



An Innovative Technology Company Providing
Custom Energy and Emission Reduction Solutions

▶ Third Quarter Report – FY 2007

Period ending February 28, 2007



THERMAL ENERGY INTERNATIONAL INC.
 Incorporated under the Ontario Business Corporations Act

CONSOLIDATED BALANCE SHEETS

As at	(Unaudited) Feb 28 2007 \$	May 31 2006 \$
ASSETS		
Current assets		
Cash	16,041	59,119
Accounts receivable (note 5)	539,956	626,495
Contracts in progress	-	89,000
Prepays and other assets	29,116	41,777
	585,113	816,391
Loans receivable (note 7)	17,000	55,500
Property, plant and equipment (note 8)	73,486	59,539
	675,599	931,430
LIABILITIES, CAPITAL STOCK, CONTRIBUTED SURPLUS AND DEFICIT		
Current liabilities		
Accounts payable	618,386	947,063
Accrued liabilities	132,920	166,728
Deferred revenue	866,373	99,000
Due to past President (note 6)	17,937	17,937
	1,635,616	1,230,728
Capital stock, contributed surplus and deficit		
Capital stock (note 9)	15,284,018	14,462,279
Contributed surplus (note 9)	1,748,090	1,509,232
Deficit	(17,992,125)	(16,270,809)
	(960,017)	(299,298)
	675,599	931,430

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

On behalf of the Board

Tim K. Angus
 President and C.E.O.

Oliver Toffoli
 Chief Financial Officer

THERMAL ENERGY INTERNATIONAL INC.

CONSOLIDATED OPERATIONS AND DEFICIT
(Unaudited)

	Three months ended		Nine months ended	
	February 28		February 28	
	2007	2006	2007	2006
	\$	\$	\$	\$
REVENUE				
Sales	108,199	655,010	338,845	1,844,554
Cost of sales	168,697	643,593	485,160	2,099,444
Gross profit (loss)	(60,498)	11,417	(146,315)	(254,890)
Expenses				
Administration	196,921	179,475	635,359	607,894
Selling, marketing and business development	378,352	155,497	880,480	662,551
Legal fees	12,962	40,656	15,029	97,700
Audit fees	15,000	11,250	45,000	42,647
Insurance	19,919	19,907	58,574	62,260
Amortization of property, plant and equipment	6,206	5,703	18,954	13,134
Patent and trademark maintenance	688	2,384	8,823	9,320
Research and development	24,361	21,344	71,725	53,855
Interest and bank charges	4,005	1,382	6,934	6,090
Foreign exchange gain	(3,609)	(11,667)	(1,226)	(7,101)
	654,805	425,931	1,739,652	1,548,350
	(715,303)	(414,514)	(1,885,967)	(1,803,240)
Other Revenue (note 12)	-	36,548	5,240	290,214
Interest revenue	148	1,008	412	10,572
Other Costs (note 13)	-	(25,206)	(36,001)	(288,990)
Loss before income taxes	(715,155)	(402,164)	(1,916,316)	(1,791,444)
Future income tax recovery (note 9)	(195,000)	-	(195,000)	-
Net loss	(520,155)	(402,164)	(1,721,316)	(1,791,444)
Deficit, beginning of period	(17,471,970)	(15,443,356)	(16,270,809)	(14,054,076)
Deficit, end of period	(17,992,125)	(15,845,520)	(17,992,125)	(15,845,520)
Net loss per share - basic and diluted	(0.01)	(0.01)	(0.02)	(0.03)
Weighted average number of common shares	79,287,780	67,660,770	76,808,458	66,077,972

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

THERMAL ENERGY INTERNATIONAL INC.

CONSOLIDATED STATEMENT OF CASH FLOWS
(Unaudited)

