MANAGEMENT'S DISCUSSION & ANALYSIS – 2009

Overview

This discussion explains the material changes in Thermal Energy International Inc's ("Thermal Energy" or the "Company") financial condition and results of operations for the fiscal year ended May 31, 2009 (or FY 2009), and compares the FY 2009 financial results to the previous year ended May 31, 2008 (or FY 2008). 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 an innovative technology company providing custom energy and emission reduction solutions. Our award winning energy recovery, conservation, bioenergy and condensate return solutions provide significant financial and environmental benefits to our customers.

Thermal Energy engages clients through a unique mix of process, energy, environmental, financial and other expertise combined with the best technology solutions and financial offerings. The Company's client can expect compelling returns and solutions with an excellent track record of longevity, proven reliability and performance.

More information on Thermal Energy can be found at www.thermalenergy.com.
FLU-ACE®, THERMALONOx™, DRY-REX™ and GEM™ are 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 United States, Canada, Europe ("EU"), and China 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 a number of proprietary energy and emission reduction technologies and solutions, designed specifically to cost-effectively reduce our customers energy use and emissions.

Thermal Energy is well positioned to provide the United States, Canada, EU, and China with the best available products, technologies, and solutions to most economically meet both the medium-term and longer-term energy conservation objectives. In order to leverage the sales of its proprietary technologies worldwide Thermal Energy continues to develop a number of strategic alliances, cooperative partnerships, and synergistic sales agencies and agreements with companies in all of its key markets.

Energy Conservation and Environmental Compliance Solutions Business

Thermal Energy'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 utility, 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 Company delivers superior proprietary and patented environmental compliance and energy conservation technologies coupled with comprehensive engineering and implementation services.

Thermal Energy's core business provides three primary client benefits:

1. Energy consumption & cost reduction;
2. Commensurate greenhouse gas and emission reductions;
3. Excellent financial returns.

The Company provides this through two core focus areas:

1. Energy Solutions
2. Environmental research and development

Energy Solutions: The Companies energy solutions portfolio comprises three primary technologies:

- **FLU-ACE® waste heat recovery:** This proprietary technology was developed by Thermal Energy to recover 75% or more of the heat wasted through exhausts. FLU-ACE® systems are designed to process exhaust gas from combustion of all fuel types, plus process exhaust from dryers such as from pulp and paper, and food and beverage industries. This waste heat is captured as condensed hot water and returned to process which displaces the use of fossil fuel and reduces energy costs with commensurate emission reductions.

- **DRY-REX™ low temperature biomass dryer:** This patented technology was acquired in 2006. DRY-REX™ dries large quantities of biomass and biowaste at relatively low temperature. It can recover energy from "waste" heat sources and reduces air quality concerns. It turns waste such as bark and sludge into high quality biofuels.

- **GEM® Condensate Return System:** The GEM® Condensate return System is a permanent replacement for traditional, mechanical steam traps. GEM® results in lower steam production costs, lower greenhouse gas emissions and improved steam efficiency. Thermal Energy acquired GEM in June 2008.

Environmental Research and Development: Thermal Energy is currently engaged in research and development of the THERMALONOx™ technology for reducing nitrogen oxide emissions (NOx) from coal-fired power plants and other industrial sources. A joint venture is under way at the South China University of Technology (SCUT), supported by Chinese government agencies, to establish a pilot demonstration facility which is expected to lead to the eventual commercialization of THERMALONOx™.

More information may be found on the Company's products, technologies and solutions by visiting the website at www.thermalenergy.com.

Throughout FY 2009 the Company maintained its close working relationship with Johnson Controls L.P. ("JCI") for developing combined energy conservation and air pollution control solutions for their selected Canadian and U.S. customers.

In FY 2008 the Company through its wholly-owned subsidiary, ForEverGreen Energy Inc. (FEI), implemented a 6 year contract with Fraser Paper Inc.'s Thurso mill for the delivery of "green" energy. Thermal Energy continues with monthly invoicing to the customer for the supply of green energy. However, the Thurso mill was temporarily shut down at the beginning of Q1 FY 2010 for an undetermined period of time and presents some risk to the Corporation if it does not re-open or at worse if Fraser Paper Inc. files for bankruptcy.

