THERMAL ENERGY INTERNATIONAL INC.

An Innovative Technology Company Providing
Custom Energy and Emission Reduction Solutions

Second Quarter Report – FY 2008

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

CONSOLIDATED BALANCE SHEETS

As at	**(Unaudited) Nov 30 2007 $**	May 31 2007 $
ASSETS		
Current assets		
Cash	**301,498**	549,196
Short term investments (note 4)	**469,241**	1,020,880
Accounts receivable (note 5)	**605,318**	428,581
Contracts in progress	**225,300**	4,000
Loan receivable (note 6)	**25,000**	-
Prepaids and other assets	**37,418**	60,894
	1,663,775	2,063,551
Construction in progress	**333,976**	
Property, plant and equipment (note 7)	**78,249**	67,612
	2,076,000	2,131,163
LIABILITIES, CAPITAL STOCK, CONTRIBUTED SURPLUS AND DEFICIT		
Current liabilities		
Accounts payable	**779,292**	328,182
Accrued liabilities	**746,880**	158,082
Deferred revenue	**608,000**	1,000,000
Due to past President (note 8)	**17,937**	17,937
	2,152,109	1,504,201
Capital stock, contributed surplus and deficit		
Capital stock (note 9)	**17,885,028**	17,459,549
Contributed surplus (note 9)	**2,034,263**	1,881,487
Deficit	**-19,995,400**	-18,714,074
	-76,109	626,962
	2,076,000	2,131,163

Contingency (note 18)

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

On behalf of the Board

Tim Angus
President & CEO

Oliver Toffoli
Chief Financial Officer

THERMAL ENERGY INTERNATIONAL INC.

CONSOLIDATED OPERATIONS AND DEFICIT
(Unaudited)

	Three months ended November 30		Six months ended November 30	
	2007	2006	**2007**	2006
	$	$	**$**	$
REVENUE				
Sales	**618,290**	127,987	**1,666,647**	230,646
Cost of sales	**637,914**	166,341	**1,423,319**	316,463
Gross profit (loss)	**-19,624**	-38,354	**243,328**	-85,817
Expenses				
Administration	**250,894**	316,177	**535,167**	438,437
Selling, marketing and business development	**480,208**	259,696	**781,317**	502,129
Legal fees	**5,312**	-10,603	**10,409**	2,067
Audit fees	**15,744**	15,000	**30,744**	30,000
Insurance	**41,563**	19,827	**71,739**	38,655
Amortization of property, plant and equipment	**7,918**	6,335	**15,611**	12,748
Patent and trademark maintenance	**6,295**	3,203	**6,295**	8,135
Research and development	**22,474**	22,705	**53,154**	47,364
Interest and bank charges	**1,163**	1,728	**4,150**	2,929
Foreign exchange loss	**21,436**	792	**39,943**	2,383
	853,007	634,860	**1,548,529**	1,084,847
	-872,631	-673,214	**-1,305,201**	-1,170,664
Other Revenue (note 12)	**-**	5,240	**-**	5,240
Interest revenue	**9,200**	141	**23,875**	264
Other Costs (note 13)	-	-21,317	-	-36,001
Net loss and comprehensive income	**-863,431**	-689,150	**-1,281,326**	-1,201,161
Deficit, beginning of period	**-19,131,969**	-16,782,820	**-18,714,074**	-16,270,809
Deficit, end of period	**-19,995,400**	-17,471,970	**-19,995,400**	-17,471,970
Net loss per share - basic and diluted	**(0.009)**	**(0.009)**	**(0.014)**	**(0.016)**
Weighted average number of common shares	**91,876,821**	76,515,443	**91,702,425**	75,589,120

