



An Innovative Technology Company Providing  
Custom Energy and Emission Reduction Solutions

## First Quarter Report – FY 2009

Period ending August 31, 2008

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

**CONSOLIDATED BALANCE SHEETS**

As at	(Unaudited)	
	Aug 31 2008 \$	May 31 2008 \$
<b>ASSETS</b>		
<b>Current assets</b>		
Cash	347,882	84,717
Short-term investments (note 5)	6,139,530	552,773
Accounts receivable (note 6)	1,048,337	627,571
Contracts in progress	194,000	156,000
Inventories	559,020	-
Net investment in lease (note 8)	237,841	227,034
Prepays and other assets	97,353	31,934
	<b>8,623,963</b>	1,680,029
Property, plant and equipment (note 7)	118,011	65,066
Net investment in lease (note 8)	1,885,235	1,948,906
Goodwill (note 4)	4,804,213	-
	<b>15,431,422</b>	3,694,001
<b>LIABILITIES, CAPITAL STOCK, CONTRIBUTED SURPLUS AND DEFICIT</b>		
<b>Current liabilities</b>		
Bank loans (note 9)	1,054,962	908,667
Accounts payable	808,732	2,001,801
Accrued liabilities	468,767	459,777
Deferred revenue	-	384,908
Due to past President (note 10)	17,937	17,937
	<b>2,350,398</b>	3,773,090
Non-controlling interest (note 4)	11,721	-
<b>Capital stock, contributed surplus and deficit</b>		
Capital stock (note 11)	32,571,553	19,479,079
Contributed surplus (note 11)	2,252,018	1,528,414
Deficit	-21,702,668	-21,086,582
Accumulated other comprehensive loss	-28,158	-
	<b>13,092,745</b>	-79,089
	<b>15,431,422</b>	3,694,001

Contingency (note 18)

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

On behalf of the Board



President and C.E.O.



Chief Operating Officer & CFO

**THERMAL ENERGY INTERNATIONAL INC.**

**CONSOLIDATED OPERATIONS, COMPREHENSIVE LOSS AND DEFICIT  
(Unaudited)**

Three months ended Aug 31

	2008	2007
	\$	\$
<b>REVENUE</b>		
Sales	1,058,318	1,048,357
Cost of sales	530,215	785,405
<b>Gross profit</b>	<b>528,103</b>	262,952
<b>Expenses</b>		
Administration	527,579	284,273
Selling, marketing and business development	521,082	301,109
Legal fees	9,585	5,097
Audit fees	18,000	15,000
Insurance	34,248	30,176
Amortization of property, plant and equipment	11,691	7,693
Patent and trademark maintenance	2,810	-
Research and development	71,643	30,680
Interest and bank charges	30,894	2,897
Foreign exchange loss	33,312	18,507
	<b>1,260,844</b>	<b>695,432</b>
Loss before the following:	<b>-732,741</b>	<b>-432,480</b>
Interest revenue	34,021	14,675
Finance revenue	85,052	-
Loss before non-controlling interest	<b>-613,668</b>	-417,895
Non-controlling interest	2,418	-
<b>Net loss</b>	<b>-616,086</b>	-417,895
Comprehensive loss due to exchange translation adjustment of net investment in self-sustaining foreign operation	28,158	-
<b>Net loss and other comprehensive loss</b>	<b>-644,244</b>	-417,895
Deficit, beginning of period	<b>-21,086,582</b>	-18,714,074
<b>Deficit, end of period</b>	<b>-21,730,826</b>	-19,131,969
Net loss per share - basic and diluted	<b>(0.004)</b>	(0.005)
Weighted average number of common shares	<b>152,578,635</b>	91,505,729

The accompanying notes are an integral part of these consolidated financial statements and Note 14 provides other information on earnings.

