937. Common share options amounting to 1,975,000 options, previously issued to Directors, became exercisable. 880,500 common share options, previously issued to Officers, became exercisable.

A loan of $60,000 was provided to the President as an advance payment draw against pending sales commissions and to be retired in FY 2007.

Supplementary Financial Information

The following table shows selected consolidated financial data for the three most recently completed financial years.

	2004 $	2005 $	2006 $
Sales	922,510	668,204	2,845,341
Net loss	(1,177,276)	(1,421,589)	(2,216,733)
Net loss per share - basic and diluted	(0.03)	(0.03)	(0.03)
Total assets	544,948	1,314,129	931,430

Trend Analysis:

The sales in FY 2004 and FY 2005 are consistent in magnitude. The increased sales funnel and resultant sales in FY 2006 increased due to the efforts of a new and more vigorous sales team which accompanied the newly placed management team in the Company.

The net losses in FY 2005 increased from those reported in FY 2004 due to a decrease in gross profits from sales and a significant increase in stock-based compensation expenses following the implementation of the new CICA pronouncements. The net losses further increased in FY 2006 in spite of greatly increased revenues from sales due to the extra cost over-runs of the Camco project, the costs to remedy design flaws at the Valley Regional Hospital and Stratford General Hospital projects and the litigation costs to defend against a claim by the past President.

The variations in assets from FY 2004 through to FY 2006 were affected primarily by an investment of $800,263 in short term investments in FY 2005 following the closing of a private placement in the amount of $1,100,100 late in the fourth quarter of FY 2005. This investment was drawn down in FY 2006 to meet cash requirements.

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 financial statements ended May 31, 2006, these statements were subject to an audit by our independent public accountants.

Business Risks

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

The Company is engaged in the development, engineering and supply of pollution control and heat recovery systems. Operational risks of the company include the ability to continue to secure and implement multiple sales contracts each year for standard, hybrid, and multi-air pollutant FLU-ACE® technology solutions. In addition, the Company has not yet been able to finance and complete the development and commercialization of its patented THERMALONOX™ technology. The THERMALONOx™ patented technology is yet to be tested and the Company will be seeking potential partners and investors to sponsor the costs associated with the implementation of a THERMALONOx™ demonstration pilot project. This will occur upon the successful completion of new, ongoing and promising

Financial Information (Cont'd)

laboratory testing. Cost Effective Energy Conservation and Environmental Compliance Solutions sales through the JCLP cooperation has not limited the size of the market but has increased the market potential.

Financial risks and uncertainties of the Corporation include:

- The Company's history of operating losses and uncertainty of future profitability;
- The ability to continue to grow sales through the existing JCLP cooperation agreement;
- 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 and;
- The ongoing litigation with its former President & CEO.

Management's addressing of the risks:

The management of the Company realizes that the increased operating losses in FY 2006, while displaying a consistent pattern of losses as in previous years, can be explained in this period as an aberration that was primarily due to the unexpected cost-over-runs encountered at the Camco project and the additional costs to remedy design flaws on the Valley Regional Hospital and Stratford General Hospital as well as the litigation costs to defend and counterclaim against the past President. In addition to the aforementioned costs, there were several months of sales and engineering man-hours that were necessarily diverted towards the redesigning and project management of equipment procurement and new construction at these project sites as well as to the litigation matters.

These lost man-hours could otherwise have been more productive instead to pursue new sales and business development opportunities. With these issues behind it, the Company is now fully focused on sales and marketing and has expanded its drive towards that purpose with the addition of new regional sales associates in Canada, the U.S. and Mexico and the addition of new internal sales professionals.

Management believes that it can continue to grow sales through the existing JCLP cooperation agreement as evidenced by the recent award of a feasibility study for one of its clients in the U.S. In addition, there are numerous projects that it is jointly pursuing with JCLP both in Canada and the U.S and abroad.

Management is presently in late discussions with several large companies that it believes will result in the signing of new cooperative partnership agreements that could help to grow its sales and possibly lead to licensing agreements after successful trials of the Corporation's technologies.

The current management has demonstrated that it can secure outside working capital as evidenced by the successful closings of its Private Placement with gross proceeds of $734,900 in Q4 FY 2006. In addition, it has realized $701,267 during the year through the exercise of options and warrants.

Management believes that by maintaining its small core of personnel and high margins on more secured contracts that it will achieve profitable operations. Small incremental staffing increases will be introduced from time to time depending on the demand arising from increased sales volumes.

Management has recently acquired new licenses and distributorship rights to GEM®, a leading European (Great Britain) line of industrial/commercial steam traps and THERMALOZOMAx™, an ozone generation technology. Recently, the Company has received its first purchase order for a trial of the GEM® at the site of one the "Big Three" Automakers in Detroit, Michigan and has conducted audits for its implementation at other industrial sites. The Company is presently working through its JCLP alliance to provide proposals to implement its THERMALOZOMAx™ technology at several of JLCP's clients in the hospitality industry.

The Company is protecting its proprietary technology through registered trademarks and confidentiality agreements. It has recently filed a new provisional patent for THERMALONOx™, a technology which is currently undergoing laboratory testing.

Management believes that competition against its core technology of FLU-ACE™ is limited at this time and in any event believes that the market place is sufficiently large enough to permit stronger competition in the future and firmly believes that the Company is in a better position now with a significantly enhanced arsenal of building blocks to draw on in presenting a more comprehensive solution to customers.