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 November 30		Six months ended November 30	
	2007	2006	**2007**	2006
	$	$	**$**	$
OPERATING ACTIVITIES				
Net loss for the period	**-863,431**	-689,150	**-1,281,326**	-1,201,161
Add items not involving cash:				
Stock-based compensation charge	**132,034**	43,700	**285,834**	52,250
Amortization of property, plant and equipment	**7,918**	6,335	**15,611**	12,748
Non-monetary compensation charge	**47,171**	123,991	**90,921**	123,991
Past President loan to acquire shares expensed	**-**	151,500	-	151,500
Changes in non-cash operating working capital				
Accounts receivable	**-271,813**	167,040	**-176,737**	585,128
Contracts in progress	**-192,300**	-	**-221,300**	89,000
Loan receivable, current	**-25,000**	-	**-25,000**	-
Prepaids and other assets	**22,023**	36,244	**23,476**	11,713
Accounts payable	**1,119**	-116,707	**451,110**	-179,280
Accrued liabilities	**602,333**	-71,772	**588,798**	5,448
Deferred revenue	**77,553**	-72,000	**-392,000**	-55,000
Net cash used in operating activities	**-462,393**	-420,819	**-640,613**	-403,663
INVESTING ACTIVITIES				
Reduction in short term investments	**817,052**	-	**551,639**	-
Additions to construction on progress	**-333,976**	-	**-333,976**	-
Additions to property, plant and equipment	**-1,567**	-	**-26,248**	-32,901
Net cash used in investing activities	**481,509**	-	**191,415**	-32,901
FINANCING ACTIVITIES				
Common shares issued (note 9)	**11,000**	383,000	**176,500**	383,000
Decrease in loans for common shares	**25,000**	-	**25,000**	18,500
Net cash provided by financing activities	**36,000**	383,000	**201,500**	401,500
Increase (decrease) in cash for the period	**55,116**	-37,819	**-247,698**	-35,064
Cash beginning of period	**246,382**	61,874	**549,196**	59,119
Cash end of period	**301,498**	24,055	**301,498**	24,055
Interest paid	**697**	922	**3,087**	1,566
Fair value of options exercised for cash	**26,041**	-	**133,058**	-

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

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 quarter and six months ended November 30, 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.

3 BASIS OF PRESENTATION AND ACCOUNTING CHANGE

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, 2007. 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, 2007 except for the changes in accounting policies described below.

Effective June 1, 2007, the Company adopted the new recommendations of the Canadian Institute of Chartered Accountants (CICA) under CICA Handbook Section 1530, Comprehensive Income, Section 3251, Equity, Section 3855, Financial Instruments; Recognition and Measurement, Section 3861, Financial Instruments; Disclosure and Presentation and Section 3865, Hedges. These new Handbook sections provide requirements for the recognition and measurement of financial instruments and on the use of hedge accounting.

Under Section 3855, all financial instruments are to be classified into one of five categories and measured at fair value except for loans and receivables, held-to maturity investments and other financial liabilities which are to be measured at amortized cost. Held-for-trading financial assets are to be measured at fair value and changes in fair value are to be recognized in net income. Available-for-sale financial instruments are to be measured at fair value with changes in fair value recorded in other comprehensive income until the instrument is derecognized or impaired. Section 1530 establishes standards for the reporting of comprehensive income, defined as the change in equity from transactions and other events from non-owner sources.

Adoption of these new recommendations resulted in the following impacts on the classification and measurement of the Company's financial instruments, which were previously recognized at cost:

- Cash is classified as a held-for-trading financial asset. It is measured at fair value and changes in fair value are recognized in net earnings. This change had no impact on the financial statements as at November 30, 2007;

- Short-term investments are classified as available-for-sale. Since the fair value and the cost base of the Company's short-term investments was the same on June 1, 2007, there was no adjustment to the opening fair value of short-term investments.

- Trade accounts receivable and other accounts receivable are classified as loans and receivables. Trade accounts receivable are measured at amortized cost, which is generally the initially recognized amount, less any allowance for doubtful accounts. Other receivables are recognized at amortized cost using the effective interest method, less any impairment. This change had no impact on the financial statements as at November 30, 2007;

- Accounts payable, accrued liabilities and amounts due to past President are classified as other financial liabilities. They are valued at amortized cost using the effective interest method. This change had no impact on the financial statements as at November 30, 2007.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

4 SHORT TERM INVESTMENTS

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

5 ACCOUNTS RECEIVABLE

	Nov 30, 2007	May 31, 2007
	$	$
Trade	**521,379**	377,124
Other	**83,939**	51,457
	605,318	428,581

At November 30, 2007 80% (May 31, 2007 – 94%) of trade receivables were from one customer.

6 LOAN RECEIVABLE

The loan receivable of $25,000 (May 31, 2007 $Nil) represents an amount due from a director, bears interest at 6.25% per annum and is due December 31, 2009.

