



First QUARTER REPORT Period Ended August 31, 2008

MANAGEMENT DISCUSSION AND ANALYSIS

The following discussion explains material changes in the Corporation's financial condition and results of operations for the first quarter of fiscal year 2009, ended August 31, 2008. The quarterly financial statements constitute an integral part of the discussion and should be read in conjunction with these comments.

Description of Business

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 and bioenergy 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™, THERMALOZOMax™, GEM® and DRY-REX™ are trademarks of Thermal Energy. Common shares of Thermal Energy are traded on the TSX Venture Exchange under the symbol TMG.

In the first quarter ended August 31, 2008, the Corporation was successful in financing its working capital requirements to support its business development efforts, by raising capital in the amount of \$15,000,000 through the completion of a brokered private placement. The funds raised were to complete the acquisition of Gardner Energy Management Ltd. (GEM) in the U.K. on July 1, 2008 (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. GEM is the supplier of the GEM® Condensate Return System which is a permanent replacement for traditional, mechanical steam traps. GEM® results in lower steam production costs, lower greenhouse gas emissions and improved steam efficiency.

The acquisition of GEM provides the Corporation with the potential of cross-selling its own heat recovery solutions to GEM's key account base made up of Fortune 500 Companies.



Discussion of Operations and Financial Conditions

Revenue and Gross Profit

Total sales for the first quarter ended August 31, 2008, was at \$1,058,318, compared to \$1,048,357 in 2007 and comprised \$556,494 resulting from the acquisition of GEM.

Gross profit (loss) for the first quarter ended August 31, 2008 was at \$528,103 (49.90%) compared with \$262,952 (25.08%) in 2007. The increase in gross profits on a comparative basis from the same period in 2007 was due to better margins on similar revenues associated with the GEM acquisition.

Expenses

Administration expenses in the first quarter ended August 31, 2008 were \$527,579, an increase of \$243,306 or 85.59% over the \$284,273 incurred in 2007. The increase was mainly due to the addition of \$143,996 from GEM related costs and the remainder was due to increased costs of the Company associated with higher staffing levels i.e. salaries and related benefits. These accounted for approximately \$41,254 of the increase. Stock-based compensation also increased by \$39,069.

Selling, marketing and business development expenses in the first quarter ended August 31, 2008 were \$521,082, an increase of \$219,973 or 73.05% over 2007. The expenses of the Company decreased by \$46,095 and was offset by increases in expenses of GEM of \$266,068.

Legal expenses in the first quarter ended August 31, 2008 were \$9,585, compared to \$5,097 in 2007.

Audit fee provision in the first quarter ended August 31, 2008 was \$18,000, compared to \$15,000 incurred in 2007. The increase of \$3,000 was due to GEM related costs.

Insurance costs in the first quarter ended August 31, 2008 were \$34,248 an increase of \$4,072 compared to \$30,176 in 2007, mainly due to additional insurance costs of GEM.

Amortization of property, plant and equipment was at \$11,691 in the first quarter ended August 31, 2008 compared with \$7,693 in 2007, an increase of \$3,998, mainly due to GEM related costs.

Patent and Trademark maintenance costs were \$2,810 in the first quarter ended August 31, 2008, compared to \$Nil in 2007. All Patent and Trademark costs incurred by the Company are expensed as incurred.

Research and Development costs were \$71,643 in the first quarter ended August 31, 2008, compared to \$30,680 in 2007. The increase was primarily due to the purchase of equipment for the purpose of conducting tests of the THERMALONox™ technology in China for reducing nitrogen oxide emissions (NOx) from coal-fired



power plants and other industrial sources. Only a small amount of \$2,556 was related to GEM.

Interest and bank charges were \$30,894 in the first quarter ended August 31, 2008 compared with \$2,897 in 2007. Interest increased by \$17,300, \$11,250 from a bank loan in Canada, the balance from a bank credit line in the United Kingdom. Bank charges of approximately \$10,700 were mostly associated with accounts receivable discounting in the United Kingdom.

Foreign exchange loss on US dollar monetary assets and liabilities increased in the first quarter ended August 31, 2008 to \$33,312 compared with \$18,507 in 2007, as a result of the decreasing value of the Canadian dollar.

Interest revenue amounted to \$34,021 in the first quarter ended August 31, 2008 compared with \$14,675 in 2007 as a result of higher levels of short-term investments.

Finance revenue was \$85,052 in the first quarter ended August 31, 2008 from the THERMAL-AUD™ project in Quebec.

Net Loss before other comprehensive loss was \$616,086 in the first quarter ended August 31, 2008 compared to a net loss of \$417,895 in 2007. 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 a dedicated effort to secure much improved sales results and to provide an increase of capital projects relative to THERMAL-AUD™ financed projects in order to increase the level of revenues in future consolidated financial statements. This is discussed more fully elsewhere in this report.