Highlights

On June 1, 2005 the Corporation announced that it had granted 250,000 new stock options at a deemed price of $0.24 per share to a new director, John Kelly. The Corporation also announced the settling of a debt with one employee for 100,000 flow-through common shares of the Corporation at a deemed price of $0.25 per share.

On June 13, 2005 the Corporation announced that it had significantly strengthened its financials and cleaned up the Company's debt position. Part of this improvement to the balance sheet includes the settling of an unsecured Convertible Debenture of $376,704 for $54,280.

On June 23, 2005 the Corporation announced that it had re-engaged Stuart McCarthy to provide in-house investor relations and communications services. Mr. McCarthy is now the Corporation's primary contact for shareholders seeking timely responses to investor and corporate matters.

On June 23, 2005 the Corporation announced the departure of Chief Technology Officer Thomas V. Hinke from the Corporation. Earlier in the year Mr. Hinke resigned as President and CEO and also from his position on the Board of Directors, to facilitate the appointment of a stronger management team to accelerate the growth and to maximize shareholder value of the Corporation.

On August 2, 2005 the Corporation announced that it would supply a FLU-ACE® heat recovery system to JCLP as part of a multi-million dollar energy efficiency project at Minas Basin Pulp and Power Co. Ltd., of Hantsport, Nova Scotia. This contract is the largest to date and represents a tremendous breakthrough into a new market segment, the pulp and paper industry.

On August 19, 2005 the Corporation announced that the Honourable George Smitherman, Health Minister for the Province of Ontario joined officials of the Corporation for the official start-up of the Corporation's latest FLU-ACE® installation at the Stratford General Hospital site of the Huron Perth Alliance. This installation will cut natural gas use and greenhouse gas emissions by 20% and free up money for health care needs.

Financial Information (Cont'd)

On September 12, 2005 the Corporation announced the appointment of R. James Ansell to the Board of Directors. Mr. Ansell has been President and CEO of Generation Resources Holding Co. LLC., of Leawood, Kansas, a private investment and holding Company, which finances, develops, operates and maintains cost-effective production operations in renewable energy projects in the United States. He is also Chairman of First Energy Sustainable Energy Funds and sits on the Board of Directors of the Pennsylvania Environmental Council. Prior to founding Generation Resources, Mr. Ansell was Vice-President of strategic development and alliances for Black and Veatch, a $2 billion global construction and engineering firm specializing in energy, water and information technology projects.

On September 28, 2005 the Corporation announced that it had resumed work on developing its patented THERMALONOx™ technology as a cost-effective solution for reducing nitrogen oxide (NOx) emissions from coal-fired electric-generating units and large industrial boilers. The Corporation appointed Dr. Raymond Belanger as chief scientist to head up its renewed research and development program. Mr. Belanger previously worked during the past five years for a fuel cell technology company based in British Columbia in charge of research and development. Dr. Belanger received his doctorate in physical chemistry at the University of Waterloo in 1996, where his thesis examined the chemical reactions involving NOx and carbon oxides on metal-oxygen clusters.

On October 20, 2005 the Corporation announced that the voluntary mediation between the Corporation and its former President and CEO (Mr. Hinke) ended without resolution and as a result, the Corporation planned to seek damages in excess of $2.5 million from Mr. Hinke. The Corporation was notified that Mr. Hinke intended to seek damages from the Corporation surrounding his dismissal.

On October 25, 2005 the Corporation announced that it was served with a statement of claim in the amount of $2.3 million by its former President and CEO (Mr. Hinke). The Corporation and its legal counsel are confident that the claim is frivolous and without merit and will be defended vigorously. The Corporation stated that it was very confident in the merits of its forthcoming counterclaim against Mr. Hinke.

On October 25, 2005 the Corporation settled an outstanding balance owing in the amount of US$57,709 with Emerson/Fabcon (the supplier of record for a past AEP Project at its Conesville plant in Ohio) with a negotiated amount of US$30,000.

On October 27, 2005 the Corporation announced that it had also received an offer of settlement on the same day of the submitted claim from its former President and CEO (Mr. Hinke) to settle his $2.3 million claim for the amount of $425,000. The Corporation further advised that it was in the process of preparing its defense to the claim and a counterclaim against Mr. Hinke.

On October 31, 2005 the Corporation announced its financial results for the first quarter of fiscal year 2006 ended August 31, 2005. The Corporation recorded a gross profit on sales of $52,825 on revenue from sales of $382,180, a 144% increase on revenue from a year earlier.

On December 2, 2005 the Corporation announced that it had filed its statement of defense to a claim launched in October by its former President and filed a counterclaim seeking damages from the former President in the amount of $5 million. Such damages stemmed from alleged breaches of the former President's fiduciary obligations to the Corporation and oppressive conduct toward the Corporation and its shareholders.

On December 21, 2005 the Corporation agreed to settle an outstanding debt of $23,635 to consultant, Denis Forget by issuing 107,432 "flow-through" Common Shares at a deemed price of $0.22 per share.

On March 27, 2006 the TSX Venture Exchange accepted for filing the Corporation's proposal to issue 107,432 "flow through" Common Shares at a deemed price of $0.22 per share.

On March 28, 2006 the Corporation announced that it had received an initial contract from Johnson Controls to conduct detailed engineering and design on a heat recovery project for a U.S.-based client. This represented not only the Corporation's first commercial project development work in the U.S. but also its expansion of offerings into non-FLU-ACE®-based heat recovery solutions.