7 PROPERTY, PLANT AND EQUIPMENT

	November 30, 2007		May 31, 2007	
	Cost	**Accumulated Amortization**	Cost	Accumulated Amortization
	$	**$**	$	$
Furniture and fixtures	**81,671**	**64,540**	81,671	62,597
Laboratory equipment	**52,857**	**17,701**	46,675	14,183
Computers	**155,341**	**139,035**	140,166	133,675
Software	**16,971**	**13,303**	12,081	12,081
Leasehold improvements	**21,401**	**15,413**	21,401	11,846
	328,241	**249,992**	301,994	234,382
Accumulated amortization	**(249,992)**		(234,382)	
Net book value	**78,249**		67,612	

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

8 RELATED PARTY TRANSACTIONS

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

	Nov 30, 2007	Nov 30, 2006
Balances owing to/from directors		
Loans receivable	**$49,647**	$37,000
Accrued liabilities	**$22,500**	-
Directors share options outstanding at November 30th		
Issued	**4,000,000**	2,300,000
Exercisable	**3,461,000**	1,985,000
Officers share options outstanding		
Issued	**1,993,000**	1,043,000
Exercisable	**1,954,000**	885,500

Transactions with directors and officers were as follows:

	Quarter Ended November 30		Year to Date November 30	
	2007	2006	**2007**	2006
	$	$	**$**	$
Directors fees for services	**15,750**	4,500	**36,000**	9,000
Officers fees for services	**51,000**	48,000	**102,000**	96,000
	#	#	**#**	#
Shares issued to Directors	**-**	61,875	**287,500**	261,875
Shares issued to Officers	**-**	143,081	**-**	218,081

The amount due to the past President is non-interest bearing and has no fixed terms of repayment.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

9 CAPITAL STOCK AND CONTRIBUTED SURPLUS

	Quarter Ended Nov 30, 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	**91,735,919**	**17,864,590**
Issued in settlement of liabilities	**200,685**	**49,849**
Issued for cash	**50,000**	**37,041**
	91,986,604	**17,951,480**
Less: loans outstanding to assist a shareholder in purchasing capital stock (ii)		**(66,452)**
Balance, end of quarter	**91,986,604**	**17,885,028**

	Year to Date Nov 30, 2007		Year Ended May 31, 2007	
	# Shares	**$**	# Shares	$
Class A Common shares issued				
Balance, beginning of period	**90,918,419**	**17,573,323**	74,570,256	14,733,084
Issued in settlement of liabilities	**238,185**	**68,599**	1,160,584	181,393
Issued for cash (i)	**830,000**	**309,558**	15,137,579	2,645,846
Issued as a result of the exercise of options	**-**	**-**	50,000	13,000
	91,986,604	**17,951,480**	90,918,419	17,573,323
Less: loans outstanding to assist a shareholder in Purchasing capital stock (ii)		**(66,452)**		(113,774)
Balance, end of period	**91,986,604**	**17,885,028**	90,918,419	17,459,549

(i) In fiscal 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.

(ii) A balance of $24,647 is outstanding on shareholder loans to the President to purchase shares, $7,500 for a loan to an officer and $34,305 to other shareholders. 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 98% (74% fiscal 2007) a risk free interest rate of 4.50% (3.85% in fiscal 2007) and for all years an expected dividend rate of 0%, and an expected life of one year.

The Company has a five year licensing and purchasing agreement with Mabarex for their Dry-Rex™ system. 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 661,500 options to directors and officers to purchase common shares at $0.16 per share based on Company performance, and which will expire on December 20, 2009.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

(a) 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. Activity in share purchase warrants was as follows:

	Year to Date Nov 30, 2007		Year to Date Nov 30, 2006	
	# Warrants	**Weighted Average Exercise Price**	# Warrants	Weighted Average Exercise Price
		$		$
Balance, beginning of period	**14,480,390**	**0.35**	10,154,896	0.30
Issued	**-**	**-**	1,256,912	0.30
Exercised	**(312,828)**	**0.33**	-	-
Expired	**(3,153,666)**	**0.35**	(2,568,668)	0.20
Balance, end of period	**11,013,896**	**0.35**	8,825,140	0.33

(b) The following table summarizes the status of warrants outstanding at November 30, 2007

Warrants Outstanding	Exercise Price $	Expiry Date
3,742,895	0.30	To April 22, 2008
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
11,013,896		

Contributed surplus

	Quarter Ended Nov 30,2007	**Year to Date Nov 30, 2007**	Year Ended May 31, 2007
	$	**$**	$
Balance, beginning of period	**1,928,270**	**1,881,487**	1,509,232
Stock-based compensation	**132,034**	**285,834**	377,755
	2,060,304	**2,167,321**	1,886,987
Fair-value of options exercised and transferred to capital stock	**26,041**	**133,058**	5,500
Balance, end of period	**2,034,263**	**2,034,263**	1,881,487

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:

	$
2008	52,200
2009	95,600
2010	82,200
2011	4,800
2012	4,800
Total	239,600

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 second quarter and six month periods ended November 30, 2007 and 2006 had vesting periods of four months.