The Company was successful in financing its working capital requirements to support its business development efforts, by raising capital through the completion of a brokered private placement. The private placement with gross proceeds of $15,000,000 closed on June 21, 2008. The financing consisted of the issuance of 68,181,818 common shares at $0.22 per share. The funds raised were to complete the acquisition of Gardner Energy Management Ltd. in the U.K. (requiring approximately CAD$5.4 M) and to provide the Corporation a funding base for future investment in its business.

The Company incurred a net loss during the year of $3,205,377 compared to $2,372,508 during the previous year and has an accumulated deficit at year-end of $24,209,973. The Company's ability to continue as a going concern has improved by obtaining a significant level of financing in the amount of $15M through a brokered private placement in Q1 FY2009 but will continue to improve only by executing new solution sales contracts that results in achieving or exceeding targeted gross margins.

Revenues and Gross Profits

Revenues were $3,958,922 in FY 2009 compared to $4,926,208 in FY 2008. Revenues decreased by 19.6% in FY 2009 compared to FY 2008 due to a reduced carry-over volume of revenue from the previous year and without new secured solution sales.

The gross profit of $2,363,629 in FY 2009 improved substantially from a gross profit of $608,024 in FY 2008. These results expressed as a percentage of sales were 59.7% in FY 2009 compared with 12.3% in FY 2008. The current year profit was due to the additional revenue stream from consolidating the newly acquired GEM Ltd.

Expenses

Administration expenses in FY 2009 were $2,033,475 compared with $1,228,984 in FY 2008. The increase was due mainly to GEM administration costs of $692,528. Other increases arose in general administration and salary increases.

Selling, marketing and business development expenses were $3,036,714 in FY 2009 compared to $1,314,208 in FY 2008, an increase of $1,722,506 or 231.10%. The major changes were GEM costs of $1,557,519 and increases due to the hiring of new sales personnel with associated costs of approximately $335,000, severance costs of $99,950 and offset by a reduction of $152,921 in stock-based compensation.

Legal expenses in FY 2009 were $90,459 including $28,076 from GEM, and combined was a significant decrease compared to the amount of $331,836 incurred in FY 2008. The greater expenses of the previous year were one time charges related to the litigation by the past President and CEO against the Company and $120,000 and legal costs by U.K. lawyers in assisting with the acquisition of GEM Ltd.

Audit expenses in FY 2009 were $55,794 including $27,038 from GEM and compared to $72,839 in FY 2008. The apparent reduction in fees is a result of not recognizing audit fees related to FY 2009 until these are actually incurred.

Insurance expenses were $119,274 in FY 2009 including $16,359 from GEM and compared with $127,993 in FY 2008 due to a reduction in premiums and a gain on settlement with a supplier of $15,445.

Patent and trademark maintenance costs were $18,151 in FY 2009 compared to $13,587 in FY 2008 with respect to countries where patents have been granted. Patent and trademark maintenance costs are expensed as incurred. The increase in costs year over year was due to costs of $1,060 from GEM and additional reporting requirements pending the testing of the Company's THERMALONOx™ technology.

Research and Development costs increased in FY 2009 to $204,880 compared to $87,572 in FY 2008. The increase was due to costs of $13,115 from GEM and equipment purchases and the costs for the container shipment of the equipment to China.

Amortization of property, plant and equipment was $51,220 in FY 2009 including $21,466 from GEM and compared with $31,314 in FY 2008.

Amortization of intangible assets was $170,958 in FY 2009. These assets were acquired on the purchase of Gardner Energy Management Ltd. and represent the amortization of the estimated useful life of these assets since the acquisition.

Interest revenue

Interest revenue of $77,891 in FY 2009 compared to $32,098 in FY 2008 resulting from higher levels of short-term investments.

Finance revenue

Finance revenue was $262,184 in FY 2009 compared to $56,201 in FY 2008. The Fraser Paper contract in Thurso, Quebec was delivered through the THERMAL-AUD program and was accounted for as a sales-type lease and accordingly, a portion of the payments received under the lease agreement were recognized as finance revenue.