On March 30, 2006 the Corporation announced that it had signed an agreement with Ozomax Ltd. of Quebec, to acquire the distribution and R&D rights for its leading ozone generating technology under a new brand of ozone products known as THERMALOZOMAx™. Under this agreement, the Corporation will have exclusive distribution rights within North, Central and South America and the Caribbean with its specific customers including Johnson Controls Inc., as well as two other large North American firms focused on infrastructure development and renewal in energy and water. In addition to the traditional uses of THERMALOZOMAx™ technology developed by Ozomax, the Corporation will have exclusivity to perform research with the Ozomax ozone technologies in flue gases in conjunction with the scrubbing of NOx and Mercury recovery from industrial boiler and power generation applications.

On April 4, 2006 the Corporation announced that it had signed a licensing agreement with Gardner Energy Management Ltd. (GEM) to acquire the exclusive rights in Canada and key U.S. markets including Michigan to the energy saving, GEM® Condensate Return Technology. The unique GEM® Condensate Return System is designed as a permanent replacement solution for traditional lower efficiency steam traps which have moving parts, are prone to frequent failures, have a short life expectancies and high maintenance and energy costs.

On April 5, 2006 the Corporation announced at its annual meeting of shareholders that it had filed a new provisional patent on a new technology at the core of its THERMALONOx™ solution to remove NOx from flue gas streams. The Corporation's Dr. Belanger developed the new process after conducting the first bench tests on the originally proposed method for ozone generation which proved to produce insufficient quantities of ozone to make THERMALONOx™ work. On the other hand and after extensive bench tests, Dr. Belanger's new process has generated significant quantities of ozone to allow the Corporation to move forward and bring THERMALONOx™ to market as a cost-effective solution to reducing NOx emissions.

On April 10, 2006 the Corporation announced that the first installation of its newly acquired energy saving, GEM® Condensate Return Technology will be introduced as a trial on a steam system in the central heating plant at a "Big Three" automaker's facility in Detroit, Michigan. After a successful trial, the Corporation hopes to proceed with further installations throughout the automakers portfolio of facilities.

On April 24, 2006 the Corporation announced that it had closed a non-brokered private placement with gross proceeds of $734,900. The financing consisted of 3,867,895 units sold at $0.19 each comprised of one Common Share and one non-transferable Share Purchase Warrant entitling the holder to acquire one additional Common Share at any time within one year of issuance at a price of $0.30 per share.

On May 18, 2006 the Corporation filed a pricing amendment with the TSX Venture Exchange for warrants previously issued on June 3, 2005. Under this amendment which affects 3,333,666 warrants, the price was set at $0.35 for both Year 1 and Year 2 of the exercise period which expires on June 3, 2007.

Financial Information (Cont'd)

Outlook

Statements in this discussion are forward-looking and as such, are subject to various risks and uncertainties concerning a variety of factors. Such information contained herein represents management's best judgment as of the date hereof based on the information currently available.

During Q1 of FY 2007, the Corporation has been focused equally on direct sales and cooperative sales development activities in both the USA and Canada. The majority of the Corporations' sales, marketing, and business development resources have been utilized equally in support of the Johnson Controls' cooperative energy solutions sales development activities; as well as in support of some direct sales development activities through independent sales agents in Michigan, Maine, Ontario, Quebec and Mexico to selected industrial process industrial facilities where existing customer relationships are already in place. This has led to the submission of several proposals currently with clients for approval and several invitations to other client sites for submission of other proposals.

The Corporation anticipates that these initiatives will not only produce increased sales revenues and gross profit in the second quarter FY 2007 (ending November 30, 2006) but become a harbinger for continued improvement to the Consolidated Balance Sheet.

On July 10, 2006, the Corporation announced that it had significantly expanded its sales capacity with the appointments of six experienced representatives from North to South America.

On September 7, 2006, the Corporation announced that together with Johnson Controls it had commenced the initial phase of a heat recovery/energy cost reduction project in the US for one of the world's largest producers of consumer foods.

On September 11, 2006, the Corporation announced that it had acquired the sole and exclusive worldwide license to the award winning Dry-Rex™ system from Mabarex Inc., of Montreal. The terms of the deal also include the transfer of all intellectual property rights to the patented Dry-Rex™ technology on an earn-out basis over five years. The value of the acquisition over time is $3,250,000 and includes an initial sum of $80,000 in the form of an issuance of 500,000 common shares of the Corporation at a deemed price of $0.16 per share. Dry-Rex™ uses waste heat to turn bark, sludge and other biomass into high-efficiency bio-energy fuel for pulp mills and other industrial applications.

Financial Information (Cont'd)

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

The consolidated financial statements of Thermal Energy International Inc. and all the information in this annual 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 consolidated financial statements conform with Canadian generally accepted accounting principles. When alternative accounting methods exist, management has chosen those that it deems most appropriate in the circumstances. Financial information presented throughout this report is consistent with that in the consolidated financial statements.

Thermal Energy International Inc. 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 International Inc.'s external auditors, Raymond Chabot Grant Thornton LLP ("RCGT"), have conducted an independent audit of the consolidated financial statements in accordance with Canadian generally accepted auditing standards, performing such tests and other procedures as they consider necessary to express an audit opinion. The external auditors have full and unrestricted access to the Audit Committee to discuss their audit and related findings.