(a) Activity in stock options was as follows:

	Quarter Ended Nov 30, 2007		Quarter Ended Nov 30, 2006	
	# Options	**Weighted Average $**	# Options	Weighted Average $
Outstanding, beginning of quarter	**8,643,000**	**0.19**	4,518,714	0.17
Granted	**100,000**	**0.34**	350,000	0.21
Exercised	**(192,857)**	**0.21**	-	-
Cancelled/expired	**-**	**-**	-	-
Outstanding, end of quarter	**8,550,143**	**0.19**	4,868,714	0.18
Number of options exercisable as at November 30	**7,788,643**		3,942,464	

	Year to Date Nov 30, 2007		Year to Date Nov 30, 2006	
	# Options	**Weighted Average $**	# Options	Weighted Average $
Outstanding, beginning of period	**8,368,000**	**0.17**	4,718,714	0.17
Granted	**850,000**	**0.37**	350,000	0.21
Exercised	**(667,857)**	**0.16**	-	-
Cancelled/expired	**-**	**-**	(200,000)	0.18
Outstanding, end of period	**8,550,143**	**0.19**	4,868,714	0.18
Number of options exercisable as at November 30	**7,788,643**		3,942,464	

Options exercised were as follows:

	Quarter ended Nov 30, 2007		Quarter ended Nov 30, 2006	
	# Shares	**$**	# Shares	$
Employees	**142,857**	**0.21**	-	-
Consultants	**50,000**	**0.22**	-	-
	192,857	**0.21**	-	-

	Year to Date Nov 30, 2007		Year to Date Nov 30, 2005	
	# Shares	**$**	# Shares	$
Employees	**317,857**	**0.17**	-	-
Directors	**250,000**	**0.13**	-	-
Consultants	**100,000**	**0.21**	-	-
	667,857	**0.16**	-	-

525,000 options were exercised for cash and 142,857 were exercised for debt.

(b) The following options are outstanding and/or exercisable at November 30, 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
750,000	750,000	0.10	February 1, 2008
500,000	500,000	0.12	February 1, 2008
150,000	150,000	0.24	March 1, 2008
750,000	750,000	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
207,143	207,143	0.21	September 7, 2009
3,500,000	2,838,500	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
100,000		0.34	October 5, 2010
8,550,143	7,788,643		

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 November 30		Year To Date November 30	
	2007	2006	**2007**	2006
Weighted average assumptions				
Expected dividend	**0.00%**	0.00%	**0.00%**	0.00%
Expected volatility	**98%**	90%	**96%**	90%
Risk-free interest rate	**4.50%**	3.85%	**4.50%**	3.85%
Expected option life in years	**2.4**	2.4	**2.4**	2.4
Fair value	**$0.20**	$0.19	**$0.23**	$0.19

Stock-based compensation in the quarter and six months ended November 30, 2007 included amounts of $9,014 (2006 - $4,400) and $28,814 (2006 - $4,400) to consultants. Employee stock-based compensation in the same periods were $123,020 (2006 - $39,300) and $257,020 (2006 - $47,850) respectively.

12 OTHER REVENUE

In the quarter ended November 30, 2006 an agreement was reached with Honeywell to settle all outstanding legal matters. The required accounting adjustments resulted in a gain to the Company of $5,240.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

13 OTHER COSTS

In the quarter ended November 30, 2006 costs of $21,317 were incurred to remedy a design deficiency of a project. In the six months ended November 30, 2006 remedial costs were $36,001.

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.

One unaffiliated customer accounted for 81% of sales in the quarter and 92% for the six months ended November 30, 2007. Two unaffiliated customers accounted for 100% of sales in the quarter and six months ended November 30, 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 cash, short-term investments, accounts receivable and accounts payable denominated in U.S. dollars. As at November 30, 2007, assets denominated in U.S. dollars are cash, short-term investments and accounts receivable totalling US$462,089 (US$nil at November 30, 2006) and liabilities denominated in U.S. dollars are accounts payable totalling US$342,022 (US$4,853 at November 30, 2006).

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

16 SUBSEQUENT EVENTS

On December 13, 2007 the Company announced that it had secured a five year $2,500,000 line of credit with the Toronto Dominion Canada Trust bank to facilitate the Company's co-investment in assets such as Flu-Ace® and Dry-Rex® systems using its Thermal-Aud™ program, through its wholly owned subsidiary ForEverGreen Energy Inc.

On January 21, 2008, the Company announced that it had closed a non-brokered private placement with gross proceeds of $1,017.500. The financing consisted of the issuance of 1,517,500 units, each unit comprising one common share and one non-transferable share purchase warrant entitling the holder to acquire one additional common share at an issue price of $0.50 per warrant any time within two years of issuance and 1,875,000 units, each unit comprising one flow-through common share. A total of 3,392,500 units were sold at a price of $0.30 per unit.

