« Creating the Improved Standard
in Healthcare Sterilization »

TABLE OF CONTENTS

MESSAGE FROM THE PRESIDENT

2009 Meeting the Challenge

2009 was a year of great accomplishments for TSO_3. It was a year where we set aggressive goals and timelines for ourselves, delivered on our commitments and created significant value for our Shareholders. A year that sets the tone for what is to come.

It was a year full of challenges. Some of which we, at TSO_3, could control and others that were simply outside of our control. Our task was to focus on actions that delivered increased business opportunities. This would better prepare our organization to address the needs of our customers when the global economy showed signs of recovery resulting in the thawing of capital budgets inside healthcare facilities.

The downturn in the economy clearly impacted $TSO_{3.}$ Early in 2009, we saw an increase in the number of quotes being requested for our products. By year's end, these quote remained mostly inactive. While we attempted to shake loose business with leasing plans, delayed payments and similar incentives, the business simply stalled. Our response was to manage our channel expenses in line with the market situation.

The challenge within our control was that of the attributes of our product. The Company had successfully developed a product based on a novel technology and there was a defined market opportunity. This opportunity was restricted however by gaps between what the customer wanted, and what the product was delivering. It was clear that to take full advantage of the market opportunity, enhancements needed to be made to our product.

Facing Challenge

It was with this understanding that we created plans to address the challenge. Our plans, as you are aware, focused on improving the overall utility of our product, or said differently, what we needed to do in order that more customers would want to use our product and to do so with increased frequency.

After meeting with existing and potential customers and conducting primary research, it became obvious that the first generation of the STERIZONE® 125L Sterilizer had not fully achieved the customers' needs for cycle speed and material compatibility. In order to increase the utility of the product, customers wanted to have faster cycles and they wanted to be able to load the sterilizer so that the chamber would be full in each load. Customers did not want to be restricted as to the number of devices they could place in chamber for each load. Customers wanted to be able to use a single sterilization technology for all their low temperature sterilization needs. This meant that we would need to create cycles that would accommodate an increased number of devices, thus requiring increased compatibility for a wider range of medical devices and materials. Equally important, customers told us they were willing to pay more for a product that would deliver these attributes.

As a team, TSO_3 set out to face this challenge. Our plan was to make sure we were ready with a product that would address these market needs by the time the economy showed signs of recovery. During the past year, we have reported our progress towards developing new cycles that meet these customer requirements. Today, the Company has a new generation sterilizer with all new cycles. These cycles promote speed, material compatibility, are cost effective, and have high throughput sterile processing while maintaining the unmatched sterile efficacy and environmentally responsible process found in our original cycle. This product has already received market clearance in Canada and we recently reported that we had met the requirements of the European market. We are engaged with the US regulatory authorities to secure market clearance in that key market.

As we aggressively developed this new product, it was equally clear that we would continue to face the challenge of gaining significant traction in the global market, based on our sales channel. Quite simply put, we did not have the breadth and scale of organization required for global distribution of our single product. Based on the strength of our new product and the quality of our data and documentation systems, TSO_3 was able to secure a global channel partner experienced in the industry and highly respected by healthcare sterilization departments worldwide. Today, as the economy shows initial signs of recovery, we stand ready to meet the global customer, backed with superior technology and customer defined benefits, and supported by a large, powerful and respected sales and marketing partner: 3M.

During 2009, capital equipment sales in healthcare slowed. Late in the year, American customers were notified by the US Food and Drug Administration (FDA) to make plans to transition to an alternative sterilization method and discontinue the use of the STERIS System 1 Sterile Processing System. We see demand increasing for our product and we now have the means to meet this demand. In 2009, we faced our challenges and the result is a stronger product-offering and customer-facing organization. In short: we are ready to change the industry.

Ready to Take on the Future

As for our future, 2010 and beyond, we remain committed to our vision of *Creating the Improved Standard in Sterilization* and are putting in place equally aggressive plans and timelines as in 2009.

To ensure our success, this upcoming year will be one where we work methodically with our channel partner to firmly establish ourselves in markets, as clearances are received. Our goal is to achieve substantial and sustainable market penetration globally in the years to come.

It is now the time to increase our product portfolio, and take what we have learned in 2009 to define further applications of our technology to address additional market segments within acute care facilities.