Net Loss

Net Loss was $3,205,377 in FY 2009 compared to a net loss of $2,372,508 in FY 2008. Together with the changes summarized above, insufficient sales volume to cover the current level of fixed costs in the Company to produce a net profit continued. Management continues to work hard to control overhead costs but its main focus at the present time is to leverage the sales of its proprietary technologies worldwide in a cost effective manner by continuing to develop a number of strategic alliances, cooperative partnerships, and synergistic sales agencies and agreements with companies in all of its key markets.

Liquidity

The working capital of $3,791,332 at the end of FY 2009 increased significantly compared to the working capital deficiency of $2,093,061 at the end of FY 2008. Current assets increased by $4,144,553 to $5,824,562. The substantial improvement in working capital was the result of the private placement in June, 2008. Cash and short-term investments increased by $2,728,022, accounts receivable by $777,353, inventories by $554,577, the current portion of the net investment in lease by $105,545 and prepaids and other assets by $135,036 while contracts in progress decreased by $156,000. Current liabilities decreased by $1,739,860 to $2,033,230. The changes were the result of decreases in the bank loan of $239,580, accounts payable of $1,438,592 and deferred revenue of $363,916, offset by an increase in accrued liabilities of $302,228.

Management continues to recognize the requirement to maintain 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

Management's discussions which began in the fourth quarter of FY 2008 to structure a multi-million dollar financing of its new Business Plan involving the acquisition of GEM Ltd., of Bristol, U.K., culminated with the successful completion of a brokered private placement with gross proceeds of $15,000,000 in the first quarter of fiscal year 2009. The proceeds raised were used for completing the acquisition of GEM, to expand sales and marketing efforts in North America, Europe and China.

Related Party Transactions

In FY 2009 Directors were paid fees for services of $113,000 and Officers were paid $132,000. The Chairman of the Board of Directors was paid an annual fee of $18,000. Additionally, one other Director was paid $50,000 for consulting services pertaining to the financing of the GEM acquisition.

800,000 common shares were issued to Directors in 2009.

Options outstanding for Directors as at May 31, 2009 were 3,500,000 of which 2,961,000 were exercisable. There were 37,500 warrants outstanding for Directors.

Loans including accrued interest to enable the exercise of options and purchase shares in the amount of $381,139 for Directors, $184,960 for Officers and $321,971 for other shareholders were outstanding at May 31, 2009.
The shares acquired by exercising options will be held by the Company until the loans are repaid.

Management Compensation Disclosure

Compensation paid to directors and officers was as follows:

	Salaries and fees		**Commissions**		Total	
	2009	2008	**2009**	2008	2009	2008
	$	$	**$**	$	$	$
Directors						
T. Angus	**174,000**	169,400	**-**	19,278	174,000	188,678
J. Parker	**25,500**	25,500	**-**	-	25,500	25,500
M. Williams	**7,500**	7,500	**-**	-	7,500	7,500
C. Sharples	**7,500**	7,500	**-**	-	7,500	7,500
J. Ansell	**7,500**	7,500	**-**	-	7,500	7,500
J. Kelly	**7,500**	7,500	**-**	-	7,500	7,500
W. Crossland	**57,500**	58,125	**-**	-	57,500	58,125
M. Lloyd	**-**	3,125	**-**	-	-	3,125
Total	**287,000**	286,150	**-**	19,278	287,000	305,428
Officers						
O. Toffoli	**132,000**	107,000	**4,219**	29,436	136,219	136,436
D. Forget	**-**	64,000	**-**	31,408	-	95,408
A. Pugliese	**96,750**	84,286	**-**	22,571	96,750	106,857
A. Pugliese - severance	**75,250**	-	**-**	-	75,250	-
G. Pliva	**43,350**	57,800	**-**	-	43,350	57,800
G. Pliva - severance	**17,500**	-	**-**	-	17,500	-
Total	**364,850**	313,086	**4,219**	83,415	369,069	396,501

Segmented Information

In fiscal 2009 and 2008 the Company operated in the energy conservation and environmental compliance (air) industry in North America and Europe (only North America in 2008) and was also engaged in the start-up phase of similar operations in China. Within this business segment, the Corporation markets, sells, engineers, fabricates, constructs, installs and supports three retrofit technology lines – waste energy recovery solutions, air emission control solutions and condensate return system solutions. Assets are located in Canada and Europe.