Tim Angus
President & CEO

Oliver Toffoli
General Manager & CFO

AUDITOR'S REPORT

To the Shareholders of Thermal Energy International Inc.

We have audited the consolidated balance sheets of Thermal Energy International Inc. as at May 31, 2006 and 2005 and the consolidated statements of operations and deficit and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at May 31, 2006 and 2005 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Raymond Chabot Grant Thornton LLP

Chartered Accountants
Ottawa, Canada
August 30, 2006

Financial Information (Cont'd)

Thermal Energy International Inc.

Incorporated under the Ontario Business Corporations Act

CONSOLIDATED BALANCE SHEETS

As at May 31

	2006	2005
	$	$
ASSETS		
Current assets		
Cash	**59,119**	174,218
Short term investments (note 5)	-	800,263
Accounts receivable (note 6)	**626,495**	231,259
Contracts in progress	**89,000**	65,000
Prepaids and other assets	**41,177**	7,611
	816,391	1,278,351
Loans receivable (note 8)	**55,500**	-
Property, plant and equipment (note 9)	**59,539**	35,778
	931,430	1,314,129
LIABILITIES, CAPITAL STOCK, CONTRIBUTED SURPLUS AND DEFICIT		
Current liabilities		
Accounts payable	**947,063**	411,301
Accrued liabilities	**166,728**	318,450
Deferred revenue	**99,000**	474,000
Due to the President (note 7)	**17,937**	300,972
	1,230,728	1,504,723
Capital stock, contributed surplus and deficit		
Capital stock (note 10)	**14,462,279**	12,625,487
Contributed surplus (note 10)	**1,509,232**	1,237,995
Deficit	**(16,270,809)**	(14,054,076)
	(299,298)	(190,594)
	931,430	1,314,129

Contingency (note 18)

The accompanying notes are an integral part of these consolidated financial statements

On behalf of the Board

Tim Angus
President & CEO

Oliver Toffoli
General Manager & CFO

Financial Information (Cont'd)

CONSOLIDATED STATEMENT OF CASH FLOWS

Years ended May 31

	2006	2005
	$	$
OPERATING ACTIVITIES		
Net loss for the year	**(2,216,733)**	(1,421,589)
Add items not involving cash:		
Non-monetary compensation charge	**431,827**	397,673
Amortization of property, plant and equipment	**18,518**	9,150
Future income taxes	**(78,400)**	(51,200)
Debt settlement with past President	**(232,305)**	-
Changes in non-cash operating working capital		
Accounts receivable	**(395,236)**	19,916
Contracts in progress	**(24,000)**	(65,000)
Prepaids and other assets	**(34,166)**	(6,197)
Accounts payable	**714,997**	(401,988)
Accrued liabilities	**(151,722)**	171,665
Deferred revenue	**(375,000)**	370,800
Changes in due to the past President	**(50,730)**	(33,029)
Net cash used in operating activities	**(2,392,950)**	(1,009,799)
INVESTING ACTIVITIES		
Short term investments	**800,263**	(800,263)
(Increase) decrease in loan receivable	**(55,500)**	2,000
Additions to property, plant and equipment	**(42,279)**	(15,865)
Net cash used in investing activities	**702,484**	(814,128)
FINANCING ACTIVITIES		
Common shares issued, net of issue costs (note 10)	**1,575,367**	1,736,849
Net cash provided by financing activities	**1,575,367**	1,736,849
Decrease in cash for the year	**(115,099)**	(87,078)
Cash beginning of year	**174,218**	261,296
Cash end of year	**59,119**	174,218
Interest paid	**1,928**	11,832
Flow through shares issue cost	**78,400**	51,200

The accompanying notes are an integral part of these consolidated financial statements

Financial Information (Cont'd)

CONSOLIDATED OPERATIONS AND DEFICIT

Years ended May 31

	2006	2005
	$	$
REVENUE		
Sales	**2,845,341**	668,204
Cost of sales	**2,972,156**	485,474
Gross profit (loss)	**(126,815)**	182,730
Expenses		
Administration	**556,350**	520,818
Selling, marketing and business development	**737,021**	574,034
Stock-based compensation expense (note 3 and 12)	**431,827**	397,673
Legal fees	**155,950**	52,450
Audit fees	**68,797**	63,050
Insurance	**82,166**	105,694
Amortization of property, plant and equipment	**18,518**	9,150
Patent and trademark maintenance	**16,059**	22,696
Research and development	**89,880**	2,550
Interest and bank charges	**6,749**	12,177
Foreign exchange gain	**(3,851)**	(16,522)
	2,159,466	1,743,770
	(2,286,281)	(1,561,040)
Other revenue (note 14)	**290,214**	87,906
Interest revenue	**11,030**	345
Other costs (note 15)	**(310,096)**	-
Loss before income taxes	**(2,295,133)**	(1,472,789)
Future income tax recovery (note 13)	**78,400**	51,200
Net loss	**(2,216,733)**	(1,421,589)
Deficit, beginning of year	**(14,054,076)**	(11,875,280)
	(16,270,809)	(13,296,869)
Change in accounting policy (note 3)	**-**	(757,207)
Deficit, end of year	**(16,270,809)**	(14,054,076)
Net loss per share - basic and diluted	**(0.03)**	(0.03)
Weighted average number of common shares	**67,418,141**	54,826,526

The accompanying notes are an integral part of these consolidated financial statements

Financial Information (Cont'd)

1 GOVERNING STATUTES AND NATURE OF OPERATIONS

The Company was incorporated under the Ontario Business Corporations Act on May 22, 1991 and is primarily engaged in the development, engineering and supply of pollution control and heat recovery systems.