	Three months ended February 28		Nine months ended February 28	
	2007 \$	2006 \$	2007 \$	2006 \$
OPERATING ACTIVITIES				
Net loss for the period	(520,155)	(402,164)	(1,721,316)	(1,791,444)
Add items not involving cash:				
Non-monetary compensation charge	228,110	16,451	404,351	365,853
Amortization of property, plant and equipment	6,206	5,703	18,954	13,134
Future income taxes (note 9)	(195,000)	-	(195,000)	-
Past President loan to acquire shares expensed	-	-	151,500	-
Changes in non-cash operating working capital				
Accounts receivable	(498,589)	(279,067)	86,539	(411,612)
Contracts in progress	-	12,000	89,000	2,000
Prepays and other assets	948	(6,352)	12,661	(34,046)
Accounts payable	(149,397)	(115,337)	(328,677)	513,016
Accrued liabilities	(39,256)	(39,894)	(33,808)	(195,933)
Deferred revenue	822,373	117,000	767,373	205,000
Changes in due to the past President (note 6)	-	(36,548)	-	(283,035)
Net cash used in operating activities	(344,760)	(728,208)	(748,423)	(1,617,067)
INVESTING ACTIVITIES				
Reduction in short term investments	-	506,199	-	800,263
Additions to property, plant and equipment	-	(8,423)	(32,901)	(40,631)
Net cash used in investing activities	-	497,776	(32,901)	759,632
FINANCING ACTIVITIES				
Common shares issued (note 9)	316,746	325,100	699,746	873,767
(Increase) decrease in loans receivable	20,000	-	38,500	(36,500)
Net cash provided by financing activities	336,746	325,100	738,246	837,267
Decrease in cash for the period	(8,014)	94,668	(43,078)	(20,168)
Cash beginning of period	24,055	59,382	59,119	174,218
Cash end of period	16,041	154,050	16,041	154,050
Interest paid	994	594	2,560	1,569

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

THERMAL ENERGY INTERNATIONAL INC.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)**

1 These interim unaudited financial statements follow the same accounting policies and methods as in the audited financial statements prepared for the year ended May 31, 2006 and should be read in conjunction with those statements.

2 **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.

3 **GOING CONCERN**

The Company incurred losses from operations in the quarter and nine months ended February 28, 2007 and 2006. It had a working capital deficiency at February 28, 2007 and 2006.

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.

4 **SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The results of the first nine months of fiscal 2007 were stated utilizing the same accounting policies and methods of application as in the audited financial statements for the year ended May 31, 2006.

5 **ACCOUNTS RECEIVABLE**

	Feb 28, 2007	May 31, 2006
	\$	\$
Trade	510,013	517,914
Other	29,943	108,581
	539,956	626,495

In the quarter ended February 28, 2007, 90% of trade receivables were from one customer and 100% of sales were from two customers. In the year ended May 31, 2006, 90% of trade receivables and 99% of sales were from one customer.

THERMAL ENERGY INTERNATIONAL INC.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)**

6 RELATED PARTY TRANSACTIONS

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

	Feb 28, 2007	Feb 28, 2006
Transactions with and balances owing to/from directors		
Loans receivable	\$17,000	-
Accrued liabilities	-	\$6,750
Flow-through shares issued	293,125	-
Directors share options and warrants outstanding at February 28th		
Options issued	4,000,000	2,200,000
Options exercisable	1,915,000	1,855,000
Warrants outstanding	66,667	-
Transactions with and balances owing to/from officers		
Accounts receivable	-	\$21,455
Accrued liabilities	-	\$2,667
Common shares issued	125,000	-
Flow-through shares issued	143,081	-
Officers share options outstanding at February 28th		
Issued	1,993,000	1,043,000
Exercisable	950,500	870,500

Transactions with officers were as follows:

	Quarter Ended February 28		Year to Date February	
	2007	2006	2007	2006
	\$	\$	\$	\$
Fees for services	48,000	46,500	144,000	139,500

Changes in the amounts due to the past President were as follows:

	Year to Date	Year Ended
	Feb 28, 2007	May 31, 2006
	\$	\$
Balance due to the past President, beginning of period	17,937	300,972
Debt settlement	-	(232,305)
Cash payment to the past President	-	(50,000)
Payments made on behalf of the past President	-	(730)
Balance due to the past President, end of period	17,937	17,937

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

7 LOANS RECEIVABLE

The loan receivable of \$17,000 represents an amount due from a director (May 31, 2006 - \$37,500 from a director, \$18,000 from an officer). This loan is due upon demand, bears no interest and has no fixed repayment terms.

THERMAL ENERGY INTERNATIONAL INC.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)**

8 PROPERTY, PLANT AND EQUIPMENT

	February 28, 2007		May 31, 2006	
	Cost	Accumulated	Cost	Accumulated
		Amortization		Amortization
	\$	\$	\$	\$
Furniture and fixtures	128,346	74,052	96,848	65,097
Computers	140,165	132,312	138,762	127,663
Software	12,081	12,081	12,081	12,081
Leasehold improvements	21,401	10,062	21,401	4,712
	301,993	228,507	269,092	209,553
Accumulated amortization	(228,507)		(209,553)	
Net book value	73,486		59,539	

