TSO3

2006 Annual Report

The Market Responds

Profile

SINCE BEING FOUNDED IN 1998, TSO_3 HAS MADE THE DEVELOPMENT AND COMMERCIALIZATION OF INNOVATIVE AND COMPREHENSIVE SOLUTIONS FOR STERILIZATION ITS MISSION.

THE COMPANY HAS DEVELOPED A UNIQUE STERILIZATION PROCESS THAT USES OZONE AS THE STERILIZING AGENT. EFFICACIOUS, RAPID, COST-EFFECTIVE AND ENVIRONMENTALLY FRIENDLY, THIS PROCESS IS SAFE FOR BOTH OPERATORS AND PATIENTS, AND ADDRESSES PERFECTLY THE EVOLVING NEEDS IN STERILIZATION.

THE FIRST PRODUCT RESULTING FROM THIS TECHNOLOGICAL PLATFORM IS THE *125L* OZONE STERILIZER (NAMED FOR ITS 125-LITRE/4.3-CUBIC-FOOT CAPACITY), A LARGE-CAPACITY STERILIZER DEVELOPED FOR GENERAL USAGE AND DESIGNED FOR ALL HOSPITAL SETTINGS. THIS RELIABLE AND EASY-TO-USE DEVICE ALLOWS THE EFFICACIOUS STERILIZATION OF SURGICAL AND DIAGNOSTIC INSTRUMENTS THAT ARE SENSITIVE TO HEAT AND HUMIDITY. THE *125L* OZONE STERILIZER HAS BEEN CLEARED FOR COMMERCIALIZATION BY HEALTH CANADA AND BY THE UNITED STATES FOOD AND DRUG ADMINISTRATION (FDA).

TSO_3 CURRENTLY HAS MORE THAN 50 EMPLOYEES, INCLUDING 22 ON THE SALES AND MARKETING TEAM. TSO_3 BECAME A PUBLICLY OWNED COMPANY ON AUGUST 30, 2001, WITH AN INITIAL PUBLIC OFFERING OF $5 MILLION. AN ADDITIONAL $35 MILLION WAS RAISED THROUGH SUBSEQUENT ROUNDS OF FINANCING. SHARES ARE NOW TRADED ON THE TORONTO STOCK EXCHANGE (TSX) UNDER THE SYMBOL TOS.

Front page:
Johanne Tremblay
Manager of the Sterilization Department
Québec, Canada

Contents

2006 Annual Review

JANUARY **NEW SALES FORCE** — The Company begins using its own sales team for the commercialization of the *125L* Ozone Sterilizer in North America.

SALE — TSO_3 closes the first sale to an American hospital not in the referral site program.

FEBRUARY **NEW ENDORSEMENTS** — Three companies in the field of medical instrument manufacturing recommend ozone sterilization to their customers.

MARCH **SALES** — Two more sales of the *125L* Ozone Sterilizer are completed at two North American hospitals, one of which was a referral site.

APRIL **SALE** — Sale of the *125L* Ozone Sterilizer to an American health network operating in more than 70 locations. This network includes six intensive care hospitals, two outpatient campuses, several clinics, nursing homes and chronic care facilities.

JUNE **SALE** — This new sale is to a hospital in the referral site program which provided TSO_3 with a positive report, notably regarding the savings made by utilizing the *125L* Ozone Sterilizer.

REINFORCING THE SALES TEAM — The creation of new sales positions in the United States supports the sales effort and accelerates the commercialization of the *125L* Ozone Sterilizer.

JULY **POSITIVE REPORTS FOR THE *125L* OZONE STERILIZER** — Obtention of written reports from users and managers in American hospitals. TSO_3 is proud to present these positive testimonials to future customers which describe the *125L* Ozone Sterilizer as a cost-effective, easy-to-use, environmentally friendly and safe device.

AUGUST **FURTHER CLEARANCE FROM THE UNITED STATES FOOD AND DRUG ADMINISTRATION** — The FDA authorizes the utilization of the *125L* Ozone Sterilizer for sterilizing a significantly broader range of lumened instruments that are longer and with smaller interior diameters. TSO_3's technology is put even further ahead of the competition and redefines sterilization standards.

SEPTEMBER **PATENTED IN THE UNITED STATES AND EUROPE** After several years of effort and waiting, TSO_3's ozone sterilization process is patented in Europe and in the United States. This patent covers the ozone sterilization method and the process for creating humidity at low temperatures – a process exclusive to the Company and necessary for effective sterilization.

NEW ENDORSEMENTS – Four new medical instrument manufacturers endorse the Company's technology and thus confirm the *125L* Ozone Sterilizer is safe and compatible with their products.

OCTOBER **NEW, EXPERIENCED RESOURCES** — Creating new positions for sales representatives supports the commercialization efforts for the *125L* Ozone Sterilizer and testifies to the growing awareness of the technology.

DECEMBER **SALES** — Three new hospitals - two university hospitals in the United States, and one Canadian-referral site hospital – purchase a *125L* Ozone Sterilizer.

—BUYERS EXPRESS TOTAL SATISFACTION

Safer and less expensive to operate

"THIS LOW-TEMPERATURE STERILIZATION TECHNOLOGY IS AN EXCELLENT ALTERNATIVE TO EXISTING APPROACHES. IT'S A UNIT THAT CAN SAVE US MONEY, BECAUSE NOT ONLY IS THE STERILIZATION TIME VERY FAST, IT PROVIDES USERS WITH WHAT THEY NEED, SAFELY AND AT LOWER COST".

"THE PEOPLE WHO USE IT EVERY DAY RECEIVED WONDERFUL TRAINING, THANKS TO THE CLINICAL SPECIALIST FROM TSO_3, AND HAVE HAD NO PROBLEMS. THE COMPANY'S FRONT-LINE SUPPORT HAS BEEN JUST GREAT". Chrystine Hatem, Coordinator for Perioperative Material and Manager of the Sterilization Department.

TSO_3's strategic positioning of the *125L* Ozone Sterilizer in the North American market originally involved agreements with various referral sites. These North American Hospitals agreed to conduct on-site trials of the *125L* Ozone Sterilizer and, if satisfied, positive testimonials of the technology to future users. The objectives of this strategic positioning were fully realized in 2006. Through this trial program, the Company was able to demonstrate the numerous advantages of the *125L* Ozone Sterilizer, such as its ability to reduce sterilization costs and its fast instrument turnaround time. For TSO_3, positive testimonials from satisfied customers are directly contributing to the success of the Company, and supporting current and future efforts with hospitals for the sale of the *125L* Ozone Sterilizer. This strategy is now showing results, as the first operators of the *125L* Ozone Sterilizer can now share their positive experiences with prospective customers of the device.

FROM REFERRAL SITES TO BUYERS

In 2006, several referral sites became the first to purchase, as is the case with a hospital in South Carolina that had shown confidence in TSO_3 from the beginning.

Chrystine Hatem has been an Operating Room nurse for more than 30 years, and has solid training in sterilization and decontamination technology. She is also the coordinator for perioperative material and manager of the sterilization department. Always on the lookout for new technologies that are more effective and allow greater savings, she immediately showed interest when she heard about a new sterilization technology using ozone. For this nurse, the *125L* Ozone Sterilizer addressed the unmet needs of the hospital.

When Ms. Hatem presented this technology to internal hospital administrators, they determined it could be the solution to all the problems they were experiencing with other low-temperature sterilization technology. Within a few months, the sterilizer was being used to full capacity and had proven to be indispensable.

During this time, an evaluation was carried out to calculate the operating costs of the *125L* Ozone Sterilizer. To evaluate savings using the device compared with other low-temperature sterilization technology, the hospital tested 32 batteries by sterilizing them with each of the technologies. This testing demonstrated that ozone technology was only one sixth of the cost to operate compared with the other devices. At this low cost of operation, users are able to recuperate the initial purchase cost quite quickly. Not only is the *125L* Ozone Sterilizer cost-effective, it is also efficient. This hospital runs two to three full sterilization loads per day. According to Ms. Hatem, these are the main reasons that compelled the hospital to make the purchase of the *125L* Ozone Sterilizer.

MORE THAN REFERRAL SITES

TSO_3's customers, including the South Carolina hospital, are excellent ambassadors for the technology. Indeed, these institutions provided numerous positive references to potential customers regarding the utilization of the *125L* Ozone Sterilizer. Over the past year, many hospitals have contacted the current users of the device to obtain information and check on the performance and advantages of the *125L* Ozone Sterilizer.

These hospitals are viewed as pioneers in the use of ozone sterilization technology and they are happy to share their experience because they know the curiosity this technology inspires.

The current users have become a powerful part of the sales effort as TSO_3 develops its base of prospective customers.

Interview number

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CHRYSTINE HATEM
Coordinator for Perioperative Material
and Manager of the Sterilization Department
South Carolina, USA

—A UNIQUE AND SUPERIOR TECHNOLOGY

Manufacturers impressed with compatibility between their instruments and the *125L* Ozone Sterilizer

"BECAUSE OUR CUSTOMERS REQUIRE SEVERAL ALTERNATIVES FOR STERILIZING THEIR PRODUCTS, WE ARE CONSTANTLY LOOKING FOR NEW STERILIZATION METHODS. TSO_3 OFFERS A TECHNOLOGY THAT IS SAFE AND ENVIRONMENTALLY FRIENDLY, THAT PERFORMS WELL AND IS COMPATIBLE WITH OUR PRODUCTS. WHEN THE COMPANY CONTACTED US, WE IMMEDIATELY DECIDED TO TRY THEM OUT".
Pete Mastores, President of *Volk Optical, Inc.*

The year 2006 was an important year that allowed TSO_3 to consolidate the efforts of recent years. All the elements necessary for the successful commercialization of the *125L* Ozone Sterilizer have been put in place.

COMPATIBILITY AT THE CORE OF EFFECTIVENESS

In order to respond to constant evolution of medical instruments, TSO_3 offers manufacturers a Manufacturers' Testing Program (MTP). The goal of this service is to assure mutual customers that their reusable medical instruments can be safely and repeatedly sterilized in the *125L* Ozone Sterilizer. This process is possible through the collaboration to date, of more than 150 firms in the medical field, including the manufacturers of medical instruments and their suppliers of materials and processes.