**THERMAL ENERGY INTERNATIONAL INC**

**CONSOLIDATED STATEMENT OF CASH FLOWS**  
**(Unaudited)**

Three months ended August 31

	2008	2007
	\$	\$
<b>OPERATING ACTIVITIES</b>		
Net loss	-616,086	-417,895
Add items not involving cash:		
Stock-based compensation charge	121,404	153,800
Amortization of property, plant and equipment	11,691	7,693
Non-monetary compensation charge	6,692	-
Changes in non-cash operating working capital		
Accounts receivable	529,385	120,076
Contracts in progress	-38,000	-29,000
Inventories	22,509	-
Prepays and other assets	-10,798	1,453
Accounts payable	-1,570,813	468,741
Accrued liabilities	-244,670	-13,535
Deferred revenue	-384,908	-469,553
Non-controlling interest	2,955	-
Net cash used in operating activities	-2,170,639	-178,220
<b>INVESTING ACTIVITIES</b>		
Acquisition of short-term investments	-5,586,757	-265,413
Acquisition of Gardner Energy Management Limited	-5,411,245	-
Additions to property, plant and equipment	-16,444	-24,681
Net cash used in investing activities	-11,014,446	-290,094
<b>FINANCING ACTIVITIES</b>		
Increase in bank loan	-291,537	-
Net investment in lease (note 8)	63,671	-
Common shares issued (note 11)	14,900,400	140,500
Financing fees	-1,223,226	-
Decrease in loan receivable	-	25,000
Net cash provided by financing activities	13,449,308	165,500
Effect of exchange rate fluctuations on cash and cash equivalents	-1,058	-
Increase (decrease) in cash for the year	263,165	-302,814
Cash, beginning of period	84,717	549,196
Cash, end of period	347,882	246,382
Interest paid	19,695	2,390
Shareholder loans to acquire shares	147,600	-
Fair value of options exercised transferred to capital stock	34,000	107,017
Fair value of warrants issued for financing fees	636,200	-

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

# THERMAL ENERGY INTERNATIONAL INC.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### 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 quarters ended August 31, 2008 and 2007 and at August 31, 2008 not all financial covenants were met.

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, its ability to generate sufficient cash from operations and its ability to operate with a gross margin.

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.

### 3 BASIS OF PRESENTATION AND ACCOUNTING CHANGES

The accompanying interim unaudited consolidated financial statements of Thermal Energy International Inc. have been prepared by management in accordance with Canadian generally accepted accounting principles applicable to interim consolidated financial statements and do not include all the information required for complete financial statements. The interim unaudited consolidated financial statements and accompanying notes should be read in conjunction with the audited consolidated financial statements and accompanying notes for the year ended May 31, 2008. These interim consolidated financial statements are also prepared in accordance with the accounting policies described in the Company's audited consolidated financial statements for the year ended May 31, 2008 except for the changes in accounting policies, and new accounting policies adopted and described below.

#### Inventories

Inventories are valued at the lower of cost and net realizable value after making due allowance for obsolete and slow-moving items. Cost includes all direct costs and an appropriate proportion of fixed and variable overheads.

#### Amortization

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

Plant and equipment	25% declining balance
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### 4 BUSINESS ACQUISITION

On July 1, 2008 the Company acquired the net assets of Gardner Energy Management Limited of Bristol, England, a company engaged in the condensate return solutions business, for a total cash consideration of \$5,411,245, including acquisition costs. An additional payment of up to £1,300,000 sterling may be made in cash and shares over a three-year period based on Gardner Energy Management Limited meeting certain performance targets.

This transaction was accounted for using the purchase method and the results of operations are included in the financial statements from the acquisition date. The purchase price allocation is as follows:

	July 1, 2008
	\$
Net assets acquired	
Current assets	1,649,363
Property, plant and equipment	50,202
Goodwill	4,804,213
	6,503,778
Current liabilities assumed	1,107,210
Non-controlling interest	(14,677)
Net assets acquired	5,411,245

**THERMAL ENERGY INTERNATIONAL INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**5 SHORT-TERM INVESTMENTS**

Short-term investments consist of excess cash invested in money market funds.

**6 ACCOUNTS RECEIVABLE**

	Aug 31, 2008	May 31, 2008
	\$	\$
Trade	804,813	438,592
Commodity taxes	124,567	145,928
Directors and Officers	42,400	34,500
Other	76,557	8,551
	<b>1,048,337</b>	<b>627,571</b>

**7 PROPERTY, PLANT AND EQUIPMENT**

	Aug 31, 2008		May 31, 2008	
	Cost	Accumulated Amortization	Cost	Accumulated Amortization
	\$	\$	\$	\$
Plant and equipment	67,731	55,424		
Furniture and fixtures	110,753	94,517	81,671	66,330
Laboratory equipment	52,857	22,636	52,857	21,073
Computers	255,099	210,332	157,861	144,787
Software	30,695	16,853	16,971	14,525
Leasehold improvements	21,401	20,763	21,401	18,980
	<b>538,536</b>	<b>420,525</b>	330,761	265,695
Accumulated amortization	<b>(420,525)</b>		(265,695)	
<b>Net book value</b>	<b>118,011</b>		65,066	