2 GOING CONCERN

The Company incurred losses from operations in the current and prior years and had a working capital deficiency and shareholders' deficiency as at May 31, 2006 and 2005.

The Company's ability to meet its obligations as they fall due is dependent upon any combination of the following: the continued financial support of its shareholders, its ability to arrange long-term financing and its ability to generate sufficient cash from operations.

The financial statements have been prepared on the going concern basis, which assumes the realization of assets and the satisfaction of liabilities in the normal course of business. These financial statements do not include any adjustments to the carrying value or classification of assets and liabilities, nor to the results of operations, should the Company not continue to operate as a going concern.

Management is of the opinion that sufficient funds will be available from operations, external financing, and the continued financial support of its principal shareholders to meet the Company's liabilities and commitments as they become due.

3 CHANGES IN ACCOUNTING POLICIES

Effective June 1, 2004, the Company adopted the new Canadian standard for "Stock-based Compensation and Other Stock-based Payments", which requires that fair-value method of accounting be applied to all stock-based compensation payments for both employees and non-employees. Under the fair-value based method, compensation cost is measured at fair value at the grant date and is expensed over the awards vesting period. The transitional provisions of the standard allow the Company to adopt this method retroactively without restatement of prior periods. Accordingly, this retroactive application increased opening deficit and opening contributed surplus by $757,207 respectively and increased the net loss by $391,673.

In March 2004, the CICA issued Emerging Issue Committee Abstract no 146 (EIC-146) Flow-through Shares, which applies to flow-through share issuances initiated after March 19, 2004. The Corporation adopted prospectively the new recommendations and now records the tax effect related to renounced deductions on the date that the Corporation renounced the deductions to investors. The impact of this change resulted in a decrease in share capital in fiscal 2005 of $51,200. The recognition of the portion of the previously unrecognized future income tax asset resulted in a tax recovery of $51,200.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies are as follows:

Basis of consolidation

The consolidated financial statements of the Company include the accounts of its wholly owned subsidiary, 2003356 Ontario Inc.

Use of estimates

Since a precise determination of many assets and liabilities is dependent upon future events, the preparation of financial statements for a period in conformity with Canadian generally accepted accounting principles necessarily involves the use of estimates and approximations which have been made by management using careful judgment. Actual results could differ from these estimates.

Revenue recognition

Contract income is recorded under the percentage-of-completion method. Under this method, contract income and profit are recognized proportionately with the degree of completion of work. Degree of completion is determined using the cost-to-cost method, which consists in comparing the costs incurred at the date of the financial statements with the last estimate of the total cost of work to be performed. Contracts in progress are valued considering labour, material and some overhead costs, which include estimated profits. Losses are recorded once they can be estimated. Amounts billed or payments received but not yet earned are deferred until the revenue is earned.

Cash and cash equivalents

All highly liquid investments with original maturities of three months or less are classified as cash equivalents. Cash and cash equivalents are recorded at cost which approximates fair value.

Amortization

Property, plant and equipment are recorded at cost. Amortization is computed using the following annual rates and methods:

Furniture and fixtures	20% declining-balance
Computers	3 years straight-line
Software	50% declining-balance
Leasehold improvements	3 years straight-line

Loss per share

The basic loss per share is calculated on the basis of net loss divided by the weighted average number of common shares outstanding during the year. The diluted per share amount is calculated giving effect to the potential dilution that would occur if securities or other contracts to issue common shares were exercised or converted to common shares. The treasury stock method is used to determine the dilutive effect of stock options. The treasury stock method assumes that proceeds received from the exercise of the in-the-money stock options are used to repurchase common shares at the prevailing market rate. The diluted loss per share is equal to the basic loss per share because the effect of dilutive stock options described in Note 12 is antidilutive.

Income taxes

The liability method is used to account for income taxes. Future tax assets and liabilities are recognized for tax consequences of temporary differences between the financial statement carrying amounts and the tax bases of assets and liabilities. Future tax assets and liabilities are measured using substantively enacted tax rates in effect for the year in which the differences are expected to be recovered or settled. A valuation allowance is established to reduce the future tax asset if it is not "more likely than not" that the related tax benefits will be realized in the future.

Financial Information (Cont'd)

Research and development costs and government assistance

The Company carries on various research and development programs, and from time to time these are funded by the Government of Canada. Funding received is accounted for using the cost reduction approach and is netted against research or development costs. Research costs are expensed as incurred. Development costs are charged to expense as incurred unless they meet generally accepted accounting criteria for deferral and amortization. No costs have been deferred to date.

Foreign currency translation

All monetary assets and liabilities denominated in foreign currency are translated into Canadian dollars at the exchange rate in effect at the balance sheet date, whereas other assets and liabilities are translated at exchange rates in effect at transaction dates. Revenues and expenses in foreign currency are translated at the average exchange rate in effect during the period. Gains and losses are included in the earnings for the year.

Investment tax credits

Investment tax credits are accounted for under the cost reduction method whereby they are netted against the cost of the property, plant and equipment to which they relate. Investment tax credits are recorded when the Company has incurred qualifying expenditures and there is reasonable assurance the tax credit will be realized.