ENDORSEMENTS AND COMMERCIALIZATION

Early in the year, the Company announced new compatibility endorsements for its technology from three medical instrument manufacturers. These endorsements cover instruments utilized in a variety of fields, such as pulmonary, cardiology, plastic and reconstructive surgery, as well as numerous other types of micro-invasive surgery. These endorsements also unquestionably give TSO_3 added value.

These new endorsements come from the Electro-Surgical Instrument Company, Canada Endoscope and Koven Technology, three well-established businesses in the field of medical instruments in North America.

Heather Flotron, President of Koven Technology, first realized the impact that ozone sterilization would have on the market when Koven's customers started asking whether their products are compatible with this technology. Since then, Koven Technology has successfully validated the compatibility of the company's vascular probes with the *125L* Ozone Sterilizer, and considers this feature a competitive advantage that puts them in a favorable position for promoting their products.

VOLK OPTICAL, INC.

Based in Mentor, Ohio, Volk Optical is a medical instrument manufacturer and an important collaborator. For more than 50 years, it has produced and sold precision diagnostic and eye surgery lenses. About 65% of its market is international, and composed of ophthalmologists, optometrists and opticians. The company's products are long lasting when well maintained using good cleaning and sterilization methods. Volk Optical is well recognized in the optical field and is proud of its fine reputation and the image it has built over the years.

Since 2003, TSO_3 has been working in close collaboration with Volk Optical – a solid partnership developed over time and based on trust and transparency. The relationship continues to grow.

Always forward-looking, Volk Optical saw the potential advantages and benefits of ozone sterilization. They were able to see how the *125L* Ozone Sterilizer would allow Volk Optical to respond to the numerous questions from their customers regarding the environmental aspects of the sterilization process.

For Pete Mastores, President of Volk Optical, endorsing a technology like ozone sterilization means ensuring good service to current and future customers. Developing collaboration with the supplier of this technology – TSO_3 – is vital to Volk Optical's growth and business opportunities.

INTERESTED MANUFACTURERS

Such endorsements mean that manufacturers are promoting the compatibility of their products with the *125L* Ozone Sterilizer. These endorsements let customers know that their instruments can be safely and repeatedly sterilized. The excellent relations that TSO_3 maintains with medical instrument manufacturers are therefore very important, because they strongly contribute to business development.

ANOTHER MAJOR RECOGNITION

The United States Patent and Trademark Office (USPTO) and the European Patent Office (EPO) have officially awarded optimal protection to TSO_3 in terms of intellectual property of 20 years. The patent covers not only the method of ozone sterilization, but the process for creating low-temperature humidity: a process necessary for efficacious sterilization that is owned by TSO_3.

This patent is in addition to the licensing contract signed in 2002 with an American company. The signing of this licensing agreement gave TSO_3 the exclusive use of the patent related to the ozone sterilization method in the United States for a period of 20 years.

The R&D department at TSO_3, which focuses on refining the technology and improving products like the 125L Ozone Sterilizer, has several more patents pending.

Interview number 2

PETE MASTORES
President of Volk Optical, Inc.
Ohio, USA

—A STRONGER SALES TEAM

Efforts focused 100% on selling the *125L* Ozone Sterilizer

"BEFORE JOINING THE TEAM AT TSO_3, I WORKED FOR MORE THAN 20 YEARS IN HOSPITAL SETTINGS, AND EVEN ON THE SALE OF A DIFFERENT LOW-TEMPERATURE STERILIZATION METHOD. TSO_3 OFFERS INCREDIBLE POTENTIAL FOR ADVANCEMENT AND A UNIQUE TECHNOLOGY THAT, ACCORDING TO MY EXPERIENCE, MEETS ALL THE NEEDS NOT PREVIOUSLY MET IN THE MARKET. I WANTED TO PUT MY EXPERTISE TO WORK FOR SUCH A BUSINESS".
David R. Wynn, Sales Manager.

"OUR FIRST JOB IS TO INSTALL THE STERILIZER, BUT OUR PRIORITY IS TO TAKE CARE OF ANY TECHNICAL PROBLEMS THAT COULD POP UP. WE ARE READY TO RESPOND QUICKLY – SUPPORT THAT IS GREATLY APPRECIATED BY USERS BECAUSE THEY FEEL THEY CAN COUNT ON TSO_3. THEY BECOME PARTNERS WITH THE COMPANY".
Nicolas Dumas, Field Service Technician.

"WE ARE DEDICATED TO EACH HOSPITAL AND OFFER PERSONALIZED SERVICE. FOR EXAMPLE, WE TRANSFER SPECIFIC REQUESTS FOR VALIDATION TO THE MANUFACTURERS' TESTING PROGRAM (MTP) DEPARTMENT AND WE KEEP OUR CUSTOMERS ADVISED OF THE LATEST ENDORSEMENTS. WE ARE CONSTANTLY DEVELOPING OUR RELATIONSHIPS WITH THEM".
Francine Paradis, Clinical Specialist.

Throughout the year, the TSO_3 team – from the customer service technicians and clinical specialists to the sales professionals – has focused their efforts on the commercialization of the *125L* Ozone Sterilizer.

AN EXPERIENCED AND GROWING TEAM

At the beginning of 2006, the Company redefined its commercial sales strategy. TSO_3 relies on its own sales and marketing team dedicated more than ever to the success of the *125L* Ozone Sterilizer. This team, in addition to increasing awareness and sales, has a mission to obtain market recognition for the value-added benefits of the ozone sterilization technology.

Today, some 20 sales professionals working for the Company share the North American market. They are managed by experienced people and have a full range of sales tools developed by TSO_3. They not only have broad experience in the sale of capital equipment, they also have thorough knowledge of hospital settings that allows them to confidently discuss issues that affect the surgical suite and the central sterilization unit.

In May, at the annual convention of the International Association of Healthcare Central Service Material Management (IAHCSMM) in Las Vegas, Nevada, the sales and marketing team – presented for the first time independently in the United States – identified more than 100 potential new customers interested in the technology. During this major industry event, the team forged excellent contacts that will ensure solid market penetration.

A LONG-TERM SALES CYCLE

Known for being conservative, hospitals have reacted positively to the arrival of the technology. The first customers are very satisfied with the performance of the *125L* Ozone Sterilizer and testify to its effectiveness and to the savings accrued, the increased safety for users, patients and the environment, and to the ease of use.

The average sales cycle for established healthcare capital equipment is estimated to be 12 months, but the sales cycle for new technology such as the *125L* Ozone Sterilizer is even longer. Nevertheless, throughout the year the Company made many contacts with potential customers, creating a pipeline of sufficient size to reach sales targets for 2007, with some sales already closed in 2006.

CONSOLIDATING RELATIONSHIPS WITH THE FIRST CUSTOMERS

One of the objectives this year was to consolidate relationships with the first customers, both referral sites and first buyers, without forgetting new manufacturers constantly being added to our list of collaborators.

The goal of TSO$_3$ is to increase the number of sterilizers in operation functioning on a regular basis. The growing base of customers will provide excellent references to future purchasers, as current users are already doing. This positioning is in accord with the Company's strategy, ensuring the best possible market penetration for the *125L* Ozone Sterilizer.

METICULOUS AND FAST CUSTOMER SERVICE

The Company employs the best technicians in their respective fields: they are attentive to customers and their questions, dedicated to the product and the Company. This team is driven by the constant search for solutions that meet customers' needs. In return, customers are satisfied with the service provided and are even eager to know more about the technology.

This relationship between technicians and customers is vital, because they are very good advisors. These customers have practical experience with the *125L* Ozone Sterilizer and therefore can provide precious advice on how to make it a better sterilization technology.

CLINICAL SPECIALISTS SERVING USERS

To determine and maximize the utilization of the *125L* Ozone Sterilizer in hospitals, the clinical specialists at TSO$_3$ are best placed to support its features advantageously. Acting as consultants, their role is to help customers utilize and integrate the technology.

The clinical specialists are responsible for observing and listening to customers. They must fully understand how the sterilization technicians and the nurses in the surgical suite work.

Clinical specialists perform a thorough account analysis of the sterilization department, assessing when and how and what the hospital is sterilizing. Once the sterilizer is installed and, the technicians ensure the proper operation of the sterilizer, the clinical specialists oversee the education necessary to integrate the *125L* Ozone Sterilizer into the department's daily routine.

FROM LISTENING TO TRAINING

Although the mission of the clinical specialists is to train the users of the ozone sterilization technology, their responsibility does not end there. The clinical specialists assist the users during their continuing training program. They must ensure the process meets current standards and recommendations, and, as needed, help the customer in this regard. For instance, the TSO$_3$ clinical team may recommend certain changes to the way a hospital packages medical devices to facilitate the introduction of this new sterilization process into the hospital. Company employees are very involved in all phases of the integration process.

PRODUCTS IN CONSTANT EVOLUTION

Among recent advances, TSO$_3$ can now count on new clearance from the Food and Drug Administration in the United States regarding lumened instruments.

This major recognition allows us to stand out even more from the competition as the Company is redefining the industry standards for sterilization capabilities. Several of our partners, among the most renowned manufacturers of rigid instruments for micro-invasive surgery, have confirmed that the 125L Ozone Sterilizer is capable of sterilizing all their instruments.

Interview number 3

DAVID R. WYNN
Sales Manager for TSO_3
Arizona, United States

NICOLAS DUMAS
Field Service Technician for TSO_3
Québec, Canada

FRANCINE PARADIS
Clinical Specialist for TSO_3
Québec, Canada

MESSAGE FROM THE MANAGEMENT

A year of consolidation and action

IN CONTINUITY WITH PREVIOUS YEARS, 2006 NONETHELESS STANDS OUT FOR THE EVOLUTION OF THE COMMERCIALIZATION OF THE *125L* OZONE STERILIZER. MARKETING BEGAN WITH THE IMPLEMENTATION OF OUR OWN SALES AND MARKETING TEAM, A DIFFICULT ADVENTURE NECESSARY FOR THE SUCCESS OF THE COMPANY.