17 COMPARATIVE AMOUNTS

Certain 2006 amounts have been reclassified to conform with the current period'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. The Company has been served with a statement of claim for approximately $4 million from its past President. The Company has filed its statement of defence and has filed a counterclaim seeking damages from the past President in the amount of $5.4 million. The Company is confident in the merits of its own case and that the claim by the past President is frivolous and without merit and the Company will defend it vigorously. Accordingly, no provision for any potential loss has been recorded in connection with this claim.

19 RECENTLY ISSUED ACCOUNTING STANDARDS NOT YET IMPLEMENTED

Capital disclosures and financial instruments disclosures and presentation

In December 2006, the CICA issued three new standards: Section 3862 "Financial Instruments – Disclosures", Section 3863 "Financial Instruments – Presentation" and Section 1535 "Capital Disclosures". These three new standards are applicable to fiscal years beginning on or after October 1, 2007.

Section 3862 describes the required disclosures related to the significance of financial instruments on the entity's financial position and performance and the nature and extent of risks arising from financial instruments to which the entity is exposed and how the entity manages those risks. This Section complements principles of recognition, measurement and presentation of financial instruments of Section 3855 "Financial Instruments – Recognition and Measurement", 3863 "Financial Instruments – Presentation" and 3865 "Hedges".

Section 3863 establishes standards for presentation of financial instruments and non-financial derivatives. It complements standards of Section 3861 "Financial Instruments – Disclosure and Presentation".

Section 1535 establishes standards for disclosing information about an entity's capital and how it is managed to enable users of financial statements to evaluate the entity's objectives, policies and procedures for managing capital.

The Company will implement these three new standards in its first quarter of fiscal year 2009 and is currently evaluating the impact of their adoption on its consolidated financial statements.

Second QUARTER REPORT
Period Ended November 30, 2007

MANAGEMENT DISCUSSION AND ANALYSIS

The following discussion explains material changes in the Corporation's financial condition and results of operations for the second quarter of fiscal year 2008, ended November 30, 2007. 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 1987 as a leading provider of cost-effective energy conservation and environmental compliance (air) products and solutions. Thermal Energy is providing its integrated turnkey solutions for customers to economically reduce multiple air pollutant emissions while deriving substantial energy savings benefits through advanced heat recycling. Thermal Energy's innovative abilities and unique technologies have ensured that the implemented solutions met or exceeded the air pollution control performance expectations, while at the same time generated sufficient renewable energy and operating cost savings to produce an attractive return on investment ("ROI"), thereby causing the solution to be self-financing.

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

More information on Thermal Energy can be found at www.thermalenergy.com. FLU-ACE®, THERMALONOx™. THERMALOZOMAx™,DRY-REX™, THERMAL-AUD™ and OPTINOx™ are trademarks of Thermal Energy, GEM® is a registered trademark used under licence from Gardner Energy Management Ltd. Common shares of Thermal Energy are traded on the TSX Venture Exchange under the symbol TMG.

Discussion of Operations and Financial Conditions

Revenue and Gross Profit

Total sales for the second quarter ended November 30, 2007, at $618,290, increased substantially from $127,987 in 2006. The increase in revenues from the previous year was due to progress on two contracts with Johnson Controls (JCI) and reflected revenues from the sale of GEM® products in Canada, USA and China.

Gross profit (loss) for the second quarter ended November 30, 2007 was at $(19,624) (-3.17%) compared with $(38,354) (-29.96%) in 2006. The gross loss is lower on a comparative basis from the same period in 2006 resulting from significantly higher revenues associated with undertaking two projects in parallel which were on time and on budget. The net loss was partly due to an increase in warranty related costs of $45,150 for the Valley Regional Hospital and Minas Basin projects.

Expenses

Administration expenses in the second quarter ended November 30, 2007 were $250,894, a decrease of $65,283 or (-20.64%) over the $316,177 incurred in 2006. The decrease was mainly as a result of a one-time expense of a loan made to the past President of $151,500 during the second quarter of 2006, offset by increases in this quarter of $40,720 in allocated stock-based compensation, $7,955 in additional computer supplies, general office supplies and equipment rentals, $11,250 in Directors' fees, $6,376 in Group Insurance costs and $5,630 in office rental .

Selling, marketing and business development expenses in the second quarter ended November 30, 2007 were $480,208, a significant increase of $220,512 or 84.91% over $259,696 in 2006. The increase was mainly the result of increases of $47,614 in allocated stock-based compensation, an increase of $122,984 in sales commissions and an increase of $61,120 for business development in China

Legal expenses in the second quarter ended November 30, 2007 were $5,312, an increase over the ($10,603) incurred in 2006. The main contributing factor is an increase in production of litigation briefs and meetings year over year as the Company is waiting for a period of discoveries to begin with respect to ongoing litigation with the past President and an insurance company.