The Company operated in three reportable segments in fiscal 2009 (two in 2008). In the waste energy recovery and air emission control business, customers finance these projects entirely from their own resources or through the Company's Thermal-AUD™ system whereby the Company finances the project and leases back the facility to the customer. This gives rise to two reportable segments. The third segment is in the condensate return system solutions business through its acquisition of Gardner Energy Management Limited (GEM™) on July 1, 2008. These three reportable segments are detailed below:

	Customer financed Contracts and other		Thermal-AUD™ contract		GEM™	
	2009	2008	2009	2008	2009	2008
	$	$	$	$	$	$
Revenue from external customers	725,603	2,716,366	-	2,209,842	3,233,319	-
Inter-segment revenues	127,068	19,111	-	-	96,206	-
Interest and finance revenue	82,823	32,098	262,184	56,201	345	-
Interest and bank charges	7,623	13,503	30,870	6,914	66,573	-
Amortization of property, plant and equipment	29,754	31,314	-	-	21,466	-
Amortization of intangibles	-	-	-	-	149,691	-
Segment loss (profit)	2,985,492	2,391,014	(100,978)	(18,506)	400,619	-
Expenditures for property, plant and equipment	25,318	28,768	-	-	13,773	-
Expenditures for intangible assets	-	-	-	-	1,679,000	-
Expenditures for goodwill	-	-	-	-	3,449,799	-
Total assets	6,450,829	2,755,526	2,064,620	2,225,562	6,370,073	-

Reconciliation to financial statements	2009 $	2008 $
Revenues		
Total revenues for reporting segments	4,182,196	4,945,319
Elimination of inter-segment revenues	(223,274)	(19,111)
Total company revenues	3,958,922	4,926,208
Loss		
Total loss for reported segments	3,205,377	2,572,508
Income tax recovery	-	(200,000)
Net loss	3,205,377	2,372,508
Assets		
Total assets for reported segments	14,885,522	4,981,088
Elimination of inter-segment receivables	(1,727,911)	(1,287,087)
Elimination of other inter-segment assets	(607,181)	-
Total assets	12,550,430	3,694,001

Other significant items	2009			2008		
	Segment totals	Adjustments	Company totals	Segment totals	Adjustments	Company totals
	$	$	$	$	$	$
						-
Interest and finance revenue	345,352	(5,277)	340,075	88,299	-	88,299
Interest and bank charges	105,066	(5,277)	99,789	20,417	-	20,417
Amortization of property, plant and equipment	51,220	-	51,220	31,314	-	31,314
Amortization of intangible assets	170,958	-	170,958	-	-	-
Expenditures for property, plant and equipment	39,091	-	39,091	28,768	-	28,768
Expenditures for intangible assets	1,679,000	-	1,679,000	-	-	-
Expenditures for goodwill	3,449,799	-	3,449,799	-	-	-

Geographic Segments	Revenues		Property, plant & equip		Goodwill & intangibles		Sales-type lease	
	2009	2008	**2009**	2008	**2009**	2008	**2009**	2008
	$	$	**$**	$	**$**	$	**$**	$
Canada	**53,028**	2,382,444	**60,630**	65,066	**-**	-	**2,002,864**	2,175,940
United States	**749,575**	2,507,137	**-**	-	-	-	-	-
Europe	**3,077,302**	-	**37,112**	-	4,957,841	-	-	-
China	**79,017**	36,627	**-**	-	-	-	-	-
Total	**3,958,922**	4,926,208	**97,742**	65,066	**4,979,108**	-	**2,002,864**	2,175,940

Revenues from outside customers are attributed to the geographic segments based on the location of the project.