9 CAPITAL STOCK AND CONTRIBUTED SURPLUS

	Quarter Ended Feb 28, 2007	
	# 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 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		
Balance, beginning of quarter	77,859,574	15,255,075
Issued in settlement of liabilities	225,016	36,002
Issued for cash, net of flow through share tax benefit (i)	1,917,162	111,746
Issued as a result of the exercise of options	50,000	13,000
	80,051,752	15,415,823
Less: loans outstanding to assist a shareholder in purchasing capital stock (ii)		(131,805)
Balance, end of quarter	80,051,752	15,284,018

	Year to Date Feb 28, 2007		Year Ended May 31, 2006	
	# Shares	\$	# Shares	\$
Class A Common shares issued				
Balance, beginning of period	74,570,256	14,733,084	63,198,899	12,776,987
Issued in settlement of liabilities	1,026,834	159,993	1,247,432	179,235
Issued for cash, net of flow through share tax benefit (i)	4,404,662	509,746	8,573,925	1,377,772
Issued as a result of the exercise of options	50,000	13,000	1,550,000	399,090
	80,051,752	15,415,823	74,570,256	14,733,084
Less: loans outstanding to assist a shareholder in Purchasing capital stock (ii)		(131,805)		(270,805)
Balance, end of period	80,051,752	15,284,018	74,570,256	14,462,279

(i) In February 2007, the Company renounced expenditures of \$540,000 from 3,484,334 flow-through common shares issued during fiscal 2007; as a result, a future income tax recovery of \$195,000 was charged against capital stock.

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)**

(ii) In fiscal 2006, the President received a shareholder loan of \$60,000 to purchase shares. A Loan to an officer of \$7,500 in the quarter ended February 28, 2007 and \$59,305 in fiscal 2006 to other shareholders to assist in the purchase of common shares were extended. 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 a weighted average volatility assumption of 74% (114% fiscal 2006) and for both years an expected dividend rate of 0%, risk free interest rate of 3.85% and an expected life of one year.

In fiscal 2006 and 2007 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.

(a) Activity in warrants was as follows:

	Quarter Ended Feb 28		Year to Date Feb 28	
	2007	2006	2007	2006
Balance, beginning of period	8,588,228	10,941,364	10,154,896	12,024,698
New	605,250	-	1,862,162	-
Exercised	-	(2,020,000)	-	(2,933,334)
Expired	(163,088)	(145,363)	(2,986,668)	(315,363)
Outstanding, end of period	9,030,390	8,776,001	9,030,390	8,776,001

(b) The following table summarizes the status of warrants outstanding at February 28, 2007:

Warrants Outstanding	Exercise Price \$	Expiry Date
3,300,333	0.35	To June 3, 2007
3,867,895	0.30	To April 22, 2008
760,000	0.30	To October 10, 2008
260,000	0.30	To November 2, 2008
236,912	0.30	To November 30, 2008
324,000	0.30	To December 6, 2008
281,250	0.30	To December 29, 2008
<u>9,030,390</u>		

Contributed surplus

	Quarter Ended	Year to Date	Year Ended
	Feb 28, 2007	Feb 28, 2007	May 31, 2006
	\$	\$	\$
Balance, beginning of period	1,561,482	1,509,232	1,237,995
Stock-based compensation	192,108	244,358	431,827
	1,753,590	1,753,590	1,669,590
Fair-value of options exercised and transferred to capital stock	5,500	5,500	160,590
Balance, end of period	1,748,090	1,748,090	1,509,232

10 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	27,200
2008	106,000
2009	34,300
2010	2,000
Total	169,500

THERMAL ENERGY INTERNATIONAL INC.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)**

11 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 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 the third quarter and nine month periods ended February 28, 2007 and 2006 had vesting periods of four months.

(a) Activity in stock options was as follows:

	Quarter Ended Feb 28, 2007		Quarter Ended Feb 28, 2006	
	# Options	Weighted Average \$	# Options	Weighted Average \$
Outstanding, beginning of quarter	4,868,714	0.18	5,043,714	0.17
Granted	3,500,000	0.16	200,000	0.18
Exercised	(50,000)	0.15	-	-
Cancelled/expired	(575,714)	0.18	(525,000)	0.16
Outstanding, end of quarter	7,743,000	0.16	4,718,714	0.17
Number of options exercisable as at February 28	4,069,250		3,889,964	