Liquidity and Solvency

At August 31, 2008, the Company had a working capital of \$6,273,565 compared to a working capital deficiency of \$2,093,061 at May 31, 2008. Current assets of \$8,623,963 increased by \$6,943,934 from May 31, 2008. The substantial improvement in working capital was the result of the private placement in June 2008. Cash and short-term investments increased by \$5,849,922, accounts receivable by \$420,766, contracts in progress increased by \$38,000. Current liabilities at \$2,350,398 decreased by \$1,422,692 from May 31, 2008. The major changes were a decline in deferred revenue of \$384,908 a decrease in accounts payable of \$1,193,069, partially offset by an increase in bank loan of \$146,295.

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 this quarter. The proceeds raised were used for completing the acquisition of GEM, to expand sales and



marketing efforts in North America, Europe and China, to assist in project financing and for R&D testing activities of THERMALONOX™ in China.

Related Party Transactions

In the quarter ended August 31, 2008, Directors fees for services were \$15,750 compared with \$15,000 in 2007. Officers fees for services were \$33,000 compared with \$51,000. Loans to exercise options and acquire shares by Directors were \$289,647 at August 31, 2008 (2007, \$71,969). Loans to Officers to exercise options and acquire shares were \$278,800 at August 31, 2008 (2007, \$7,500). The shares acquired by exercising options will be held as security by the Company until the loans are repaid. Directors acquired 550,000 common shares for cash.

Segmented Information

In the quarter ended August 31, 2008 the Company operated in the energy conservation and environmental compliance (air) industry in North America and Europe 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 systems solutions. Assets are located in Canada and Europe.

The Company operated in three reportable segments in the quarter ended August 31, 2008 (one in 2007). 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 solutions business through its acquisition of Gardner Energy Management Limited (GEM™) on July 2, 2008. These three reportable segments are detailed below:

	Quarter Ended August 31, 2008		
	Customer financed contracts and other	Thermal-AUD™ contract	GEM™
	\$	\$	\$
Revenue from external customers	501,824	-	556,494
Inter-segment revenues	28,667	-	2,400
Interest and finance revenue	34,007	85,052	14
Interest expense and bank charges	1,859	11,259	17,776



Stock-based compensation charge	121,404	-	-
Amortization of property, plant and equipment	8,593	-	3,098
Segment loss (profit)	650,368	(42,626)	8,344
Segment assets	13,271,163	2,182,011	1,394,650
Expenditures for property, plant and equipment	16,444	-	-

Reconciliation to financial statements

August 31,
2008
\$

Revenues	
Total revenues for reporting segments	1,089,385
Elimination of inter-segment revenues	(31,067)
Total company revenues	1,058,318
Loss	
Total loss for reported segments	616,086
Net loss	616,086
Assets	
Total assets for reported segments	16,847,824
Elimination of inter-segment receivables	(1,416,402)
Total assets	15,431,422

Other significant items	Segment totals \$	Adjustments \$	Company totals \$
Interest revenue	34,021	-	34,021
Interest expense and bank charges	30,894	-	30,894
Finance revenue	85,052	-	85,052
Stock-based compensation charge	121,404	-	121,404
Amortization of property, plant and equipment	11,691	-	11,691
Expenditures for property, plant and equipment	16,444	-	16,444
Goodwill	4,804,213	-	4,804,213



Geographic Segments

	Quarter ended Aug 31, 2008 Revenues \$	As at Aug 31, 2008 Property, plant and equipment \$
Canada	4,889	1,958,153
United States	504,253	-
Europe	549,176	45,093
Total	1,053,318	2,003,246

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 most recent eight quarters. The quarterly information has been prepared on the same basis as the consolidated financial statements.

Quarterly financial information (unaudited)
For the eight quarters ended August 31, 2008

	2007			2008				2009
	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
Sales	127,987	108,199	482,179	1,048,357	618,200	509,074	2,750,487	1,058,318
Net loss	689,150	520,155	721,949	417,895	863,431	569,794	521,388	616,086
Net loss per Share basic And diluted	0.009	0.007	0.008	0.005	0.009	0.006	0.005	0.004

Trend Analysis:

The losses incurred in each quarter from Q2 FY 2007 through to Q1 FY 2009 are consistent in magnitude, with the exception of Q2 FY 2007, Q4 FY 2007, Q2 FY 2008 and Q1 FY 2009.

The losses in Q2 FY 2007 of \$689,150 are higher than the more consistent magnitude of losses in the range of \$500,000 due to a one-time charge to retire a previous shareholder loan of \$151,500 made to the past President to purchase shares in 1999 and due to the initial payment of \$40,000 for the Mabarex rights to their patented DRY-REX™ product.



The losses in Q3 FY 2007 decreased to \$520,155 from \$689,150 in Q2 FY 2007 due mainly to a future income tax recovery provision of \$195,000 arising from the renouncing of \$540,000 expenditures on 3,484,334 flow-through common shares.