Supplementary Financial Information

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

Financial information for the years ending
May 31, 2007, May 31, 2008 and May 31, 2009

	2007 $	2008 $	2009 $
Sales	821,024	4,926,208	3,958,922
Net loss	(2,443,265)	(2,372,508)	(3,205,377)
Net loss per share – basic and diluted	(0.031)	(0.025)	(0.020)
Total assets	2,131,163,	3,694,001	12,550,430

The earned revenue from sales in FY 2007, FY 2008 and FY 2009 are inconsistent in magnitude. In FY 2007, while secured sales orders increased to approximately $3.9 million year-over-year, because of long delays in the awarding of two contracts, the revenue recognized nonetheless fell significantly.

The net losses in FY 2007 were due to a significant drop in earned revenue from sales as a result of a three to four month delay encountered in signing its first two U.S. contracts.

While the net losses decreased slightly in FY 2008 compared to FY 2007, they remained consistent in magnitude due to cost over-runs and foreign exchange losses at the Phillips project in the amount of $380,163 and warranty related costs of $122,793 at Valley Regional Hospital, Minas Basin and Camco. Increased administration, selling, marketing and business development costs of $396,500, increased legal and insurance costs of $313,000 and $49,500 respectively all contributed to the loss.

The net losses increased in FY 2009 due to a decrease in carry-over volume of work from FY 2008, a decrease in new sales revenue, increases due to the hiring of 4 new sales personnel of $335,000, severance costs resulting from terminations of $99,950, additional GEM costs of approximately $1,557,000.

The variations in assets from FY 2007 through to FY 2009 were affected primarily by the closing of five private placements in the amount of $2,747,138 in FY 2007. The increase in assets for FY 2008 was primarily due to the accounting treatment of the Fraser Paper contract as a sales-type lease. The increase in asset in FY 2009 was due to the closing of a brokered private placement in the amount of $15,000,000.

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, 2009, 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 its FLU-ACE® technology solutions. In addition, the Company had not yet been able to complete the development and commercialization of its patented THERMALONOX™ technology at year end. The Cost Effective Energy Conservation and Environmental Compliance Solutions sales through the close working relationship with JCI and Honeywell China 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 quicker sales through its working relationship with JCI;
- The ability to grow sales through the establishment of new cooperative partnerships and strategic alliances;
- The ability to grow sales through the licensing of the corporation's technologies;
- The ability to secure and maintain the required outside working capital financing;
- The ability to achieve profitable operations through increased sales,
- Reliance on third party collaborations and license arrangements;
- Reliance on proprietary technology;
- Competition in the energy conservation and environmental compliance solutions;
- Product liability claims and insurance;
- Reliance on key personnel;
- The ongoing litigation with its former President & CEO;
- The ability to control costs and achieve a positive gross margin on projects; and,

- The effect of a prolonged recession in Canada, USA and Europe to the financial markets in securing project financing and in particular to industrial and commercial customers in committing capital to projects.
- The effect of a temporary or permanent plant shutdown at Fraser Paper Inc.'s Thurso plant.

Management's addressing of the risks:

The management of the Company realizes that the operating losses in FY 2009, display a consistent pattern of losses as in previous years. However with the previous fiscal year's losses partly attributed to new management transition costs and to remedial costs on past projects, the Company is now fully focused on sales and marketing and is expanding its drive towards that purpose with the addition of a number of new sales staff, sales agents, strategic alliances and cooperative partnerships to promote the Company's solutions in the United States, Canada, Europe and China.

The costs in FY 2009 associated with administration and sales, marketing and business development were necessary to advance the sales cycle forward which will become evident in future quarters.

Management believes that it can leverage off of its wholly-owned subsidiary's (ForEverGreen Energy Inc.) successful signing of an agreement of up to $3.75M with Fraser Paper Inc. to recover waste heat using the THERMAL-AUD™ program and use the same process in other mills.

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 Company's technologies.

Management is also increasing focus on key institutional markets which are anticipated to receive significant investment from the federal governments both in the US and Canada. This includes a focus on hospitals, universities and government facilities. In line with the strategy, the Company is focused on leveraging the current relationship with JCI and building new relationships with other Energy Service Companies which are expected to benefit greatly in the US by the new administration's spending plans and loan guarantees to increase energy efficiency of institutional facilities.