Stock-based compensation

The Company accounts for its grants under stock-based compensation plans using the fair value method and compensation expense is recognized in the period in which the options vest. When holders exercise their options, any consideration received and any contributed surplus related to these options is credited to capital stock.

Share purchase loans are accounted for in accordance with EIC Abstract 132 "Share Purchase Financing". These loans, which were extended to shareholders to purchase Class A common shares are considered to be stock options and are treated as stock-based compensation and recorded at their fair market value.

5 SHORT TERM INVESTMENTS

The Company invested excess cash in a cashable guaranteed investment certificate, bearing interest at a rate of 2.5% per annum. These funds had been drawn down by May 31, 2006.

6 ACCOUNTS RECEIVABLE

	2006	2005
	$	$
Trade	**517,914**	184,592
Other	**108,581**	46,667
	626,495	231,259

At May 31, 2006 90% of trade receivables and 99% of revenues were from one customer. At May 31, 2005 all trade receivables and revenues were from one customer.

7 RELATED PARTY TRANSACTIONS

Related party transactions are measured at exchange value which represents the amounts established and agreed upon by both parties.

	2006	2005
	$	$
Transactions with and balances owing to/from directors		
Fees for services	**-**	64,500
Accounts receivable	**1,635**	-
Loans receivable	**37,000**	-
Accrued liabilities	**6,750**	49,292
Flow-through shares issued	**20,000**	69,944
Directors share options outstanding at May 31		
Issued	**2,300,000**	2,650,000
Exercisable	**1,975,000**	1,650,000

	2006	2005
	$	$
Transactions with and balances owing to/from officers		
Fees for services	**187,000**	178,570
Accounts receivable	**2,955**	2,955
Loan receivable	**18,500**	-
Accrued liabilities	**2,667**	7,618
Flow-through shares issued	**-**	105,622
Officers share options outstanding at May 31		
Issued	**1,043,000**	1,143,000
Exercisable	**880,500**	593,000

Changes to the amounts due to the past President during the year were as follows:

	2006	2005
	$	$
Balance due to the past President, beginning of year	**300,972**	334,001
Debt settlement	**(232,305)**	-
Payments made on behalf of past President	**(730)**	(33,029)
Cash payment to the past President	**(50,000)**	-
Balance due to the past President, end of year	**17,937**	300,972

Amounts due to the past President have no fixed repayment terms and are non-interest bearing.

8 LOANS RECEIVABLE

Loans receivable include an amount of $37,000 from a director (2005 - $nil) and $18,500 from an officer (2005 - $nil). These loans are due on demand and bear no interest.

Financial Information (Cont'd)

9 PROPERTY, PLANT AND EQUIPMENT

	2006		2005	
	Cost $	**Accumulated Amortization $**	Cost $	Accumulated Amortization $
Furniture and fixtures	**81,671**	**58,176**	78,351	53,194
Computers	**153,939**	**134,584**	136,382	127,861
Software	**12,081**	**12,081**	12,081	9,981
Leasehold improvements	**21,401**	**4,712**	54,548	54,548
	269,092	**209,553**	281,362	245,584
Accumulated amortization	**(209,553)**		(245,583)	
Net book value	**59,539**		35,779	

10 CAPITAL STOCK AND CONTRIBUTED SURPLUS

	2006		2005	
	# Shares	**$**	# Shares	$

Authorized

Unlimited number of Class A common shares, no par value

Unlimited number of Series 1 preferred shares, voting only in the case of dissolution of the Company, redeemable at the option of the Company at $0.01 per share and convertible to common shares on a 1 to 1 basis at the rate of 20% of the number originally issued per year.

Class A Common shares issued

	2006 # Shares	2006 $	2005 # Shares	2005 $
Balance, beginning of year	**63,198,899**	**12,776,987**	50,947,118	11,008,303
Issued in settlement of liabilities, net of issue costs	**1,247,432**	**179,235**	2,523,750	261,496
Issued for cash, net of issue costs	**8,573,925**	**1,456,172**	9,103,031	1,328,153
Issued as a result of the exercise of options	**1,550,000**	**399,090**	625,000	179,035
	74,570,256	**14,811,484**	63,198,899	12,776,987
Less: loans outstanding to assist shareholders in purchasing capital stock (i)		**(270,805)**		(151,500)
Balance, end of year	**74,570,256**	**14,462,279**	63,198,899	12,625,487

(i) The past President received shareholder loans of $151,500 to purchase shares during 1999. The current President received a shareholder loan of $60,000 to purchase shares during 2006. Loans of $59,305 were also extended to other shareholders to assist in the purchase of common shares. These loans are due upon demand, bear no interest and have no fixed repayment terms. Stock-based compensation on these loans was estimated using the Black-Scholes option pricing model with the following weighted average assumptions: volatility of 114%, expected dividend rate of 0%, risk-free interest rate of 3.85% and an expected life of 1 year.

In fiscal 2005 and 2006 the Company completed private placements. The funds were raised by issuing Units that included one Class A common share and one non-transferable share purchase warrant. Given the inherent subjectivity of evaluating the warrants, the Company determined it preferable to attribute the full amount of the proceeds to the issued shares.