**8 NET INVESTMENT IN LEASE**

The Company's net investment in lease includes the following:

	Aug 31, 2008	May 31, 2008
	\$	\$
Total minimum lease payments receivable	3,467,831	3,605,747
Unearned income	1,344,755	1,429,807
	<b>2,123,076</b>	2,175,940
Less: current portion	<b>(237,841)</b>	(227,034)
	<b>1,885,235</b>	1,948,906

Future minimum lease payments receivable under the sales-type lease are as follows:

	\$
2009	478,056
2010	615,972
2011	615,972
2012	615,972
2013	615,972
2014	525,887
	<b>3,467,831</b>

## THERMAL ENERGY INTERNATIONAL INC.

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

#### 9 BANK LOAN

At August 31, 2008, the Company had two bank loans aggregating \$1,054,962. The first loan has an authorized amount of \$2,500,000. At August 31, 2008 this loan, secured by accounts receivable and a general security agreement, with interest rate at prime plus 0.25%, amounted to \$783,667 (May 31, 2008 - \$908,667). Prime rate at August 31, 2008 was 4.75%.

In accordance with the loan agreement, the Company is subject to certain loan covenants and must meet certain financial ratios. At August 31, 2008 not all financial covenants were met.

a At August 31, 2008, the second loan amounted to \$271,295 (May 31, 2008 - \$Nil). It is secured by certain trade debts of subsidiary and carries a service charge of 0.805% of gross debts subject to a minimum annual charge of approximately \$32,000 and an interest rate of 1.95% over the United Kingdom bank base rate. At August 31, 2008 the United Kingdom bank rate was 5.0%.

#### 10 RELATED PARTY TRANSACTIONS

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

	August 31, 2008	August 31, 2007
<b>Balances owing to/from directors</b>		
Accounts receivable	\$34,450	-
Loans receivable	\$289,647	\$71,969
Accrued liabilities	\$9,375	\$9,375
<b>Directors share options and warrants outstanding at August 31</b>		
Issued	3,500,000	3,750,000
Exercisable	2,711,000	2,983,000
Warrants outstanding	37,500	-
<b>Balances owing to/from officers</b>		
Accounts receivable	\$8,000	\$192,000
Loans receivable	\$278,800	\$7,500
<b>Officers share options and warrants outstanding at August 31</b>		
Issued	-	1,993,000
Exercisable	-	1,726,000
Transactions with directors and officers were as follows:		
Directors fees for services	\$15,750	\$15,000
Officers fees for services	\$33,000	\$51,000
<b>Shares issued to Directors</b>		
Shares issued to Directors	550,000	287,500
<b>Shares issued to officers</b>		
Shares issued to officers	-	-

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

**THERMAL ENERGY INTERNATIONAL INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**11 CAPITAL STOCK AND CONTRIBUTED SURPLUS**

	Quarter Ended Aug 31, 2008		Year Ended May 31, 2008	
	# Shares	\$	# Shares	\$
<b>Authorized</b>				
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 convertible to common shares on a one to one basis at the rate of 20% of the number originally issued per year.				
<b>Class A Common shares issued</b>				
Balance, beginning of period	99,052,104	20,122,830	90,918,419	17,573,323
Issued in settlement of liabilities	50,000	17,500	350,685	104,848
Issued for cash, net of flow through share tax benefit (i)	68,281,818	15,058,000	4,190,000	1,867,359
Issued as a result of the exercise of options for loans (ii)	100,000	24,000	3,593,000	577,300
	<b>167,483,922</b>	<b>35,222,330</b>	99,052,104	20,122,830
Less: loans outstanding to assist a shareholder in purchasing capital stock (iii)		(791,351)		(643,751)
Share issue costs		(1,859,426)		-
Balance, end of period	<b>167,483,922</b>	<b>32,571,553</b>	99,052,104	19,479,079

(i) In fiscal 2008, the Company renounced expenditures of \$615,000 (2007 - \$540,000) from 4,190,000 (2007 - 3,484,334) flow-through common shares issued during the respective fiscal years. The resulting future income tax recovery of \$200,000 (2007 - \$195,000) was charged against capital stock as share expenses.

	Aug 31, 2008	Aug 31, 2007
	\$	\$
Loans to exercise options:		
Directors and officers	24,000	-

Loans were extended to directors and officers to acquire shares of the Company through the exercise of options. These loans are for a two-year period with an interest rate of 5%. The borrower's liability in respect of these loans shall at all times be limited to the value of the underlying shares for which the loan was granted. They can be repaid in part or in full at any time within the two year period at which time the shares with an equivalent value to the repayment will be released to the borrower by the Company.