Management has demonstrated that it can secure outside working capital as evidenced by the successful closings of its private placement with gross proceeds of $778,639, in Q3 FY 2007, with gross proceeds of $1,968,500 in Q4 FY 2007 and with gross proceeds of $1,017,750 in Q3 FY 2008. In addition, during this period, it has realized $200,000 through the closing of smaller private placements and the exercise of options and warrants. Finally, in Q1 FY 2009, management closed an oversubscribed brokered private placement of common shares with gross proceeds of $15,000,000.

Management believes that by maintaining its small core of personnel, reducing non-essential employee costs and miscellaneous overhead and higher margins on more secured contracts, it will achieve profitable operations. Small incremental staffing increases will be introduced from time to time as evidenced in FY 2009 depending on the demand arising from increased sales volumes, however management has also been aggressively implementing measures to reduce total SG&A costs as evidenced by the reduction of five (5) employees in Q3 and Q4 FY 2009 due to deteriorating economic conditions.

Management has acquired GEM®, a leading European (Great Britain) line of industrial/commercial steam traps; and DRY-REX™, a technology that uses waste heat to turn bark, sludge and other biomass into high–efficiency bio-energy fuel for the pulp & paper and other industrial applications. In connection with these technologies, the Company has received multiple purchase orders from Dow Corning in Kentucky, Hemlock Semiconductor Corporation in Michigan, Anheuser-Busch, Inc. in Colorado, GlaskoSmithKline in North Carolina, Greenfield Ethanol in Chatham, Ontario, Alberta Envirofuels Inc., Rogers Sugar in B.C., CFB Kingston, CFB Trenton, Fraser Papers at Thurso, Catalyst Paper in B.C., Lee & Man Paper Manufacturing Co. and Jiangsu Huachang Chemical Co., Coca Cola, BASF, all located in China, and has conducted audits for its implementation at other industrial sites and awaits new trial orders.

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.

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

Management believes that competition against its core technology of FLU-ACE™and DRY-REX® is limited at this time and believes that the market place is sufficiently large enough to permit stronger competition in the future. Management also believes that while there is greater competition to its newly acquired GEM® product line, that the Company is well positioned to penetrate the market with a far superior product. It is the opinion of management 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.

The Company is adequately protected in its contract with Fraser Paper Inc. for payments arising from a temporary shutdown of the mill on an established per diem rate. If the temporary shutdown becomes a permanent shutdown, Fraser Paper is obligated to pay a lump sum payment and the Company is required to remove the equipment within six months of such notification. However, the Company has no control or ability to recoup any receivables in the event of a declared bankruptcy by Fraser Papers Inc.

Highlights

On June 23, 2008, the Corporation announced that it had closed an oversubscribed brokered private placement of common shares with gross proceeds of $15,000,000. The placement was subscribed by a number of the most recognized renewable energy and sustainability focused funds in Toronto, New York and London (U.K.). The funds raised were to complete the acquisition of Gardner Energy Management Ltd. in the U.K. (requiring approximately CAD$5.4 M) and to provide the Corporation a funding base for future investment in its product line of assets under THERMAL-AUD™ green energy supply contracts. The financing which was handled by agents

Max Capital Markets Ltd. and Jacob and Company Securities Inc. (both headquartered in Toronto) consisted of an issuance of 68,181,818 commons shares of the Corporation at a price of $0.22 per share.

On July 2, 2008, the Corporation announced that it had completed the acquisition of Gardner Energy Management Ltd. ("GEM") of Bristol, U.K. Under the terms of the transaction, the Corporation made a base payment of 2.7 M British Pounds Sterling (or CAD $5.4M) upon closing on July 1, 2008. An additional payment of up to 1.3 M British Pounds Sterling (or CAD $2.6M) may be made on an earn-out basis in a combination of cash and shares over a three-year period subject to defined future growth targets of the GEM® business unit.