	Year to Date Feb 28, 2007		Year to Date Feb 28, 2006	
	# Options	Weighted Average \$	# Options	Weighted Average \$
Outstanding, beginning of period	4,718,714	0.21	7,043,714	0.16
Granted	3,850,000	0.16	850,000	0.23
Exercised	(50,000)	0.15	(1,550,000)	0.15
Cancelled/expired	(775,714)	0.15	(1,625,000)	0.15
Outstanding, end of period	7,743,000	0.17	4,718,714	0.17
Number of options exercisable as at February 28	4,069,250		3,889,964	

Options exercised were as follows:

	Quarter ended Feb 28, 2007		Quarter ended Feb 28, 2006	
	# Shares	\$	# Shares	\$
Employees	50,000	0.15	-	-
Directors	-	-	-	-
Consultants	-	-	-	-
	-	-	-	-

	Year to Date Feb 28, 2007		Year to Date Feb 28, 2006	
	# Shares	\$	# Shares	\$
Employees	50,000	0.15	1,125,000	184,500
Directors	-	-	225,000	34,000
Consultants	-	-	200,000	20,000
	-	-	1,550,000	238,500

All options were exercised for cash.

THERMAL ENERGY INTERNATIONAL INC.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)**

(b) The following options are outstanding and/or exercisable at February 28, 2007:

Number of Options Outstanding	Number of Options Exercisable	Exercise Price Per Share \$	Expiry Date
193,000	193,000	0.10	January 12, 2008
250,000	250,000	0.20	January 24, 2008
1,000,000	915,000	0.10	February 1, 2008
500,000	457,500	0.12	February 1, 2008
150,000	103,750	0.24	March 1, 2008
900,000	900,000	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
350,000	350,000	0.21	September 7, 2009
3,500,000		0.16	December 20, 2009
7,743,000	4,069,250		

c) Stock-based compensation to employees

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

	Quarter Ended February 28		Year To Date February 28	
	2007	2006	2007	2006
Weighted average assumptions				
Expected dividend	0.00%	0.00%	0.00%	0.00%
Expected volatility	90%	90%	90%	100%
Risk-free interest rate	3.85%	4.00%	3.85%	4.00%
Expected option life in years	2.4	2.4	2.4	2.4
Fair value	\$0.15	\$0.08	\$0.15	\$0.14

12 OTHER REVENUE

Other revenue was \$Nil in the quarter ended February 28, 2007 and \$5,240 on a year-to-date basis and resulted from a legal settlement. In the quarter ended February 28, 2006 the amount of \$36,548 resulted from an adjustment to the obligations due to the past President. The 2006 year-to-date amount of \$290,214 included a gain of \$32,380 from the extinguishment of a liability and the balance of \$257,834 from an agreement reached with the past President.

13 OTHER COSTS

Other costs have been incurred to remedy a design deficiency of a project. In the quarter ended February 28, 2007, costs were \$Nil (2006 - \$25,206). In the nine months ended February 28, 2007 remedial costs were \$36,001 (2006 - \$288,990).

THERMAL ENERGY INTERNATIONAL INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

14 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 the quarter and nine months ended February 28, 2007 and one customer accounted for 99% of sales in 2006. The Company continues to work aggressively with other partners and potential new partners to attract new customers.

15 FINANCIAL INSTRUMENTS

Given that they will mature shortly, the carrying values of the Company's short-term financial instruments are equivalent to their carrying amounts.

The Company is exposed to foreign exchange risk due to accounts receivable and accounts payable denominated in U.S. dollars. As at February 28, 2007, accounts receivable and accounts payable denominated in U.S. dollars totalled US\$394,349 and US\$13,949 respectively (US\$Nil and US\$5,025 at February 28, 2006).

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

16 SUBSEQUENT EVENTS

On April 2, 2007 the Company announced that it had closed a non-brokered private placement with gross proceeds of \$189,000. The financing consisted of an issuance of 1,350,000 common shares at \$0.14 per share.

On April 27, 2007 the Company announced that it had closed a non-brokered private placement with gross proceeds of \$656,000. The financing consisted of an issuance of 4,100,000 common shares at \$0.16 per share.

17 COMPARATIVE AMOUNTS

Certain 2006 amounts have been reclassified to conform with the current period's presentation. This included stock-based compensation, previously presented separately in the Consolidated Operations and Deficit statement which has now been included in the expenses to which it relates. In the quarter ended February 28, 2007, \$12,322 (2006 - \$14,176) was reclassified to Administration and \$179,786 (2006 - \$2,275) to Selling, marketing and business development. In the nine months ended February 28, 2007 \$37,238 (2006 - \$229,080) was reclassified to Administration and \$207,120 (2006 - \$136,773) to Selling, marketing and business development.