In early 2006, we hired sales professionals having relevant experience in the commercialization of medical capital equipment – a long and arduous task which was longer than expected, as we were committed to finding and recruiting the very best people. Today, we are confident and convinced that we have put together the right elements to reach our objectives.

In addition to increasing both awareness of the Company, and our sales, this expert team has the mission to gain recognition for our ozone sterilization technology. Mission accomplished – we made several sales in 2006, and the ultraconservative market in which we are active has adopted our technology.

The growing number of endorsements from consistently satisfied users, committed to providing positive references to potential customers, is excellent proof of this acceptance. These referrals are essential to the success of the commercialization of our product.

Introducing a new technology like ours, to the market, is estimated to take between 12 to 18 months, which is long and normal. Nevertheless, our sales and marketing team made many contacts with potential customers during the year and concluded several sales in 2006. The number of potential clients in our pipeline for 2007 is sufficient to reassure us that we will reach the objectives of our business plan.

Another of our objectives for this year was to consolidate relationships with our initial customers – the referral sites and the first buyers – without forgetting new manufacturers who are continually being added to our list of collaborators. We reached our target: today, the hospitals we selected as referral sites all testify to the efficacy of our sterilization process to our potential customers, contributing to our development. For several of our first clients, the acquisition process for more units is already underway.

Our technology is now recognized and accepted, as is demonstrated by the numerous positive reports from our customers. As a result, this year we have decided, with some exceptions, to terminate the strategic phase of referral sites and trial periods for the *125L* Ozone Sterilizer.

Our efforts in 2006 were not solely focused in the area of sales. For example, we received the third clearance from United States Food and Drug Administration, attesting that the *125L* Ozone Sterilizer is capable of sterilizing a much broader range of lumened instruments with much smaller interior diameters and much longer lengths. Through this major recognition, TSO_3 has redefined industry standards in terms of sterilization capabilities and now stands out even more from the competition.

New medical instrument manufacturers have also been added to our list of collaborators and have endorsed our technology. This adds significant value, because each manufacturer affirms by these endorsements that their instruments can be safely sterilized in the *125L* Ozone Sterilizer.

After years of waiting, our ozone sterilization process was finally patented in Europe and the United States, thereby ensuring TSO_3 additional intellectual property protection of 20 years.

All our efforts are oriented to the commercialization of the *125L* Ozone Sterilizer – a step that requires patience and perseverance. The testimonials from hospitals and customers, and the receptivity of the market to our product, clearly demonstrate the need for a simple, environmentally-friendly and cost-effective technology like ours. This year of consolidation and action has allowed us to bring together the conditions necessary for our development, – and will leverage our commercial success.

Germain Carrière
Chairman of the Board

Jocelyn Vézina
Chief Executive Officer

ACKNOWLEDGEMENTS

The year 2006 allowed us to realize major advances resulting in a very stimulating outlook. We want to thank all of our employees for their determination and dedication to the Company, giving each day their maximum to make TSO_3 a genuine success.

We thank all our partners in North America and abroad, as well as the referral sites that agreed to testify to the performance of our ozone sterilizer whenever needed, to the benefit of future users.

We also thank the members of our Board of Directors, who put their enormous experience to the benefit of TSO_3, as well as the members of our scientific committee for their outstanding support.

Thanks as well go to our shareholders, who believe in the immense potential of TSO_3 and are confident with what the future will bring.

Financial Statements 2006

Analysis of financial situation and operating results

This management analysis presents information on TSO_3 Inc. activities, and compares the operating results and financial situation for the years ended December 31, 2006 and December 31, 2005. The following information must be read in conjunction with the audited financial statements and unless advised otherwise, all figures are in Canadian dollars.

OVERVIEW

Founded in June 1998, TSO_3 (the "Company") has developed a unique new sterilization process that uses ozone as the sterilizing agent. The first device resulting from this technological platform, the *125L* Ozone Sterilizer was designed to sterilize the new generation of surgical and diagnostic instruments made of heat-sensitive polymers. After receiving approval from Health Canada on May 3, 2002, the Company obtained clearance from the United States Food and Drug Administration (FDA) to sell the *125L* Ozone Sterilizer and the accompanying Chemical Indicator on September 3, 2003.

INTERNAL SALES FORCE

The sales and marketing department was strengthened significantly between December 31, 2006 and December 31, 2005. At the beginning of 2006, the Company redefined its commercial sales strategy and decided to implement its own sales and marketing team. As a result, the Company hired new sales managers during the year. The sales and marketing team counts 22 employees at the end of the period. The team can now profit from the contribution of sales professionals who have extensive experience working with capital equipment sales to both operating rooms and central sterilization departments in hospitals.

CANADIAN PILOT SITES

The Company entered into agreements with six hospital centres. These hospitals have agreed to make their sterilization department facilities, personnel and equipment available for the project. These tests aim to validate the compatibility of an increasing number of instruments and packaging, and also to demonstrate to hospitals how the *125L* Ozone Sterilizer can considerably reduce direct and indirect operating costs.

As of December 31, 2006, the in-use evaluations and the transfer of property have been completed in two of the Canadian Pilot Sites. During the fourth quarter of 2006, two other sites were not in a position to buy the sterilizer so the Company decided to remove the devices. As of December 31, 2006, two remaining sites are still testing the sterilizers. The Company anticipates concluding evaluations within the coming months.

AMERICAN REFERRAL SITES

The Company received market recognition for its innovative technology by promoting the use of its *125L* Ozone Sterilizer at several prestigious hospitals in the United States. These in-use evaluations are presently ongoing and function as a trial period before using the sterilizer in a real hospital setting. The users agree to testify to their satisfaction and to act as a showcase site for the technology for future clients. In exchange, the referral site participants receive a discount on the selling price of the *125L* Ozone Sterilizer.

The principal objectives of the referral sites were: to allow the users to experience the operation of the *125L* Ozone Sterilizer in a live hospital context; and to receive testimonials from the referral sites to aid sales to future clients. These objectives are currently being met. The Company expects that certain referral sites will not acquire the sterilizer at the end of the trial period, for budgetary reasons for example, while others may purchase more than one.

The Company has signed agreements with seven renowned hospital networks. By December 31, 2006, five referral sites had completed their in-use evaluations and one had bought the sterilizer. Four sites returned the sterilizer. Among them, two were not able to proceed to the acquisition due to budgetary constraints, and two other devices - installed in the same site - were returned due to the departure of the manager involved in the operation of the *125L*. However this site wrote a testimonial and agreed to testify to its effectiveness.

As of December 31, 2006, two remaining sites are still testing the sterilizers. The Company anticipates concluding evaluations at the referral sites within the coming months.

Critical accounting policies

The Company financial statements are prepared in accordance with Generally Accepted Accounting Principles in Canada ("G.A.A.P."). The Company's critical accounting policies include the use of estimates, revenue recognition, the recording of research and development expenses and the determination of the useful lives or fair value of goodwill and intangible assets. Some of our critical accounting policies require the use of judgment in their application or require estimates of inherently uncertain matters. We believe that these policies, described hereafter, are critical and require the use of complex judgment in their application:

INTANGIBLE ASSETS

Intangible assets consist of the acquisition cost of a patent licence, the acquisition cost of a technology including all related rights, patent and trademark costs.

Amortization of intangible assets is calculated using the straight-line method over the useful lives, of the patents, licence or trademarks, according to the following:

Patents	20 years
Licence	16 years
Trademarks	10 and 15 years

The patents are amortized using the straight-line method over the 20 years useful life.

During the fiscal year 2006, an amount of $220,370 was recorded for the amortization of intangible assets.

Intangible assets are periodically tested for impairment based on an estimate of undiscounted cash flows for the remaining amortization period. Any impairment loss revealed by this test will be carried to earnings for the period during which the loss occurred.

REVENUES RECOGNITION

The Company generates revenue mainly from the sale of ozone sterilization units, parts and instruments related to these units and contracts for the after-sale service and maintenance of these units. The Company is generally committed under revenue arrangements with multiple deliverables that include delivery of units, installation, maintenance, consulting and after-sale service. The Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred, the price to the buyer is fixed or determinable and collection is reasonably assured.

Revenue from revenue arrangements with multiple deliverables are divided into separate units of accounting when the Company has reliable evidence. When revenue cannot be determined, it is deferred and calculated using the straight-line method over the term of the contract.

Revenue related to units sold, parts and instruments related to those units, installation and consulting services are recognized once the services are provided and the client accepts the services received. Maintenance and after-sales service contracts are calculated using the straight-line method over the term of the contract.

COMPENSATION AND OTHER STOCK-BASED PAYMENTS

Commencing January 1, 2004, the Company now records stock-based compensation and other stock-based payments according to the fair value method as required by the new Canadian Institute of Chartered Accountants (CICA) regulations. The compensation expense associated with this method of stock-based payment is therefore recognized as earnings. The adoption of this new regulation resulted in an increase of $651,630 in compensation expenses for 2006 ($416,672 in 2005). The stock-options granted for fiscal year 2003 through 2006 will result in additional expenses of $494,127 in 2007, $214,853 in 2008 and $53,819 in 2009. These costs constitute non-cash operations.

FUTURE ACCOUNTING CHANGES

Under new CICA accounting standards “Comprehensive Income”, “Financial Instruments – Recognition and Measurement”, and “Hedges” effective January 1, 2007, the Company has elected to classify temporary investments as investments held for trading. Consequently, any differences in the fair value of these assets will be recorded directly in net earnings (loss). The adjustments attributable to the classification of certain assets and liabilities as held for trading will be recognized in the opening balance of retained earnings (deficit) as of January 1, 2007. The Company has not yet determined the impact that these new standards will have on its financial statements.