(iii) Repayments made on these loans during the quarter ended August 31, 2008 were \$Nil (August 31, 2007 - \$25,000). Amounts outstanding are as follows:

	Aug 31, 2008	May 31, 2008
	\$	\$
President	124,647	124,647
Directors and Officers	385,800	361,800
Other shareholders	280,904	157,304
	<b>791,351</b>	643,751

**THERMAL ENERGY INTERNATIONAL INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

Stock-based compensation on these loans was estimated using the Black-Scholes option pricing model with the following assumptions:

	Loans to exercise options		Loans to acquire shares	
	August 31		August 31	
	2008	2007	2008	2007
Weighted average assumptions:				
Expected dividend	0%	-	0%	0%
Expected volatility	87%	-	82%	80%
Risk-free interest rate	2.50%	-	2.50%	4.50%
Expected option life in years	2.0	-	1.0	1.0

The Company has a five-year licensing and purchasing agreement with Mabarex for their Dry-Rex™ system ending September 8, 2011. Under the terms of this agreement, the Company is required to issue 125,000 common shares at \$0.16 each to Mabarex for each of the first two contracts to use the Dry-Rex™ system.

In addition, the Company is committed to issue 539,000 options to directors to purchase common shares at \$0.16 per share, based on Company performance and which will expire on December 20, 2009.

(a) In the quarter ended August 31, 2008 the Company completed a private placement. Part of the share issue cost was the issue of non-transferable warrants to the lead broker. Activity in share purchase warrants was as follows:

	August 31, 2008		August 31, 2007	
	# Warrants	Weighted Average Exercise Price	# Warrants	Weighted Average Exercise Price
		\$		\$
Balance, beginning of period	8,788,501	0.40	14,480,390	0.35
Issued	5,236,363	0.22	-	-
Exercised	-	-	(305,000)	0.33
Expired	-	-	(3,153,666)	0.35
Balance, end of period	14,024,864	0.33	11,021,724	0.35

(b) The following table summarizes the status of warrants outstanding at August 31, 2008:

Warrants Outstanding	Exercise Price \$	Expiry Date
760,000	0.30	To October 10, 2008
260,000	0.30	To November 2, 2008
229,084	0.30	To November 30, 2008
324,000	0.30	To December 6, 2008
281,250	0.30	To December 29, 2008
4,166,667	0.40	To May 23, 2009
1,250,000	0.40	To May 29, 2009
1,517,500	0.50	To December 7, 2009
5,236,363	0.22	To June 20, 2010
<u>14,024,864</u>		

Contributed surplus	Aug 31 2008	May 31 2008
	\$	\$
Balance, beginning of year	1,528,414	1,881,487
Stock-based compensation	121,404	495,786
Share issue costs	636,200	-
	<u>2,286,018</u>	2,377,273
Fair-value of options exercised and transferred to capital stock	34,000	848,859
Balance, end of year	<u>2,252,018</u>	1,528,414

**THERMAL ENERGY INTERNATIONAL INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**12 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:

	\$
2009	203,600
2010	208,600
2011	87,400
2012	80,800
2013	60,800
<b>Total</b>	<b>641,200</b>

**13 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 quarters ended August 31, 2008 and 2007 had vesting periods ranging from four to twelve months.

(a) Activity in stock options was as follows:

	Quarter ended Aug 31, 2008		Quarter ended Aug 31, 2007	
	# Options	Weighted Average Exercise Price \$	# Options	Weighted Average Exercise Price \$
Outstanding, beginning of year	5,857,143	0.21	8,368,000	0.17
Granted	375,000	0.33	750,000	0.17
Exercised	(200,000)	0.24	(475,000)	0.14
Forfeited	(57,143)	0.21	-	-
Expired	(100,000)	0.24	-	-
<b>Outstanding, end of quarter</b>	<b>5,875,000</b>	<b>0.22</b>	<b>8,643,000</b>	<b>0.17</b>
Number of options exercisable as at August 31	4,672,000		6,526,000	

Options exercised during the period were as follows:

	Quarter ended Aug 31, 2008		Quarter ended Aug 31, 2007	
	# shares	\$	# shares	\$
Employees	200,000	48,000	175,000	30,000
Directors	-	-	250,000	25,000
Consultants	-	-	50,000	10,000
	<b>200,000</b>	<b>48,000</b>	<b>475,000</b>	<b>65,000</b>

In the quarter ended August 31, 2008, 100,000 options were exercised in consideration of loans receivable of \$24,000 (2007 – \$Nil) and 100,000 options were exercised for cash of \$24,000 (2007 – 475,000 for cash of \$65,000).