The losses on Q4 FY 2007 increased to \$721,949 from \$520,155 in Q3 FY 2007 mainly due to an expense of \$133,000 in stock-based compensation and \$77,000 in sales commissions.

The losses in Q2 FY 2008 increased to \$863,431 partly due to lower recognized revenues from sales. The Company's work at FPS's Thurso mill could not be recognized until the construction asset was complete and generating revenue from monthly billings to FPS.

The losses in Q3 FY 2008 decreased to \$569,794 partly due to increased recognized revenues from sales. Q3 results also reflect the entry for the future income tax recovery of \$200,000 in 2008, \$195,000 in 2007. The Company's work at FPS's Thurso mill was completed on time and although not impacting the third quarter, began generating revenue in the fourth quarter with the first monthly billing to FPS on March 31, 2008.

The losses in Q1 FY 2009 increased to \$616,086. Gross margins were much improved but were more than offset by increases in the major areas of administration and sales and marketing and increases in R&D expenditures for equipment related to testing the THERMALONox technology. Expenses were impacted on a comparative basis by the acquisition of GEM.

Without the exceptions noted above, the net losses remained in a fairly constant range throughout the eight quarters summarized from Q2 FY 2007 through Q1 FY 2009, demonstrating the need to significantly increase sales to cover and exceed the amount of fixed costs in order to overcome the consistent pattern of losses.

Evaluation of Disclosure Controls and Procedures

Disclosure controls and procedures are designed to provide assurance that all relevant information is gathered and reported to senior management, including the Company's Chief Executive Officer (CEO) and Chief Financial Officer (CFO), on a timely basis so that appropriate decisions can be made regarding public disclosure. Management of the Company, with the participation of the CEO and the CFO, has evaluated the effectiveness of the Company's disclosure controls and procedures as at August 31, 2008 as required by Canadian securities laws. Based on that evaluation, the CEO and CFO have concluded that, as of August 31, 2008, the disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed in the Company's interim filings (as such terms are defined under National Instrument 52-109 Certification of Disclosure in Issuer's Annual and Interim Filings) and other reports filed or submitted under Canadian securities laws is recorded, processed, summarized and reported within the time periods specified by those laws and that material information is accumulated and communicated to management of the Company, including the CEO and CFO, as appropriate to allow for accurate disclosure to be made on a timely basis.



Changes in Internal Control over Financial Reporting

Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian GAAP. The CEO and CFO have concluded that there has been no change in the Company's internal control over financial reporting at August 31, 2008 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting. The Company has recognized the need to improve internal control by a better segregation of duties in the accounting and finance area. An Administrative assistant/accounting clerk has been added to relieve the current accountant of bookkeeping duties and enable the Company to devote more resources to the controllership function

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 for the quarter ended August 31, 2008, these statements were not subject to an audit nor a review 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. However, with the successful completion of its brokered private placement in Q1 FY 2009, the Company began the design work in earnest to be in a position to test the THERMALONOX™ patented technology by Q3 FY 2009.

The Cost Effective Energy Conservation and Environmental Compliance Solutions sales through the close working relationship with JCI has not limited the size of the market but has actually increased the market potential.

Financial risks and uncertainties of the Company include:

- The Company's history of operating losses and uncertainty of future profitability;
- The ability to continue to grow sales by maintaining its close 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 Company'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; and
- The ability to control costs and achieve a positive gross margin on projects.

Management's addressing of the risks:

The management of the Company realizes that the operating losses of the period ended August 31, 2008, 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 behind it, the Company is now fully focused on sales and marketing and is expanding its drive towards that purpose with the addition of five sales persons under the supervision of our new Vice-President of Sales and a new Account Manager, Solution Sales to oversee the regional sales associates in Canada, the U.S. and Mexico.

The costs in the first quarter 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 continue to grow sales by working closely with JCI as evidenced by two recent contracts performed for its clients in the U.S. In addition there are numerous projects that it is jointly pursuing with JCI both in Canada and the U.S and abroad.

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.

The new 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 in excess of \$600,000 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 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 2008 depending on the demand arising from increased sales volumes.

Management has acquired GEM®, a leading European (Great Britain) line of industrial/commercial steam traps; THERMALOZOMAx™, an ozone generation technology 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, 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. both 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.

The Company has not only maintained its core of key personnel but has already added one sales person to the sales team in Q1 FY 2009, with several other sales reps to be added in Q2 FY 2009 for Canada and the US.

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.

Highlights

On June 3, 2008, the Corporation announced that it had entered into an agreement with a North American integrated paper company for the delivery of a green energy supply program worth in excess of \$20M, using recovered waste heat at one of its facilities in the north eastern United States.

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 23-24, 2008.

Signed in Ottawa, Ontario on this 30th day of October, 2008.

A handwritten signature in black ink that reads "Tim Angus".

Tim K. Angus
President and CEO

A handwritten signature in black ink that reads "Oliver Toffoli".

Oliver Toffoli, P.Eng
Chief Operating Officer & CFO