Summary of operating results

Fiscal years ended December 31 (in thousands of dollars except loss/share)

Download Chart in Excel Format

	2006	2005	2004
Sales	**$ 1,070**	$ 172	$ -
Operating Expenses	**$ 1,643**	$ 994	$ 567
Marketing	**$ 3,185**	$ 1,873	$ 1,651
Research and Development (before tax credits)	**$ 1,682**	$ 1,878	$ 1,573
Administrative	**$ 3,090**	$ 2,378	$ 2,854
Financial Fees	**$ 18**	$ 14	$ 13
Other Revenues	**$ 1,071**	$ 530	$ 726
Income Tax	**$ -**	$ -	$ 12
Net Loss	**$ 7,477**	$ 6,435	$ 5,946
Net Loss Per Share	**$ 0.20**	$ 0.19	$ 0.19
Weighted Average Number of Shares Outstanding (in thousands)	**36,560**	33,824	31,400

SALES

For the fiscal year ended December 31, 2006, sales amounted to $1,069,739 compared to $171,766 for the same period in 2005. During this fiscal year, the Company recorded the sale of eight *125L* Ozone Sterilizers and accessories compared to one sale and accessories in 2005.

OPERATING

For the fiscal year ended December 31, 2006, Operating expenses increased $649,474 (65.4%) to reach $1,643,116 compared to $993,642 in 2005. Operating expenses are related to the Production and After-Sales Service Department operations as well as manufacturing the devices. Having sold more devices during 2006, the variance between the two periods is explained by an increase in the cost of goods sold, warranty fees, travel and transportation expenses.

MARKETING

For the fiscal year ended December 31, 2006, Sales and Marketing expenses increased to $1,312,093 (70%) to reach $3,184,933 compared to $1,872,840 for the corresponding period in 2005. This increase is explained by the hiring of new sales managers during the fiscal year 2006. This Department counts 22 employees at the end of the fiscal year 2006 compared to 16 at the beginning of the year. The variance between these two periods is explained by an increase in the costs related to salaries, bonus, commissions, recruitment, as well as representation fees. On the other hand, costs related to referral sites have decreased during the fiscal year 2006.

RESEARCH AND DEVELOPMENT ACTIVITIES

For the fiscal year ended December 31, 2006, the Company continued its research and development efforts as per its budget. For the fiscal year 2006, R&D expenses before tax credits realized a decrease of $195,897 (10.4%) to reach $1,682,413 compared to $1,878,310 for the corresponding period in 2005. The declines between these two periods is explained by a reduction in material purchases and expenses related to scientific advisor committees, as well as a decrease in work on the inactivation of prions. The majority of the prion research is being funded by the British Government. On the other hand, the amount paid in salaries, fringe benefits and bonuses during the fiscal year 2006 increased.

ADMINISTRATION

For the fiscal year 2006, administration expenses increased $712,199 (29.9%) to reach $3,090,571 compared to $2,378,372 for the corresponding period in 2005. This increase is mainly attributed to an increase in *Stock-based Compensation,* professional fees, salary and bonus paid. During the fiscal year 2006, two employees were added to this department.

OTHER REVENUES

For the fiscal year ended December 31, 2006, other revenues increased $541,264 (102%) to reach $1,071,477 compared to $530,213 in 2005. The increase is explained primarily by an increase in investment revenues, in R&D income tax credits, and in government grants. The Company received the $250,000 representing the third installment of payments from IQ Immigrants Investisseurs Inc.

NET LOSS

The Company recorded for the period ended December 31, 2006 a net loss of $7,477,443 or $0.20 per share, compared to a net loss of $6,434,885, or $0.19 per share in 2005.

Financial position

As at December 31 (in thousands of dollars)

Download Chart in Excel Format

	2006	2005	2004
Liquid Assets (Cash & Temporary Investments)	$ 7,309	$ 14,595	$ 10,679
Accounts Receivable	$ 811	$ 344	$ 332
Inventories	$ 3,388	$ 3,303	$ 2,845
Property, Plant and Equipment	$ 391	$ 416	$ 498
Intangible Assets	$ 3,712	$ 3,832	$ 3,908
Short & Long Term Debt	$ -	$ -	$ 69
Deferred Revenues	$ 76	$ 962	$ 36
Share Capital and Contributed Surplus	$ 52,149	$ 50,657	$ 39,866
Shareholders' Equity	$ 14,624	$ 20,610	$ 17,431

LIQUID ASSETS AND FINANCIAL SITUATION

As of December 31, 2006, cash, temporary investments and accounts receivable amounted to $8,119,901 compared to $14,939,305 as of December 31, 2005.

INVENTORIES

As of December 31, 2006, short term assets showed inventory valued at $3,387,837 compared to $3,303,258 as of December 31, 2005. These amounts were attributable to the cost of producing sterilizers for the commercial launch as well as different trials performed in hospitals.

DEFERRED REVENUES

As of December 31, 2006, deferred revenues amounted to $75,709 compared to a total amount of $961,821 for the same period last year. These deferred revenues reflect amounts received for a certain number of sterilizers that were delivered but for which the ownerships had not been transferred. It also includes warranties and service contracts that had been paid in advance. As of December 31, 2006, deferred revenues did not include any device for which the ownership had not yet been transferred. During the fiscal year 2006, the sterilizers, included in the item Deferred Revenues, were the object of a transfer of property or were paid off.

REQUIRED CAPITAL PAYMENTS AND CONTRACTUAL COMMITMENTS

Required capital payments and the various contractual commitments in the coming fiscal year are as follows:

Download Chart in Excel Format

	2007	2008
R&D Contract	$ 114,447	$ -
Rent	$ 28,355	$ 19,632
Referral and Pilot Sites	$ 105,688	$ -

Summary of quaterly results

Download Chart in Excel Format

	2006				2005			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
($000 except loss/share)								
Sales	434	34	301	301	11	161	-	-
Other Revenues	242	150	443	236	197	157	75	101
Net Loss	1,967	2,013	1,492	2,005	1,834	1,401	1,638	1,562
Net Loss per share	0.05	0.06	0.04	0.05	0.05	0.04	0.05	0.05

This figure shows the quarterly evolution of sales and other income as well as losses. The item *Net Loss per Share* has been relatively stable and constant for the past eight quarters.

Fourth quarter

Three-month period ended December 31, 2006 compared to period ended December 31, 2005.

SALES

For the three-month period ended December 31, 2006, Sales amounted to $433,629 compared to $10,421 for the corresponding period in 2005. The Company recorded the sale of three sterilizers and its accessories during the last quarter of 2006 while in the period corresponding in 2005, the Company recorded only accessory sales.

OPERATING

For the three-month period ended December 31, 2006, operating expenses were $456,976 compared to $300,327 for the same period in 2005. The variance between the two periods is explained by an increase in the cost of goods sold, having sold more devices during the quarter, warranty fees, travelling and transportation expenses.

MARKETING

Marketing expenses amounted to $895,178 for the three-month period ended December 31, 2006 compared to $578,203 for the corresponding period in 2005. This increase is mainly due to more intensive marketing activities, costs related to salaries, commissions, and recruitment as well as representation fees. On the other hand, the amount paid for referral sites decreased between the two periods.

RESEARCH & DEVELOPMENT ACTIVITIES

For the three-month period ended December 31, 2006, Research and Development expenses before tax credits amounted to $414,830 compared to $507,570 for the same period in 2005. The decline between the two periods is explained primarily by a reduction in expenses related to scientific advisor committees, as well as a decrease in the expenses related to the inactivation of prions. On the other hand the amount paid in salaries during the fiscal year 2006 increased.

ADMINISTRATION

Administration expenses amounted to $870,078 for the three-month period ended December 31, 2006 compared to $654,463 for the corresponding period in 2005. This increase is mainly attributed to a rise in professional fees, and *Stock-based Compensation*.

OTHER REVENUES

For the last quarter of 2006, the Company realized Other Revenues $241,852 compared to $196,648 for the corresponding period in 2005. The increase between these two periods is mainly due to a rise in investment revenues and R&D income tax credits.

NET LOSS

The Company recorded, for the fourth quarter of 2006, a net loss of $1,966,937, or $0.05 per share, compared to $1,833,666 for the corresponding period in 2005, or also $0.05 per share.

Capital resources

Historically, the Company has funded its activities from several rounds of public and private financing, as well as from various government subsidies. Since its inception in June 1998, the Company has raised $47,000,000 from the sale of its equity.

For the fiscal year 2006, the monthly burn-rate was approximately $680,000, the Company anticipates that its monthly burn-rate could increase slightly during the upcoming months due to an increase in expenses related to the commercialization of the *125L,* and then decrease as sales accelerate.

On July 7, 2005, the Company closed a private placement of $10,000,000 from the sale of 5,000,000 units. Each unit is composed of one common share and one-half warrant. Each whole warrant entitles its holder to purchase one additional common share of the Company at a price of $2.50 at any time until July 7, 2007. As of December 31, 2006, 2,419,850 warrants were outstanding representing potential additionnal funds for the Company of $6,049,625.

The Company has a line of credit with which it can obtain advances up to a maximum of $350,000. Amounts drawn on this line of credit, renewable on an annual basis, bear interest at the prime rate plus 1.0%. The Company's accounts receivable and inventories are pledged as security against this line of credit, and the Company must satisfy certain financial ratios commonly found in this type of loan. This line of credit had not been used as of December 31, 2006.

The Company has entered into a non-refundable financial contribution agreement with *IQ Immigrants Investisseurs Inc*. Under this agreement and upon reaching specific objectives, the Company may receive a contribution totalling $1,000,000. This contribution is payable in four annual instalments of $250,000 beginning in 2002. The Company received the first three instalments in 2002, 2003 and 2006, totalling $750,000. The Company believe that the fourth instalment will be received in 2007, when the established sales objective has been reached.

Capital resources (continued)

On February 14, 2007, the Company has entered into an agreement to sell, on a bought deal basis, 8,000,000 units at a price of $2.50 per unit for gross proceeds of $20,000,000. Each unit consist of one common share and one-half warrant. Each whole warrant entitles its holder to purchase one additional common share at a price of $3.00 for a period of two years from the closing date. In addition, the Company granted an option to sell that number of additional units as is equal to 15% of the size of the offering. Furthermore, as additional consideration for services rendered, the Underwriters have been granted by the Company with a number of warrants equal to 5% of the number of units issued. Each warrant can be used to subscribe to one common share of the Company. Each whole warrant is exercisable at a price of $2.50 for a period of 18 months from the closing date.

As of December 31, 2006, the number of outstanding shares was 36,800,853.