The following table summarizes the status of warrants outstanding at May 31, 2006:

Warrants Outstanding	Exercise Price $	Expiry Date
2,586,668	0.20	November 04, 2006
400,000	0.60	January 18, 2007
3,300,333	0.35	To June 03, 2007
3,867,895	0.30	To April 22, 2007
10,154,896		

In accordance with the terms of the Company's flow-through share offerings, and pursuant to certain provisions of the Income Tax Act (Canada), the Company is committed to renounce, for income tax purposes, start-up phase expenditures of renewable and energy conservation projects to purchasers of its flow-through shares. During fiscal 2006, the Company renounced approximately $216,973 (2005 - $556,654) of expenditures. At May 31, 2006, $nil (2005 - $430,582) of expenditures are required to be incurred before December 31, 2006. Participation in this program is subject to verification by tax authorities with respect to the nature and timing of expenditures.

Contributed surplus

	2006 $	2005 $
Balance, beginning of year	**1,237,995**	166,150
Change in accounting policy (note 3)	**-**	757,207
Stock-based compensation	**431,827**	397,673
	1,669,822	1,321,030
Fair-value of options exercised and transferred to capital stock	**160,590**	83,035
Balance, end of year	**1,509,232**	1,237,995

11 COMMITMENTS

The Company is committed under the terms of operating leases for premises and office equipment contracts with various expiry dates in the following amounts:

	$
2007	109,900
2008	96,900
2009	35,000
2010	2,000
Total	243,800

12 SHARE OPTION PLAN

The Company established the Company's Share Option Plan applicable to Directors, Officers and full-time and part-time employees of the Company. In the plan, the aggregate number of options may not exceed 20% of the outstanding shares and the total number of shares to be optioned to any optionee may not exceed 5% of the number of issued and outstanding shares as at the option granting date. The options are granted with an exercise price equal to the market value of the common shares of the Company at the date of grant, less any permissible discounts, and may be exercised at any time after the

Financial Information (Cont'd)

vesting date, not to exceed five years from the date of granting. Vesting period for options granted is at the discretion of the Board of Directors. Options granted in fiscal 2006 and 2005 had vesting periods ranging from four to six months.

(a) Activity in stock options was as follows:

	2006		2005	
	# Options	**Weighted Average $**	# Options	Weighted Average $
Outstanding, beginning of year	**7,043,714**	**0.19**	6,512,714	0.22
Granted	**850,000**	**0.23**	5,218,000	0.16
Exercised	**(1,550,000)**	**0.15**	(625,000)	0.15
Cancelled	**(975,000)**	**0.18**	(2,770,000)	0.19
Expired	**(650,000)**	**0.15**	(1,292,000)	0.19
Outstanding, end of year	**4,718,714**	**0.21**	7,043,714	0.19
Number of options exercisable as at May 31	**4,024,964**		4,943,714	

Options exercised during the year were as follows:

	2006		2005	
	# shares	**$**	# shares	$
Employees	**1,025,000**	**169,500**	150,000	22,500
Directors	**325,000**	**49,000**	400,000	60,000
Consultants	**200,000**	**20,000**	75,000	13,500
	1,550,000	**238,500**	625,000	96,000

In 2006 and 2005, all options were exercised for cash.

(b) The following options are outstanding and/or exercisable at May 31, 2006:

Number of Options Outstanding	Number of Options Exercisable	Exercise Price Per Share $	Expiry Date
400,000	400,000	0.15	January 16, 2007
175,714	175,714	0.18	January 16, 2007
193,000	193,000	0.10	January 12, 2008
250,000	250,000	0.20	January 24, 2008
1,000,000	675,000	0.10	February 1, 2008
500,000	337,500	0.12	February 1, 2008
150,000	43,750	0.24	March 1, 2008
950,000	950,000	0.22	April 29, 2008
250,000	250,000	0.24	May 19, 2008
100,000	100,000	0.24	June 2, 2008
150,000	150,000	0.24	June 10, 2008
150,000	150,000	0.24	August 15, 2008
250,000	250,000	0.26	September 9, 2008
200,000	100,000	0.18	January 3, 2009
4,718,714	4,024,964		

c) Stock-based compensation

The fair value of options granted was estimated using the Black-Scholes option pricing model with the following weighted average assumptions:

	2006	2005
Weighted average assumptions:		
Expected dividend	**0.00%**	0.00%
Expected volatility	**111%**	113%
Risk-free interest rate	**3.85%**	3.75%
Expected option life in years	**2.4**	2.4

The weighted average fair value of the Company's stock options, calculated using the Black-Scholes option pricing-model, granted during the two years ended May 31, 2006 and May 31, 2005 were $0.14 and $0.21, respectively.

Stock-based compensation expense in fiscal 2006 includes an amount of $407,627 for options granted to employees (2005 - $391,673.)