On September 22, 2008, the Corporation announced the launch of a new "quick fit" line of Emerald traps for its GEM® Condensate Return System. The Emerald GEM® Trap is compatible with other manufacturers' fittings, which allows them to be easily bolted on to existing connectors. These "quick fit" traps as well as the entire series of GEM® Traps were showcased at the Oil Sands Trade Show in Edmonton, Alberta between September 23 and 24, 2008.

On November 6, 2008, the Corporation announced the appointment of numerous sales, marketing and business development staff in Canada, United States and Europe.

On November 20, 2008, the Corporation announced that it had shipped equipment to China for demonstration-scale testing of its THERMALONOx™ process for reducing nitrogen oxides (NOx) for power plants. The equipment is to be installed at Guangzhou Yuanchun Cogeneration Co., Ltd., a 50 MW power plant in Guangdong province, China, under the joint venture research and development program with the South China University of Technology.

On December 1, 2008, the Corporation announced that the resolutions presented in the Management Information Circular of October 16, 2008 were approved by shareholders at Annual and Special Meeting held on November 25, 2008. The Corporation also gave an update to a press release made on June 3, 2008 by stating that the proposed project had been scaled back due to a number of changes at the client's site resulting in a reduction of approximately 50% to the proposed project still under negotiations.

On February 16, 2009, the Corporation announced that the project initially referred to in a press release made on June 3, 2008, followed with an update in the press release made on December 1, 2008, has been removed from the sales pipeline and forecast and that the Corporation no longer anticipates the project proceeding in the foreseeable future. The reasons given by the customer was related to capital appropriation and availability challenges under the current economic conditions.

On April 17, 2009, the Corporation announced the departure of Anthony Pugliese, Vice President of Sales.

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 2010, the Corporation has been focused equally on direct sales and cooperative sales development activities in Canada, USA, Europe and China. The majority of the Corporations' sales, marketing, and business development resources have been utilized in support of some direct sales development activities through independent sales agents in Michigan, Maine, Ontario, Quebec, British Columbia, Alberta, Mexico and China to selected industrial process facilities where existing customer relationships are already in place and to a lesser extent in support of the Johnson Controls' cooperative energy solutions sales development activities.

The Corporation anticipates that these initiatives will produce increased sales revenues and gross profit and become a harbinger for continued improvement to the Consolidated Balance Sheet.

On June 8, 2009, the Corporation announced that it had concluded an agreement with Kemco Systems Inc. (Kemco) of Clearwater, Florida to become the exclusive distributor of Kemco products in all areas globally except North and South America. Kemco is a recognized leader in providing high efficiency, environmentally friendly water heaters, heat recovery and water treatment systems that will save water, labour, energy, sewer and chemical costs.

On June 9, 2009, the Corporation announced that it had secured several important orders for the GEM business in the Middle East and China. One order in excess of CAD$450,000 was from the Kuwait National Petroleum Corp at its Mina Al-Ahmed refinery located in Kuwait. The other two orders in excess of CAD$200,000 from an European based global pharmaceutical corporation for its plants in North East China.
On July 22, 2009, the Corporation announced that it had received an order of 215,000 British Pound Sterling (approximately CAD$393,000) from a hospital located in Belfast, Northern Ireland to install a condensing heat recovery system. This is the first contract secured under the Corporation's new exclusive distribution agreement for the Kemco product lines.

On August 7, 2009, the Corporation announced that Tim Angus resigned as President and CEO and as Director from the Corporation's board for personal reasons and William Crossland was appointed President and CEO.

On August 21, 2009, the Corporation announced that Clint Sharples resigned from the Board of Directors, effective August 20, 2009 in order to pursue other business opportunities.

On September 15, 2009, the Corporation announced Board of Director and Officer changes. John R. Parker resigned as Chairman of the Board and Director of the Corporation. John Kelly was appointed as Chairman of the Board. Oliver Toffoli resigned as Chief Financial Officer of the Corporation but is to remain with the company in the areas of operations and project management. Michael Williams assumed the role of Chief Financial Officer on an interim basis until such time as a permanent replacement can be appointed.

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 to 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.

William Crossland	Michael Williams
President & CEO	CFO