Statements of cash flows

FISCAL YEAR ENDED DECEMBER 31, 2006 COMPARED TO FISCAL YEAR ENDED DECEMBER 31, 2005

Cash Flows used in operating activities increased $2,975,177 to reach $8,037,203, for the fiscal year ended December 31, 2006, compared to $5,062,026 for the corresponding period in 2005. This increase is explained primarily by a rise in net loss in 2006 compared to the net loss in 2005 and also an increase in changes in non-cash operating working capital items between these periods. This increase related to non-cash operating working capital is explained by an increase of accounts receivable between the two fiscal years and a decrease of deferred revenues.

For the period ended December 31, 2006, the cash flow from investment activities amounted to $7,208,924 mainly due to disposal of investments. For the fiscal year ended December 31, 2005, Cash Flow used for investment activities amounted to $5,571,715 mainly due to acquisition of investments.

For the fiscal year ended December 31, 2006, Cash Flows from financing activities amounted to $840,426 mainly due to exercised options and warrants. Cash Flows from financing activities, for the fiscal year ended December 31, 2006, amounted to $9,128,757 from the issuance of shares during the 2005 financing where the Company issued 5 million units at a price of $2.00 each.

FOURTH QUARTER

Cash flows from operating activities increased $14,811 to reach $1,900,446, for the three-month period ended December 31, 2006 compared to $1,885,635 $ for the corresponding period in 2005.

For the three-month period ended December 31, 2006, cash flows from investment activities increased $3,859,020 to reach $3,970,530, compared to $111,510 for the corresponding period in 2005. The variance is explained by the disposal of investments.

For the three-month period ended December 31, 2006, cash flows from financing activities increased $395,002 compared to the corresponding period in 2005, due to exercised options and warrants.

Off-balance sheet transaction

The Company made no off-balance sheet transaction.

Transactions with related parties

The Company leases its premises from a company owned by some Company's shareholders.

Over the last three complete fiscal years, the Company has made the following related transactions, assessed at fair market value:

Download Chart in Excel Format

	2006	2005	2004
Rent	$ 57,804	$ 56,560	$ 55,560
Other Rent-Related Expenses	$ 76,431	$ 73,462	$ 60,650
	$ 134,235	$ 130,022	$ 116,210

Risks factors

RISKS RELATED TO OPERATING ACTIVITIES

The Company's activities entail certain risks and uncertainties inherent to the industry in which it operates. However, management has implemented a risk-reduction strategy that addresses:

Risks Associated with International Operations

TSO_3 must carry out the majority of its sales outside of Quebec and Canada, either in the United States or in Europe. The necessity to market on an international scale will put the Company in a position of direct competition with firms that possess networks and resources greater than its own. Nothing can guarantee that the marketing campaigns planned by the Company for international markets, alone or with strategic alliances, will be successful. The operations of TSO_3 at an international level could be affected negatively by factors such as the policies of Canada and the United States in regard to foreign trade, investments and taxes, foreign exchange rate controls and fluctuations, political instability and increased payment periods. One or more of these factors could have a significantly negative effect on the financial situation and results of the Company.

Compatibility, Biocompatibility and Research and Development Projects

All sterilization processes can affect medical instruments or alter their key properties over a period of time. Taking into consideration the nature of the devices to be sterilized and the oxidative effects on devices in contact with ozone, TSO_3 limits to a minimum the frequency and duration that the devices are exposed to ozone. Nevertheless, oxidization can produce several effects, depending on the material. In order to fully establish the true commercial value of its sterilization process, the Company must demonstrate the compatibility of its technology with a wide range of medical instruments. Even though the tests and studies undertaken to date by TSO_3 have shown that its ozone sterilization process is compatible with the majority of medical instruments currently used in the hospital environment, the Company must maintain ongoing studies in this respect. Besides, the Company can not guarantee the success of its different R&D projects.

Risks factors (continued)

RISKS RELATED TO OPERATING ACTIVITIES (CONTINUED)

Dependency on Key Personnel

TSO_3 believes that its success will continue to depend on its ability to attract and retain qualified managers and other key personnel. Losing a key employee could have a major negative impact on TSO_3.

Management of Business Growth

Achieving its short-term objectives could launch the Company into a phase of significant and rapid growth and force it to considerably increase its personnel, the number of partners, cash flow and operating capacity.

Intellectual Property and Counterfeiting Risks

The success of the Company is based on its unique technology. TSO_3 relies on a combination of patents, trade secrets, non-disclosure agreements and various contractual provisions in order to protect its technology. Nothing can guarantee that these measures will be sufficient to protect any illegal appropriation or infringement of its technology by a third party.

Product Liability Issues

In the health sector, lawsuits, often claiming substantial damages, are becoming increasingly common. In particular, in the United States, lawsuits are filed by patients, employees or beneficiaries against healthcare providers, as well as authorities operating and managing hospitals in the private and public sectors. During these proceedings, claimants could allege and blame the non-sterility of certain instruments or defective functioning of products sold, installed or derived from TSO_3's technology. To address the problems associated with such lawsuits, the Company is of the opinion that it has the necessary insurance coverage.

Liquidity and financial resources

Management believes that it will be able to raise the necessary long-term capital to achieve the Company's corporate objectives. However, the availability of these financial resources cannot be guaranteed.

Volatility of share price

Company share prices are subject to volatility. Financial and scientific results that differ from analysts' projections may lead to significant variations in the price of Company shares.

Disclosure controls and procedures

The Chief Executive Officer and the Chief Financial Officer of the Company are responsible for establishing and maintaining the Company's controls and disclosure procedures. They are assisted in this responsibility by the Company's Communication Committee, which is composed of members of Senior Management, by the Director of Communications and IR, as well as by the Company's legal advisor. As required by Securities Legislation, the CEO and the CFO have conducted an evaluation for the controls and procedures regarding information disclosure and have concluded that these controls and procedures are effective.

Prospective statement

This document contains certain prospective statements that reflect the Company's current expectations concerning future activities. These prospective statements include risks and uncertainties. Actual results can differ considerably from the results, as previously described in this report, expected by the Company. Investors are advised to consult the Company's quarterly and annual reports, as well as the filing of the Company's annual information form for more details on the risks and uncertainties related to these prospective statements. The reader must not unduly rely upon the Company's prospective statements. The Company is not obliged to update these prospective statements.

This Management Report has been prepared as of February 26, 2007. Additional information on the Company is available through regular filing of press releases, quarterly financial statements and the Annual Information Form on the SEDAR website (www.sedar.com).

Marc Boisjoli

Marc Boisjoli, M.Sc.
Vice President, Finances and Chief Financial Officer

February 26, 2007

Management report

RESPONSIBILITY OF THE FINANCIAL STATEMENTS

The financial statements of TSO$_3$ Inc., which have been approved by the Board of Directors were prepared by Management in accordance with Canadian Generally Accepted Accounting Principles and contain certain amounts based on best judgment and estimates as their final determination is dependent upon subsequent events. It is the opinion of Management that the accounting policies utilized are appropriate in the circumstances and are adequate to reflect the financial position and the results of operations within reasonable limits of materiality. The financial information presented elsewhere in this annual report is consistent with the information contained in the financial statements.

In order to carry out its responsibilities with regard to the financial statements, Management maintains internal control systems that aim to provide a reasonable degree of certainty that transactions are duly authorized, that the assets are well protected, and that adequate records are kept.

The Board of Directors' Audit Committee, comprised solely of board members who are neither managers nor employees of the Company, ensures that Management assumes its responsibility in terms of financial statements.

The functions of the Audit Committee are to:

- Review the financial statements and recommend them for approval by the Board of Directors;
- Review the systems of internal control and security;
- Recommend the appointment of the external auditors and their fee arrangements to the Board of Directors;
- Review other accounting, financial, and security matters as required.

This committee meets regularly with Management and the external auditors. The latter may, as they see fit, meet with the Audit Committee, with or without Management, to discuss matters affecting the audit and financial information.

The external auditors are appointed to report to the shareholders regarding the fairness of presentation of the Company's financial statements. The auditors fulfil this responsibility by carrying out an independent examination of these statements in accordance with Canadian generally accepted auditing standards.

On behalf of Management,

Jocelyn Vézina
Chief Executive Officer

Marc Boisjoli
Vice President, Finances
and Chief Financial Officer

February 27, 2007

Auditors' Report

TO THE SHAREHOLDERS OF TSO_3 INC.,

We have audited the balance sheets of TSO_3 Inc. as at December 31, 2006 and 2005 and the statements of earnings, contributed surplus, deficit and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statements presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of TSO_3 Inc. as at December 31, 2006 and 2005 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Samson Bélair
Deloitte & Touche s.e.n.c.r.l.