Audit fee provision in the second quarter ended November 30, 2007 was $15,744, compared to $15,000 incurred in 2006.

Insurance costs in the second quarter ended November 30, 2007 were $41,563, an increase of $21,736 compared to $19,827 in 2006, due to new coverage of Errors & Omission (E&O) insurance.

Amortization of property, plant and equipment was at $7,918 in the second quarter ended November 30, 2007 compared with $6,335 in 2006, due primarily to the amortization of leasehold improvements associated with a new office lease and the acquisition of research and development test equipment.

Patent and Trademark maintenance costs were $6,295 in the second quarter ended November 30, 2007, compared to $3,203 in 2006. All Patent and Trademark costs incurred by the Company are expensed as incurred.

Research and Development costs were $22,474 in the second quarter ended November 30, 2007, compared to $22,705 in 2006. The similar results demonstrate the continued work effort in establishing a testing protocol for China with the Company's partner, South China University of Technology (SCUT) following the Company's decision to resume work in developing its patented THERMALONOx™ technology through laboratory testing.

Interest and bank charges were at $1,163 in the second quarter ended November 30, 2007 compared with $1,728 in 2006.

Foreign exchange loss on US dollar transactions increased in the second quarter ended November 30, 2007 to $21,436 compared with $792 in 2006, the result of the increasing value of the Canadian dollar.

Interest revenue amounted to $9,200 in the second quarter ended November 30, 2007 compared with $141 in 2006 as a result of increased interest from short-term investments.

Other Costs of $21,317 in the second quarter ended November 30, 2006 were to remedy the design deficiencies at the Valley Regional Hospital.

Net Loss was $863,431 in the second quarter ended November 30, 2007 compared to a net loss of $689,150 in 2006. Contributing factors resulting in the loss in 2007 were a stock-based compensation charge amounting to $132,034, increase in staff salaries and associated costs amounting to $60,977, increase of $122,984 in sales commissions, and insufficient sales volume to cover the current level of fixed costs in the Company to produce a net profit. Management continues to work hard to control overhead costs but its main focus at the present time is a dedicated effort to secure much improved sales results 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 November 30, 2007, the Company had a working capital deficiency of $488,334 compared to a positive working capital of $559,350 at May 31, 2007. Current assets of $1,663,775 declined by $399,775 from May 31, 2007. Accounts receivable were higher by $176,737, contracts in progress increased by $221,300 and cash and short-term investments declined by $799,337, which were used to meet short term cash requirements. Current liabilities at $2,152,109 increased by $647,908 from May 31, 2007. Increases of $451,110 in accounts payable together with increases of $588,798 in accrued liabilities were partially offset by a substantial decrease in deferred revenue of $392,000, to $608,000, which will be earned in subsequent periods.

Management continues to recognize the requirement to further improve liquidity in order to continue as a going concern, and as a result is aggressively working to increase sales and is continuing to develop new cooperative business relationships and exclusive sales distributorships in different, but complementary, product lines.

Additionally, the Company is engaged in discussions to structure a multi-million dollar financing arrangement with investors. The additional proceeds raised would be used for expanded sales and marketing efforts and R&D activities with THERMALONOx™.

Construction in progress

The Company's wholly owned subsidiary (ForEverGreen Energy Inc. or FEI) signed a THERMAL-AUD™ greenpower purchase agreement with FPS Canada Inc. (FPS) on August 20, 2007. The THERMAL-AUD™ Program was used as an alternative to capital budgeting and balance sheet impact by the customer to fund an energy cost reduction project at its Thurso mill, Quebec.

The Company began constructing a revenue-generating asset at Thurso in October, 2007 and, when completed in March, 2008, this asset is expected to generate $3.75 M of gross revenue over its contractual term of 6 years or approximately $625,000 per year.

Project financing by way of a $2.5 M line of credit has been secured with the Toronto Dominion Bank, together with the partial support of the Export Development Corporation.

Revenues will be recognized by the Company in the consolidated statements on a progressive basis in quarterly and year end financial reports over the course of its 6 year contract and in accordance with FEI's Power Purchase Agreement with FPS.

Related Party Transactions

In the quarter ended November 30, 2007, Directors fees for services were $15,750 compared with $4,500 in 2006. Officers fees for services were $51,000 compared with $48,000. Loans to acquire shares by a Director were $49,647 at November 30, 2007 compared with $37,000 at November 30, 2006. 250,000 options were issued to a new Director in the quarter ended November 30, 2007.