**THERMAL ENERGY INTERNATIONAL INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

(b) The following options are outstanding and/or exercisable at August 31, 2008:

<b>Number of Options Outstanding</b>	<b>Number of Options Exercisable</b>	<b>Exercise Price Per Share \$</b>	<b>Expiry Date</b>
250,000	250,000	0.26	September 9, 2008
3,000,000	2,422,000	0.16	December 20, 2009
500,000	500,000	0.20	March 15, 2010
350,000	350,000	0.37	June 11, 2010
300,000	300,000	0.35	June 15, 2010
100,000	100,000	0.43	July 20, 2010
500,000	500,000	0.20	January 25, 2011
250,000	250,000	0.285	April 29, 2011
250,000		0.27	May 16, 2011
375,000		0.33	August 15, 2011
<b>5,875,000</b>	<b>4,672,000</b>		

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:

	<b>Quarter ended Aug 31, 2008</b>	Quarter ended Aug 31, 2007
Expected dividend	<b>0.00%</b>	0.00%
Expected volatility	<b>79%</b>	95%
Risk-free interest rate	<b>2.50%</b>	4.50%
Expected option life in years	<b>2.4</b>	2.4

Stock-based compensation expense in the quarter ended August 31, 2008 includes an amount of \$21,280 for options granted to consultants (2007 - \$19,800). Employee stock-based compensation expense is \$18,620 (2007 - \$134,000).

**14 INFORMATION INCLUDED IN OPERATIONS**

	<b>Quarter ended Aug 31, 2008 \$</b>	Quarter ended Aug 31, 2007 \$
Interest expense	<b>16,252</b>	2,390

## THERMAL ENERGY INTERNATIONAL INC.

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

#### 15 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 system 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 system solutions business through its acquisition of Gardner Energy Management Limited (GEM™) on July 1, 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	

## THERMAL ENERGY INTERNATIONAL INC.

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

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

#### 16 FINANCIAL RISKS

##### Interest rate risk

The Company has contracted a short-term bank loans bearing floating rates of interest. These financial instruments expose the Company to risk in the event market interest rates fluctuate.

##### Foreign exchange risk

The Company is exposed to foreign exchange risk as follows:

	August 31, 2008			May 31, 2008
	US\$	£	Euros	US\$
Cash	6,706	26,758	3,841	7,115
Short-term investments	200	-	-	200
Accounts receivable	69,478	187,990	208,686	394,798
Inventories	-	281,015	10,082	-
Bank loans	-	48,767	112,834	-
Accounts payable	367,995	45,496	16,804	824,252
Accrued liabilities	-	118,071	36,484	-

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

##### Credit risk

The financial instruments that potentially expose the Company to credit risk are accounts receivable and loans outstanding to assist shareholders in purchasing capital stock.

##### Liquidity risk

Liquidity risk management serves to maintain a sufficient amount of cash and cash equivalents and to ensure that the Company has financing sources such as bank loans for a sufficient authorized amount. The Company continues to actively seek external financing to ensure it has the necessary funds to fulfill its obligations.

## **THERMAL ENERGY INTERNATIONAL INC.**

### **NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

#### **Fair value of financial instruments**

Given that they will mature shortly, the fair value of short-term financial assets and liabilities are equivalent to their carrying amount.

#### **17 COMPARATIVE AMOUNTS**

Certain 2007 amounts have been reclassified to conform with the current year's presentation.

#### **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 had been served with a statement of claim for \$2.3 million from its past President. On December 2, 2005 the Company had filed its statement of defence and had filed a counterclaim seeking damages from the past President in the amount of \$5.4 million. As the ultimate resolution of the lawsuits cannot be reasonably estimated, no provision has been recorded in the accounts.

#### **19 RECENTLY ISSUED ACCOUNTING STANDARDS NOT YET IMPLEMENTED**

##### **Capital disclosures and financial instruments disclosures and presentation**

Section 3064 establishes standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets by profit-oriented companies. It clarifies the recognition of intangible assets and deals with the recognition of internally generated intangible assets.

The Company will implement these new standards in its first quarter of fiscal year 2010 and is currently evaluating the impact of their adoption on its consolidated financial statements.