Chartered Accountants

Québec City, February 20, 2007
[February 26, 2007, for the subsequent event in Note 20c)]

Statements of Earnings

Years ended December 31

Download Chart in Excel Format

	2006	2005
SALES	$ 1,069 739	$ 171,766
EXPENSES		
Operating	1,643,116	993,642
Marketing	3,184,933	1,872,840
Research and development	1,682,413	1,878,310
Administrative	3,090,571	2,378,372
Financial	17,626	13,700
	9,618,659	7,136,864
OPERATING LOSS	8,548,920	6,965,098
OTHER REVENUES (Note 17)	1,071,477	530,213
INCOME TAXES (Note 13)	-	-
NET LOSS	$ 7,477,443	$ 6,434,885
Basic and diluted net loss per share (Note 16)	$ 0.20	$ 0.19

References:
Amortization of property, plant and equipment and intangible assets (Notes 7 and 8)
Interest (Note 11)
Research and development tax credits (Note 14)
Foreign exchange gain (Note 17)

Statements of Contributed Surplus

Years ended December 31

Download Chart in Excel Format

	2006	2005
Balance, beginning of year	$ 4,620,592	$ 2,213,699
Warrants (Note 10)	-	1,639,871
Warrants exercised	(269,897)	-
Compensation options (Note 10)	-	350,350
Options exercised	(2,475)	-
Stock-based compensation (Note 10)	651,630	416,672
Balance, end of year	$ 4,999,850	$ 4,620,592

Statements of Deficit

Years ended December 31

Download Chart in Excel Format

	2006	2005
Balance, beginning of year	$ 30,047,204	$ 22,434,946
Share issue expenses	-	827,023
Compensation options (Note 10)	-	350,350
Net loss	7,477,443	6,434,885
Balance, end of year	$ 37,524,647	$ 30,047,204

Balance Sheets

As at December 31

Download Chart in Excel Format

	2006	2005
CURRENT ASSETS		
Cash	$ 753,885	$ 294,101
Temporary investments (Note 4)	6,554,897	14,300,902
Accounts receivable (Note 5)	811,119	344,302
Inventories (Note 6)	3,387,837	3,303,258
Prepaid expenses	133,651	95,894
	11,641,389	18,338,457
PROPERTY, PLANT AND EQUIPMENT (Note 7)	390,608	416,327
INTANGIBLE ASSETS (Note 8)	3,711,742	3,832,250
	$ 15,743,739	$ 22,587,034
CURRENT LIABILITIES		
Accounts payable and accrued liabilities	$ 1,043,700	$ 1,015,491
Deferred revenue	75,709	961,826
	1,119,409	1,977,317
SHAREHOLDERS' EQUITY		
Share capital (Note 10)	47,149,127	46,036,329
Contributed surplus	4,999,850	4,620,592
Deficit	(37,524,647)	(30,047,204)
	14,624,330	20,609,717
	$ 15,743,739	$ 22,587,034

On behalf of the Board,

Jocelyn Vézina
Director

Simon Robitaille
Director

Statements of Cash Flows

Years ended December 31

Download Chart in Excel Format

	2006	2005
OPERATING ACTIVITIES		
Net loss	$ (7,477,443)	$ (6,434,885)
Adjustments for:		
Amortization of property, plant and equipment	139,758	157,744
Amortization of intangible assets	220,370	214,350
Amortization of premiums and discounts on investments	(131,637)	(66,510)
Stock-based compensation	651,630	416,672
Loss on disposal of property, plant and equipment	882	1,698
Loss on disposal of investment	6,298	-
	(6,590,142)	(5,710,931)
Changes in non-cash operating working capital items (Note 11)	(1,447,061)	648,905
Cash flows used in operating activities	(8,037,203)	(5,062,026)
INVESTING ACTIVITIES		
Acquisition of temporary investments	(4,433,793)	(7,256,449)
Disposal of temporary investments	11,857,500	1,901,535
Acquisition of property, plant and equipment	(116,723)	(87,496)
Acquisition of intangible assets	(99,862)	(138,605)
Disposal of property, plant and equipment	1,802	9,300
Cash flows from (used in) investing activities	7,208,924	(5,571,715)
FINANCING ACTIVITIES		
Options exercised	65,632	-
Warrants exercised	774,794	-
Share issue	-	10,024,280
Share issue expenses	-	(827,023)
Reimbursement of long-term debt	-	(68,500)
Cash flows from (used in) financing activities	840,426	9,128,757
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	12,147	(1,504,984)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	7,296,635	8,801,619
CASH AND CASH EQUIVALENTS, END OF YEAR (Note 11)	$ 7,308,782	$ 7,296,635

Notes to the Financial Statements

Years ended December 31, 2006 and 2005

1. DESCRIPTION OF BUSINESS

The Company was incorporated on June 10, 1998 under Part 1A of the *Companies Act* (Québec). Its activities consist of developing and marketing a sterilization process for heat-sensitive medical instruments using ozone as a sterilizing agent.

2. ACCOUNTING POLICIES

The financial statements have been prepared in accordance with Canadian generally accepted accounting principles and include the following significant accounting policies:

Use of estimates

The preparation of financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Since the financial reporting process requires the use of estimates, actual results could differ from these estimates.

Cash and cash equivalents

Cash and cash equivalents include bank balances and highly liquid temporary investments with maturities of three months or less that are held for the purpose of meeting short-term cash commitments.

Temporary investments

Temporary investments are recorded at the lower of cost including amortization of the premium or discount and market value. Premiums and discounts are amortized over the term of the temporary investment.

Inventories

Inventories are valued at the lower of cost and replacement cost for raw materials, and at the lower of cost and net realizable value for work in process and finished goods. The cost of inventories is determined substantially according to the first in, first out method. The cost of work in process and finished goods consists of the cost of raw materials and an applicable share of the cost of labour and manufacturing overhead.

Property, plant and equipment

Property, plant and equipment are recorded at cost. Amortization is calculated under the declining balance method except for software, the Web site and leasehold improvements, which are amortized under the straight-line method, using the following annual rates, terms or useful lives:

Office furniture, stand, equipment and tools	*20%*
Computer equipment and lift truck	*30%*
Software and Web site	*3 years*
Leasehold improvements	*Lease term*

Notes to the Financial Statements

Years ended December 31, 2006 and 2005

2. ACCOUNTING POLICIES (CONTINUED)

Intangible assets

Intangible assets consist of the acquisition cost of a patent licence, the acquisition cost of a technology, including all the related rights, the cost of patents and the costs of trademarks.

Amortization of intangible assets is calculated using the straight-line method over their estimated useful lives as follows:

Patents	*20 years*
Licence	*16 years*
Trademarks	*10 and 15 years*

Technology is amortized using the straight-line method over the estimated useful life of 20 years.

Impairment of long-lived assets

Long-lived assets are tested for recoverability whenever events or changes in circumstances indicate that their carrying amount may not be recoverable. An impairment loss is recognized when their carrying value exceeds the total undiscounted cash flows expected from their use and eventual disposition. The amount of the impairment loss is determined as the excess of the carrying value of the asset over its fair value.

Foreign currency translation

Foreign currency transactions are translated into Canadian dollars as follows: monetary assets and liabilities are translated at the exchange rates in effect at the balance sheet date, and revenues and expenses are translated at the exchange rates in effect at the time of the transaction. Non-monetary assets and liabilities are translated at historical rates. The gains or losses resulting from translation are carried to earnings.

Government assistance and research and development tax credits

Government assistance is recorded in the financial statements when there is reasonable assurance that the Company has complied with, and will continue to comply with, all of the conditions necessary to obtain the assistance.

The Company incurs research and development expenditures that are eligible for tax credits. The recorded tax credits are based on management's estimates of amounts expected to be recovered and are subject to audit by taxation authorities.

Government assistance, including investment tax credits for research and development, is reflected as a reduction in the cost of the assets to which it relates or in other revenues.

Income taxes

The Company follows the liability method of accounting for income taxes. Under this method, future income taxes are recognized based on the expected future tax consequences of differences between the carrying amount of balance sheet items and their corresponding tax basis, using the enacted and substantively enacted income tax rates for the years in which the differences are expected to reverse. Future income tax assets are recognized in the earnings only if their realization is considered more likely than not.

Notes to the Financial Statements

Years ended December 31, 2006 and 2005

2. ACCOUNTING POLICIES (CONTINUED)

Revenue recognition

The Company generates revenue mainly from the sale of ozone sterilization units, parts and instruments related to these units and contracts for the support and maintenance of these units. The Company is generally committed under revenue arrangements with multiple deliverables that include delivery of units, installation, maintenance, consulting and after sale service. The Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred, the price to the buyer is fixed or determinable and collection is reasonably assured.

Revenue from revenue arrangements with multiple deliverables are divided into separate units of accounting when the Company has reliable evidence. When revenue cannot be determined, it is deferred and calculated using the straight-line method over the term of the contract.

Revenue related to the units sold, the parts and instruments related to these units, and installation and consulting services are recognized once the services are provided and the client accepts the services received. Maintenance and support contracts are recognized using the straight-line method over the term of the contract.

Provision for guarantee

The Company offers its clients a standard twelve-month guarantee. Revenue related to guarantees is deferred and recognized on a straight-line basis over the term of the contract. The estimated cost of the guarantee is based on the following: the Company's history with defective ozone sterilization units as well as the parts and instruments related to these units; the probability that these defects will arise; and the costs to repair them. Given that the Company's history regarding these guarantees is quite recent, it records the costs of these guarantees only when they are incurred.

Stock-based compensation

The Company uses the fair value method to measure compensation expense at the date of grant of stock options to employees. The fair value of options is determined using the Black-Scholes option pricing model and is amortized to earnings over the vesting period with an offset to contributed surplus. When options are exercised, the corresponding contributed surplus and the proceeds received by the Company are credited to share capital.

Consolidation of variable interest entities

The Company adopted Accounting Guideline 15 "Consolidation of Variable Interest Entities" (AcG-15) issued by the CICA. Variable interest entities (VIEs) are entities in which equity investors do not have a controlling financial interest or in which the equity investment at risk is not sufficient to permit the entity to finance its activities without additional support from other parties. Under AcG-15, a VIE must be consolidated by its primary beneficiary, i.e., the party that receives the majority of the expected residual returns and/or absorbs the majority of the expected losses. The Company has determined that this Guideline has no impact on its financial statements.

3. FUTURE ACCOUNTING CHANGES

Financial instruments

In 2005, the CICA issued three new accounting standards: Section 1530 "Comprehensive Income," Section 3855 "Financial Instruments – Recognition and Measurement," and Section 3865 "Hedges." These three standards will apply to the Company effective January 1, 2007.

Notes to the Financial Statements

Years ended December 31, 2006 and 2005

3. FUTURE ACCOUNTING CHANGES (CONTINUED)

Financial instruments – Recognition and measurement

Under this new standard, all financial assets will be classified in one of the following four categories: held to maturity, loans and receivables, held for trading and available for sale. Financial liabilities will have to be classified as "held for trading" or "other." Financial assets and liabilities held for trading will be valued at their fair value, and gains and losses will be recorded in net earnings. Held-to-maturity financial assets, loans and receivables, and financial liabilities classified as "Other" will be recognized at amortized cost using the effective interest rate method. Available-for-sale financial assets will be valued at fair value, and all the unrealized gains and losses will be recorded in other comprehensive income. The new standard will enable entities to designate all financial instruments as held for trading when they are initially recognized or when this standard is adopted, even if this financial instrument does not fall within the definition of a financial instrument held for trading. Financial instruments held for trading under the fair value option must have a reliable fair value.