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 November 30, 2007

	2006		2007				2008	
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Sales	655,010	1,000,787	102,659	127,987	108,199	482,179	1,048,357	618,200
Net loss	402,164	425,289	512,011	689,150	520,155	721,949	417,895	863,431
Net loss per share basic and diluted	0.006	0.006	0.007	0.009	0.007	0.008	0.005	0.009

Trend Analysis:

The losses incurred in each quarter from Q3 FY 2006 through to Q2 FY 2008 are consistent in magnitude, with the exception of Q2 FY 2007, Q4 FY 2007 and Q2 FY 2008.

The losses in Q1 FY 2007 increased to $512,011 from $425,289 in Q4 FY 2006 due to additional operational costs to complete the Minas Basin and Stratford General Hospital projects.

The losses in Q2 FY 2007 increased to $689,150 from $512,011 in Q1 FY 2007 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 $683,431 partly due to lower recognized revenues from sales. The Company's work at FPS's Thurso mill is proceeding on time but cannot be recognized until the construction asset is complete and generating revenue from monthly billings to FPS.

Without the exceptions noted above, the net losses remained in a fairly constant range throughout the eight quarters summarized from Q3 FY 2006 through Q2 FY 2008, 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 November 30, 2007 as required by Canadian securities laws. Based on that evaluation, the CEO and CFO have concluded that, as of November 30, 2007, 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 Multilateral 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 November 30, 2007 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 November 30, 2007, 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. The THERMALONOx™ patented technology is yet to be tested however the Company had signed an agreement with SCUT with Chinese backing to jointly research and develop industrial applications for the Company's technology. The R&D program envisions demonstrating THERMALONOx™ on a coal-fired power plant slip stream in the Guangdong province which has been tentatively identified by SCUT as a suitable test site. Cost effective energy conservation and environmental compliance solutions sales through cooperation with JCI that have achieved or exceeded design performance has not limited the size of the market but has actually increased the market potential as evidenced by the Company's improved direct sales efforts excluding JCI

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 cooperation with JCI and through its THERMAL-AUD™ program;
- 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.

Management's addressing of the risks:

The management of the Company realizes that the operating losses of the period ended November 30, 2007, 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 a 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 second 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 maintaining its cooperation 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 it has realized in excess of $600,000 in the same period of time through the closing of smaller private placements and the exercise of options and warrants.

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 Q1 and Q2 FY 2008 depending on the demand arising from increased sales volumes.

Management has acquired new licenses and distributorship rights to 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.

Management believes that competition against its core technology of FLU-ACE™ is limited at this time and believes that the market place is sufficiently large enough to permit stronger competition in the future. 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 15, 2007 the Company announced the appointment of Anthony J. Pugliese as Vice President, Sales. Mr. Pugliese came from Direct Energy Business Services where he was Manager, Business Development, Health Care Sector, responsible for leading the development and implementation of market strategies in the Canadian healthcare and public sector markets. Prior to his tenure at Direct Energy, Mr. Pugliese was Account Manager, Healthcare Solutions with Johnson Controls, Inc. in eastern Canada.

On June 19, 2007 the Company announced that it had signed a Memorandum of Understanding to develop a joint venture with the Jiangnan Boilers and Pressure Vessels Company, Ltd. (JBPV), to deploy the Company's energy recovery solutions in key Chinese markets. JBPV, with revenues of $90 million annually, serves the chemical fertilizer, medical, oil and chemical industries in China and works with a number of international companies such as York International, BASF, SECCO, Inc., and SPX Corp.

On June 21, 2007 the Company announced that it had formalized a research and development agreement with South China University of Technology (SCUT) focused on the commercialization of the Company's THERMALONOx™ nitrogen oxides (NOx) removal technology for China's coal-fired power market. The formal agreement opened the door for the initial Chinese investment in the research of $1 million RMB (the lawful currency of the People's Republic of China) or (CAD$140,000) by the Guangzhou Municipal Science and Technology Bureau for SCUT's project resources commitment to the Company. The funding was secured in Q1 FY 2008.

On June 26, 2007 the Company announced that it had signed a letter of intent to enter its first long-term energy services agreement with one of the largest North American forest products pulp and paper process, which has a wide-spread, repeatable, application for the industry. The agreement envisages an initial five-year solution to provide the customer with approximately $2.5 M in positive cash flow and to cut greenhouse gas emissions by 50,000 tons of CO_2.