13 INCOME TAXES

The Company's effective tax rate differs from the combined federal and provincial income tax rate in Canada. This difference comes from the following items:

	2006 $	2005 $
Loss before income taxes	**(2,295,133)**	(1,472,589)
Income taxes calculated using the combined federal and provincial income tax rate in Canada of 36.12% (2005 - 36.12%)	**(829,000)**	(531,900)
Stock-based compensation	**156,000**	143,600
Expenditures incurred relating to prior year renouncement	**164,900**	191,300
Non-deductible expenses and other items	**50,100**	8,700
Change in valuation allowance	**183,900**	(95,200)
Effect of change in opening balances	**195,700**	232,300
Future income tax provision (recovery)	**(78,400)**	(51,200)

The future income tax assets and liabilities result from differences between the carrying amount and the tax basis of the following:

	2006 $	2005 $
Future income tax assets		
Non-capital losses	**2,409,900**	2,198,000
Property, plant and equipment	**90,700**	84,000
Share issue costs	**3,500**	11,000
	2,504,100	2,293,000
Valuation allowance	**(2,425,700)**	(2,241,800)
Net future income tax asset	**78,400**	51,200
Future income tax liability		
Tax effect of flow-through shares	**(78,400)**	(51,200)
Net future tax asset (liability)	-	-

Financial Information (Cont'd)

The Company has financed part of the start-up phase of renewable energy and energy conservation projects through the issuance of flow-through shares. Under the terms of the flow-through share agreements, the tax attributes of the related expenditures are renounced to subscribers. To recognize the foregoing tax benefits to the Company, the carrying value of the shares issued is reduced by the tax effect of the tax benefits renounced to subscribers. The tax effect of the renouncement is recognized on the date the Company files the renouncement documents with the tax authorities to renounce the tax credits associated with the expenditures, provided there is reasonable assurance that the expenditures will be made.

As at May 31, 2006, the Company had available income tax loss carry forwards in the following amounts which may be used to reduce federal and provincial taxable income.

Year of Expiry	Amount $
2007	2,027,000
2009	1,086,000
2010	1,395,000
2014	355,000
2015	533,000
2026	1,276,000
Total	6,672,000

14 OTHER REVENUE

	2006 $	2005 $
Write-off of due to past President	**232,305**	-
Gain on extinguishment of liabilities	**57,909**	87,906
	290,214	87,906

After review by the past President, creditors and the Company, in June 2005, an agreement was reached to reduce the resulting obligations to the past President to $50,000. A cheque for this amount was issued in August 2005 (note 7).

15 OTHER COSTS

In fiscal 2006, costs incurred to remedy a design deficiency for a project were charged to other costs in the amount of $310,096 (2005 - $nil).

16 SEGMENTED INFORMATION

The Corporation operates in one operating segment - energy conservation and environmental compliance (air). Within this business segment, the Corporation markets, sells, engineers, fabricates, constructs, installs and supports two retrofit technology lines - waste energy recovery solutions and air pollution control solutions. Revenue is derived mainly from engineering and constructing the complete retrofit energy recovery and air pollution control solution, with some revenue derived from the custom fabrication and assembly of the proprietary hardware components and the core major equipment package of the technologies. All assets are located in Canada.

Two unaffiliated customers accounted for 100% of sales in 2006 and in one customer accounted for 100% in 2005. The Company continues to work aggressively with other partners and potential new partners to attract new customers.

17 FINANCIAL INSTRUMENTS

The following methods and assumptions were used to determine the estimated fair value of each class of financial instruments.

Short-term financial instruments

The fair value of the short-term financial assets and liabilities approximates their carrying amount given that they will mature shortly.

Loans receivable

The fair value of loans receivable, all of which have been granted to directors and officers, has not been determined because such transactions have been negotiated with non-arm's length parties.

Foreign exchange risk

The Company is exposed to foreign exchange risk due to accounts payable denominated in U.S. dollars. As at May 31, 2006, accounts payable denominated in U.S. dollars totalled US$17,007 (US$56,561 at May 31, 2005).

The Company does not enter into arrangements to hedge its foreign exchange risk.

18 CONTINGENCY

On October 20, 2005 the Company announced that the voluntary mediation between the Company and its past President had ended without resolution. On October 25, 2005 the Company announced that it had been served with a statement of claim for $2.3 million from its past President. On December 2, 2005 the Company announced that it had filed its statement of defence and had filed a counterclaim seeking damages from the past President in the amount of $5.0 million. The Company is confident in the merits of its own case and that the claim by the past President is frivolous and without merit and the Company will defend it vigorously. Accordingly, no provision for any potential loss has been recorded in connection with this claim.

19 COMPARATIVE FIGURES

Certain comparative figures have been reclassified to conform with the presentation adopted in the current year.

Information for Shareholders

Board of Directors

John R. Parker, Chairman of the Board
Tim K. Angus
R. James Ansell
Mark Lloyd
Clint Sharples
Michael Williams
John Kelly

Officers and Senior Management

Tim Angus
President & CEO

Denis Forget, P. Eng
Vice President Engineering & Director of Project Management

Gustav Pliva
Manager, Corporate Development & Human Resources & Corporate Secretary

Oliver Toffoli, P. Eng
General Manager & CFO

Auditors

Raymond Chabot Grant Thornton LLP

General Counsel

Heenan Blaikie LLP

Registrar & Transfer Agent

Computershare Investor Services, Inc.
100 University Avenue, 11th Floor
Toronto, ON M5J 2Y1
Tel: (416) 263-9496

Stock Listing

The common shares of Thermal Energy International Inc., are traded on the TSX Venture Exchange (www.tsxventure.com) under the symbol "TMG"

Investor Relations

Stuart McCarthy
http://www.thermalenergy.com
investor@thermalenergy.com

Annual Meeting

The Annual and Special Meeting of Shareholders will be held on:
Thursday, February 1, 2007, at 9:00 a.m. EST
Brookstreet Hotel in the Mulligan Room
525 Legget Drive,
Kanata, Ontario

Company Address

Thermal Energy International Inc.
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