All financial instruments must initially be recorded at fair value on the balance sheet except those pertaining to related party transactions. The valuation in subsequent periods will be determined based on the category in which the financial instrument has been classified.

The fair value of financial instruments is equal to the amount at which this instrument could be traded knowingly and voluntarily between the parties involved. The fair value is based on the prices (buyer-seller prices) in an active market. If this is not the case, the fair value is based on market prices prevailing for instruments with similar risk profiles or characteristics or on internal or external valuation models that use observable market data.

According to this new standard, derivative financial instruments must be recorded at fair value unless they are specifically designated in an effective hedging relationship, and the change in fair value will be recorded directly in net earnings.

The Company has elected to classify temporary investments as investments held for trading. Consequently, any differences in the fair value of these assets will be recorded directly in net earnings (loss).

Comprehensive income

Following the adoption of these standards, a new item, *Accumulated other comprehensive income,* will be added to the balance sheet under shareholders' equity. The new item will include unrealized gains and losses net of income taxes for financial assets classified as available for sale as well as gains and losses on the foreign currency translation.

Hedges

This new standard specifies the criteria for hedge accounting as well as how to apply hedge accounting to each hedging strategy allowed.

Impact of adopting these new standards

The adjustments attributable to the classification of certain assets and liabilities as held for trading will be recognized in the opening balance of retained earnings (deficit) as of January 1, 2007. Adjustments attributable to the revaluation of financial assets classified as available for sale will be recognized in the opening balance of other accumulated comprehensive income as of January 1, 2007.

The Company has not yet determined the impact that these new standards will have on its financial statements.

Notes to the Financial Statements

Years ended December 31, 2006 and 2005

4. TEMPORARY INVESTMENTS

	2006	2005
Commercial paper and bonds, maturing at various dates through March 2007, average yield of 3.83% (market value of $6,114,211)	$ 6,114,211	$ 8,554,882
Deposit certificates maturing in February 2007, average yield of 3% (equivalent market value)	102,564	581,500
Money market fund (market value of $358,337)	338,122	4,066,926
Strategic yield fund	-	1,097,594
	$ 6,554,897	$ 14,300,902

Temporary investments that fall within the definition of cash and cash equivalents totalled $6,554,897 as at December 31, 2006 ($7,002,534 in 2005).

5. ACCOUNTS RECEIVABLE

	2006	2005
Accounts receivable	$ 464,477	$ 8,033
Grants receivable	9,807	2,457
Tax credits receivable	297,000	249,000
Other	39,835	84,812
	$ 811,119	$ 344,302

6. INVENTORIES

	2006	2005
Raw materials	$ 969,286	$ 851,554
Work in progress	106,281	306,949
Finished goods	1,935,210	1,231,324
Finished goods on consignment	377,060	913,431
	$ 3,387,837	$ 3,303,258

Notes to the Financial Statements

Years ended December 31, 2006 and 2005

7. PROPERTY, PLANT AND EQUIPMENT

	2006			2005
	COST	ACCUMULATED AMORTIZATION	NET BOOK VALUE	NET BOOK VALUE
Equipment and tools	$ 452,327	$ 305,391	$ 146,936	$ 178,100
Computer equipment	354,840	237,740	117,100	120,495
Software	305,513	254,539	50,974	40,190
Office furniture	105,278	59,881	45,397	49,872
Lift truck	14,115	11,234	2,881	4,115
Web site	44,077	36,381	7,696	12,827
Stand	18,259	6,770	11,489	3,012
Leasehold improvements	172,891	164,756	8,135	7,716
	$ 1,467,300	$ 1,076,692	$ 390,608	$ 416,327

Amortization for the year totalled $139,758 ($157,744 in 2005).

8. INTANGIBLE ASSETS

	2006			2005
	COST	ACCUMULATED AMORTIZATION	NET BOOK VALUE	NET BOOK VALUE
Technology	$ 2,978,874	$ 297,888	$ 2,680,986	$ 2,829,930
Licence	991,063	185,824	805,239	867,180
Patents	233,621	12,771	220,850	135,140
Trademarks	4,846	179	4,667	-
	$ 4,208,404	$ 496,662	$ 3,711,742	$ 3,832,250

Amortization for the year totalled $220,370 ($214,350 in 2005).

9. CREDIT FACILITIES

The Company has a line of credit with which it can obtain advances up to a maximum of $350,000. This line of credit, which is renewable on an annual basis, bears interest at prime rate plus 1%. The Company's accounts receivable and inventories are pledged as security on this line of credit, and the Company must comply with certain financial ratios usually found in this type of loan. This line of credit was undrawn as at December 31, 2006.

Notes to the Financial Statements

Years ended December 31, 2006 and 2005

10. SHARE CAPITAL

Authorized

An unlimited number of shares

Common, voting, participating, without par value

Class A, voting, participating, with a par value of $1.00 each

Class B, voting, participating, without par value

	2006	2005
Issued		
36,800,853 common shares (36,413,695 in 2005)	**$ 47,149,127**	$ 46,036,329

On July 7, 2005, the Company issued 5,000,000 units at a price of $2.00/unit. Each unit is comprised of one common share and a half warrant. Each full warrant entitles its owner to purchase one common share of the Company at a price of $2.50 at all times until July 7, 2007.

The proceeds from this issuance of units was divided proportionally between share capital and contributed surplus using the respective fair values of the shares and the warrants issued.

During 2005, holders exercised their stock options and subscribed to a total of 13,400 shares in consideration of $24,280.

During 2006, holders exercised certain options and warrants and subscribed to a total of 387,158 shares in consideration of $840,426.

Stock options

The Company's Board of Directors adopted a stock option plan solely for directors, executives, employees and service providers of the Company, which was approved by its shareholders. The total number of common shares from the Company's share capital that can be issued under this plan is 2,713,872. The total number of common shares reserved for the exercise of stock options in favour of a holder cannot, at any time, represent more than 5% of the Company's common shares issued and outstanding at the time of granting less the total number of options already exercised by this person from any other stock options. The options granted pursuant to this plan, which vest over a three-year period, may be exercised within a maximum of 10 years of the grant date.

During 2006, the Company awarded 458,001 stock options to its employees at a weighted average exercise price of $3.00. The weighted average fair value of these stock options was $2.12 per option.

Notes to the Financial Statements

Years ended December 31, 2006 and 2005

10. SHARE CAPITAL (CONTINUED)

Stock options (continued)

The stock-based compensation expense pertaining to the options granted has been amortized using the graded vesting method and a compensation expense of $651,630 in 2006 ($416,672 in 2005). Stock options granted from 2003 to 2006 will also involve additional compensation expenses of $494,127 in 2007, $214,853 in 2008, and $53,819 in 2009.

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

Risk free interest rate	*4,29%*
Expected volatility	*59,1%*
Life	*10 years*
Expected dividend yield	*0%*

The Black-Scholes options pricing model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable, a practice significantly different from how stock options are granted by the Company. In addition, option pricing models require the input of highly subjective assumptions including the expected stock price volatility. Any changes in the assumptions can materially affect the fair value estimate.

The following table summarizes the stock option activity:

	2006		2005	
	NUMBER	**WEIGHTED AVERAGE EXERCISE PRICE**	**NUMBER**	**WEIGHTED AVERAGE EXERCISE PRICE**
Outstanding, beginning of year	**2,002,826**	**$ 1.99**	1,734,516	$ 1.96
Granted	**458,001**	**3.00**	352,710	2.15
Exercised	**(35,800)**	**1.83**	(13,400)	1.81
Forfeited	**(132,961)**	**2.68**	(71,000)	1.95
Outstanding, end of year	**2,292,066**	**$ 2.16**	2,002,826	$ 1.99
Exercisable, end of year	**1,564,768**	**$ 1.95**	1,281,967	$ 1.95

Notes to the Financial Statements

Years ended December 31, 2006 and 2005

10. SHARE CAPITAL (CONTINUED)

Stock options (continued)

The following table summarizes certain information regarding the stock options of the Company as at December 31, 2006:

	2006			
	OUTSTANDING OPTIONS		EXERCISABLE OPTIONS	
EXERCISE PRICE	NUMBER	AVERAGE REMAINING CONTRACTUAL LIFE (YEARS)	NUMBER	AVERAGE REMAINING CONTRACTUAL LIFE (YEARS)
1.35 to $1.85	**1,539,732**	**5.42**	1,366,324	5.06
2.30 to $2.99	**380,333**	**9.15**	63,444	7.91
3.10 to $3.45	**372,001**	**8.37**	135,000	6.80
	2,292,066	**6.52**	1,564,768	5.33

Warrants and other options

Upon issuance of the 5,000,000 units on July 7, 2005, 2,500,000 warrants were granted. Each warrant can be used to purchase one common share of the Company at a price of $2.50 through July 7, 2007. During 2006, 80,150 of these warrants had been exercised.

Also, as additional consideration for services rendered for the issuance of these units, the Company granted 350,000 warrants to the underwriter. Each warrant can be used to subscribe to one common share of the Company at a price of $2.18 each before January 7, 2007. During 2006, 148,750 of these warrants had been exercised. Moreover, 338,018 warrants granted for services rendered in a prior transaction expired in 2006.