On June 28, 2007 the Company announced that it reached an agreement with Gardner Energy Management of Bristol, UK, to market its GEM® Condensate Return System in China. China represents a multi billion dollar market for condensate return systems and is the fastest growing steam systems market in the world.

On July 11, 2007 the Company announced that one of the largest pulp and paper manufacturers in China was commencing a trial installation of the GEM® Condensate Return System.

On August 7, 2007 the Company announced that it had received its first order in China for GEM® Steam Traps from Lee and Man Paper Manufacturing Co. to be installed on one of its paper machines in one of their massive plants that produces over 1.5 million tons of containerboard annually. Lee and Man will monitor the results as a basis for considering other conversions of their large condensate systems at their various plants.

On August 9, 2007 the Company announced that it had ventured into Alberta's oil, gas and petrochemical sector with a contract from an Edmonton-area petrochemical manufacturer, to begin retrofitting approximately one-third of its mid-size facility with GEM® steam traps.

On August 15, 2007 the Company announced the establishment of ForEverGreen Energy Inc., a wholly-owned green energy services subsidiary. The subsidiary will own and operate the Company's assets to be used under the THERMAL-AUD™ (Alternate Utility Delivery) program, that will allow the Company's customers to benefit from energy savings without capital investments..

On August 27, 2007 the Company announced that its wholly-owned energy services subsidiary, ForEverGreen Energy Inc. (FEI) signed an agreement for up to $3.75M with Fraser Paper Inc. to recover waste heat at its Thurso Mill. The green power agreement using THERMAL-AUD™'s program is for a term of six years. The Company will enter into a contract with FEI to supply, install and manage performance of its FLU-ACE® system at the Thurso pulp mill.

On September 18, 2007 the Company announced that it had signed a Letter of Intent with an Eastern Canada pulp and paper mill for a DRY-REX® biomass drying system to dry the mill's biomass waste stream including paper sludge for use as biofuel. The feasibility study will be completed in December, 2007 and if accepted by the mill, would lead to a contract to implement the DRY-REX® system using the THERMAL-AUD™ program through Thermal's energy services subsidiary (FEI).

On October 3, 2007, the Company announced that it had received three new initial orders for the "no fail" GEM® steam traps and an engineering contract from an existing customer involving the optimization of an older FLU-ACE® waste heat recovery system and steam system. The total value of the contracts is in excess of $125,000.

On October 29, 2007, the Company announced that it had completed its first waste heat recovery project in the U.S., valued at $1.4 M.

On November 1, 2007, the Company that it had received a second order for 39 GEM® steam traps at the Jiangsu Huachang Chemical Co.'s plant in China. The order was secured by Jiangnan Boilers and Pressure Vessels Company Ltd. (JBPV), in advance of completing a joint venture agreement under development between the Company and JBPV, a multi-billion dollar, national large scale chemical enterprise.

On November 20, 2007, the Company announced that it was being honoured by the Ottawa Section of the Institute of Electrical Engineers (IEEE) with an award for its innovative technology and success in providing custom energy and emission reduction solutions.

On November 28, 2007, the Company announced that it was entering as majority owner through its wholly owned subsidiary (Thermal Energy International (Guangzhou) Ltd.) into a joint venture with Oriental-Unicorn Sales and Marketing Co., of Guanzhou, China and E5 Enterprises LLC, of Markham, Ontario. Oriental-Unicorn was instrumental in the Company's first sale of GEM® steam traps to Lee & Man Paper Co.

Subsequent Events

On December 13, 2008, the Company announced that it had secured a five-year, $2.5 million line of credit with the Toronto-Dominion Bank to facilitate the Company's co-investment in assets such as FLU-ACE® and DRY-REX™ systems using its THERMAL-AUD Program through its wholly owned subsidiary, ForEverGreen Energy Inc. The Company's first commercial line of credit with a leading financial institution was partially supported by guarantees by Export Development Corporation because it was deemed to contribute to export-related sales.

On January 21, 2008, the Company announced that it had closed a non-brokered private placement with gross proceeds of $1,017,500. The financing consisted of the issuance of 1,517,500 units, with each unit comprising one common share and one non-transferable share purchase warrant entitling the holder to acquire one additional common share at an issuance price of $0.50 per warrant any time within two years of issuance, and, 1,875,000 units, each unit comprising one "flow-through" common share. A total of 3,392,500 units were sold at the deemed price of $0.30 per share. The proceeds of the private placement will be used to support on-going sales and marketing.

Signed in Ottawa, Ontario on this 29th day of January 2008.

Tim Angus	Olivier Toffoli
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Tim K. Angus	Oliver Toffoli, P.Eng
President and CEO	General Manager & CFO