Warrants and other options varied as follows:

	2006		2005	
	NUMBER	WEIGHTED AVERAGE EXERCISE PRICE	NUMBER	WEIGHTED AVERAGE EXERCISE PRICE
Outstanding, beginning of year	**3,310,476**	**$ 2.41**	460,476	$ 2.12
Granted	**-**	**-**	2,850,000	2.46
Exercised	**(351,358)**	**2.21**	-	-
Expired	**(338,018)**	**2.15**	-	-
Outstanding, end of year	**2,621,100**	**$ 2.48**	3,310,476	$ 2.41
Exercisable, end of year	**2,621,100**	**$ 2.48**	3,310,476	$ 2.41

Notes to the Financial Statements

Years ended December 31, 2006 and 2005

10. SHARE CAPITAL (CONTINUED)

Stock options (continued)

The following table summarizes certain information regarding the stock options of the Company as at December 31, 2006:

	2006			
	OUTSTANDING OPTIONS AND OTHER OPTIONS		EXERCISABLE OPTIONS AND OTHER OPTIONS	
EXERCISE PRICE	NUMBER	AVERAGE REMAINING CONTRACTUAL LIFE (YEARS)	NUMBER	AVERAGE REMAINING CONTRACTUAL LIFE (YEARS)
$2.18	201,250	0.02	201,250	0.02
$2.50	2,419,850	0.52	2,419,850	0.52
	2,621,100	0.48	2,621,100	0.48

11. ADDITIONAL INFORMATION TO THE STATEMENTS OF CASH FLOWS

	2006	2005
Changes in non-cash operating working capital items		
Decrease (increase) in current assets		
Accounts receivable	**$ (418,817)**	$ 6,029
Tax credits receivable	**(48,000)**	(18,000)
Inventories	**(84,579)**	(457,672)
Prepaid expenses	**(37,757)**	(47,023)
Increase (decrease) in current liabilities		
Accounts payable and accrued liabilities	**28,209**	239,805
Deferred revenues	**(886,117)**	925,766
	$ (1,447,061)	$ 648,905
Cash flows and cash flow equivalents		
Cash	**$ 753,885**	$ 294,101
Temporary investments, maturing in less than three months	**6,554,897**	7,002,534
	$ 7,308,782	$ 7,296,635
Interest		
Received	**$ 157,505**	$ 71,026
Research and development tax credits		
Received	**$ 270,554**	$ 201,533

Notes to the Financial Statements

Years ended December 31, 2006 and 2005

12. RELATED PARTY TRANSACTIONS

During 2006, the Company carried out the following transactions, measured at fair value, with a company held by certain shareholders of the Company:

	2006	2005
Rent	$ 57,804	$ 56,560
Other rent-related expenses	76,431	73,462
	$ 134,235	$ 130,022

As at December 31, 2006, an amount of $4,279 was included in accounts payable related to a related party.

13. INCOME TAXES

For tax purposes, the operations of each year result in a loss that can be applied against future taxable income. The income tax expense for the current year relates to taxes pertaining to the Company's capital.

As at December 31, 2006, the accumulated tax losses that can be carried forward are as follows:

Expiry date	Deferred losses	
	Federal	Provincial
2026	$ 5,893,000	$ 5,494,000
2015	5,009,000	4,700,000
2014	4,601,000	4,380,000
2010	4,188,000	4,018,000
2009	2,793,000	2,610,000
2008	1,426,000	1,426,000
2007	145,000	145,000
	$ 24,055,000	$ 22,773,000

As at December 31, 2006, in addition to these tax losses carried forward, the Company has unclaimed research and development expenses ($5,950,000 at the federal level and $8,500,000 at the provincial level) and $623,000 in financing costs that can be carried forward to reduce future taxable income. The unrealized tax benefit, estimated at $9,621,000, and related to these losses carried forward and undeducted expenses, has not been recorded.

With respect to property, plant and equipment, the Company has a future income tax asset related to the tax cost that is higher than the net book value of these capital assets, estimated at $623,000, which has not been recorded.

In addition, as at December 31, 2006, the Company has $1,320,000 in additional tax credits, representing the outstanding and unrecorded portion of the federal tax credit receivable.

Notes to the Financial Statements

Years ended December 31, 2006 and 2005

13. INCOME TAXES (CONTINUED)

Furthermore, the cost of intangible assets for tax purposes is $581,000 (net book value of $3,711,742) resulting from the Company taking advantage of provisions in the federal and provincial income tax laws with respect to rollovers. Future income taxes estimated at $680,000 and resulting from the difference between the carrying value and the tax value of intangible assets have not been recorded.

Future income tax assets related to tax losses and undeducted expenses will be recorded in the financial statements, resulting in an increase in earnings and shareholders' equity, once the Company concludes that these losses likely will be realized. At the same time, the future income tax liability related to the cost of the intangible assets for tax purposes will be recorded, and the amount of intangible assets will be increased accordingly.

14. RESEARCH AND DEVELOPMENT TAX CREDITS

For tax credit purposes, research and development expenditures incurred during 2006 amount to $998,788 ($1,123,150 in 2005); of these research and development expenses, $5,755 as at December 31, 2006 ($22,470 in 2005) relate to property, plant and equipment.

Some of these expenses qualify for refundable scientific research tax credits and a balance of $297,000 as at December 31, 2006.

The tax credits received in 2005 have not been reviewed by the tax authorities. Consequently, the amount of tax credits awarded could differ from the one already recorded.

15. FINANCIAL INSTRUMENTS

FOREIGN EXCHANGE RISK

Approximately 78% of the Company's sales are mainly in U.S. dollars, and it is therefore exposed to foreign currency fluctuations. This risk is partly offset by purchases and operating expenses in U.S. dollars.

FAIR VALUE

The fair value of cash, temporary investments, accounts receivable, and accounts payable and accrued liabilities approximates their carrying values due to the short-term maturities of these items.

Notes to the Financial Statements

Years ended December 31, 2006 and 2005

16. EARNINGS PER SHARE

The following table reconciles the basic and the diluted earnings per share:

	2006	2005
Net loss		
Basic and diluted	$ 7,477,443	$ 6,434,885
Number of shares		
Weighted average number of outstanding shares (1)	36,560,408	33,824,100
Loss per share		
Basic	$ 0.20	$ 0.19
Diluted (1)	$ 0.20	$ 0.19

(1) The calculation of the weighted average number of outstanding shares is determined as a function of the number of outstanding common shares based on the fraction of the period during which the shares were outstanding.

The weighted average number of outstanding shares is the same number used in the calculation of the diluted net loss per share since including potential common shares in the computation of the diluted per share amount of a loss is always anti-dilutive.

17. OTHER REVENUES

	2006	2005
Investment income	$ 481,206	$ 221,633
Research and development tax credits	318,554	242,563
Government grants	253,967	34,999
Foreign exchange gain	9,800	30,397
Losses on disposal of assets	(882)	(1,698)
Other	8,832	2,319
	$ 1,071,477	$ 530,213

The Company entered into a non-refundable financial contribution agreement with *IQ Immigrants Investisseurs Inc.*, under which the Company can receive a contribution totalling $1,000,000, receivable in four annual instalments of $250,000 beginning in 2002. During the current year and previous years, the Company received the first three instalments, i.e., $750,000. As at December 31, 2006, upon attaining specific objectives, the Company is eligible to receive the balance of $250,000.

Notes to the Financial Statements

Years ended December 31, 2006 and 2005

18. SEGMENTED INFORMATION

Operating revenues according to geographic area are as follows:

	2006	2005
Canada	$ 234,722	$ 1,774
United States	835,017	169,922
	$ 1,069,739	$ 171,696

Operating revenues are assigned to geographic area based on the location of the client.

19. COMMITMENTS AND GUARANTEES

The Company is committed to pay an amount of $30,000 per Canadian referral site and $22,844 (US$20,000) per U.S. referral site. On December 31, 2006, the Company signed agreements with referral sites for a total commitment of $369,908. During the year, almost all of these agreements had terminated. As at December 31, 2006, there were only four active referral sites for a total amount of $105,688. An amount of $256,880 has been paid for these referral sites since 2003.

Under its operating leases, the Company is committed to make payments totalling $28,355 in 2007, $19,632 in 2008, $3,589 in 2009 and $839 in 2010.

The Company is committed under a research contract to pay a total sum of $113,453 (75,000 €). As at December 31, 2006, an amount of $11,345 (7,500 €) had been paid. The Company expects to make a payment of $102,108 (67,500 €) during 2007.

Under a research contract, the Company is committed to pay an amount of $24,477. As at December 31, 2006, $12,338 had been paid. The Company expects to make a payment of $12,339 during 2007.

Notes to the Financial Statements

Years ended December 31, 2006 and 2005

20. SUBSEQUENT EVENTS

a) At the beginning of 2007, holders exercised certain options and subscribed to 231,249 shares for a total of $511,290.

b) On February 14, 2007, the Company entered into an agreement to sell, on a bought deal basis, 8,000,000 units (the "Units") at a price of $2.50 per Unit for gross proceeds to the Company of $20 million. Each Unit will consist of one common share of the Company and one-half of one common share purchase warrant. Each whole warrant will entitle the holder to acquire one additional common share at a price of $3.00 for a period of two years from the closing date.

   Furthermore, as additional consideration for services rendered, the Underwriters have been granted by the Company with a number of warrants equal to 5% of the number of units issued. Each warrant can be used to subscribe to one common share of the Company. Each whole warrant is exercisable at a price of $2.50 for a period of 18 months from the closing date.

c) On February 26, 2007, the Company filed a final prospectus to sell 8,000,000 units (the "Units") at a price of $2.50 per Unit for gross proceeds to the Company of $20 million. The Company also granted an over-allotment option representing 15% of the Units issued as part of the investment. Each Unit will consist of one common share of the Company and one-half of one common share purchase warrant. Each whole warrant will entitle the holder to acquire one additional common share at a price of $3.00 for a period of two years from the closing date.

   The closing of the investment should take place on or about March 8, 2007 and is subject to certain conditions, such as obtaining the required regulatory approvals, including those of the Toronto Stock Exchange (TSX).

21. COMPARATIVE FIGURES

Certain comparative figures have been reclassified to conform to the current year's presentation.

DIRECTORS

Jocelyn Vézina
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TSO_3 Inc.

Simon Robitaille
Vice President, Operations
and Director of Research
TSO_3 Inc.

André Boulanger
Engineer
Project Manager

Germain Carrière
President and Chief
Operating Officer
Desjardins Securities

André de Villers
President CEMA

Régis Labeaume
Chief Executive Officer
of the *Fondation de l'Entrepreneurship*

Serge Lapointe
Portfolio Manager
Life Sciences
Fonds de solidarité FTQ

Jacques Marcotte
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Borden Ladner Gervais LLP
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Corporate Solicitors
Lavery, De Billy LLP

Bank
National Bank of Canada

Annual Shareholder Meeting
Thursday, May 3, 2007,
at 10:30 a.m.
McCord Museum
of Canadian History
J. Armand Bombardier Theater
690 Sherbrooke Street West
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