Initiatives are being undertaken in order to reduce costs in our system, while improving overall quality within our organization.

Based on our results from 2009, I am confident in our future plans.

In summary, we met the challenges presented in 2009 and thrived in doing so. As a Company we are the strongest we have been and our future is taking shape as planned. I would like to express my appreciation firstly to you, our shareholders, who have supported the Company these past years. Your confidence is well placed. I would like to express my profound gratitude to all the members of the TSO_3 team for their incredible focus and dedication to meeting the challenge head on. And lastly, I would like to thank the TSO_3 Board of Directors for their counsel and guidance as we faced the challenges of 2009.

Richard M. (Ric) Rumble
President and CEO

MANAGEMENT, DISCUSSION AND ANALYSIS

The following discussion and analysis provides Management's point of view on the financial position and the results of operations of TSO_3 Inc. ("TSO_3" or the "Company"), for the twelve-month periods ended December 31, 2009 ("2009") and December 31, 2008 ("2008"). This information is dated March 11, 2010, and should be read in conjunction with the Annual Audited Financial Statements and the accompanying notes. Unless specified otherwise, the amounts are in Canadian dollars.

The financial information contained in this Management's Discussion and Analysis (MD&A) and in the Company's Audited Financial Statements has been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). The Audited Financial Statements and Management's Discussion and Analysis have been reviewed by the Audit Committee of TSO_3 and approved by its Board of Directors.

This Management's Discussion and Analysis contains forward-looking information. Additional information about the forward-looking information as well as the associated risks and uncertainties can be found on pages 24 to 30 of the report.

COMPANY OVERVIEW

TSO_3 was founded in June of 1998, supported by a patented and unique technology for the sterilization of medical devices. This process uses ozone as the sterilizing agent and has been designed to allow the sterilization of heat and moisture-sensitive medical devices in healthcare settings.

Traditional gaseous low-temperature sterilizing methods rely on toxic chemistry and require lengthy sterilization cycle times and newer competitive oxidizing sterilizers are very costly to operate and limited in capabilities due to load restrictions. In contrast to these methods, the TSO_3 STERIZONE® Sterilization process sterilizes large loads of medicals devices quickly, cost effectively, safely and in an eco-friendly manner.

TSO_3's first product, the STERIZONE® 125L Sterilizer has been cleared for commercialization by both Health Canada and the United States Food and Drug Administration (FDA).

A NEW VISION

Starting in late 2008, TSO_3 made a series of changes in its leadership that would introduce new people and skills to build on progress previously achieved. TSO_3's Board of Directors appointed Mr. Richard M. (Ric) Rumble to the position of CEO. Mr. Rumble then selected Mr. Robert F. Mosher, as Global Marketing Vice-President. Mid-year 2009, the Board nominated Dr. James R. Husman as Board Member and chairman of the Scientific Advisory Committee. These changes added more than 75 years of medical device and sterilization expertise.

THE PLAN

At TSO_3's 2009 Annual General Meeting of the Shareholders held on April 30th, the new management team presented a three year plan covering the period from 2009 to 2011, consistent with the company's new vision. This vision is: "To Create the Improved Standard in Healthcare Sterilization".

The plan described the following core objectives:

1. Improve product utility through increased compatibility (gentler cycles on device materials) and cycle speed;

2. Increase market opportunity via expansion outside North America.

3. Develop relationships leading to a strategic channel partner;

UPDATE ON 2009

1. Improve product utility:

a) Increased utilization :

Earlier in 2009, the Company filed with the US Regulatory Agency and Health Canada for enhanced claims which included sterilization of complex multi-channel flexible endoscopes. On March 31, 2009, the Company received the approval from Health Canada and on December 4, 2009, the clearance from the US Food and Drug Administration (FDA). These claims demonstrated the technologies superior sterilization efficacy albeit still in a cycle that lasted 4.5 hours and was aggressive on some materials used in medical device construction.

b) New cycles

The Company has been commercializing its first generation ozone sterilizer, the STERIZONE® 125L Sterilizer since 2006. This initial product has had limited market penetration. Late in 2008, the Company surveyed the market to confirm the improvements to the technology it felt were necessary to address market needs. It became obvious that the first generation of the 125L had failed to meet the customers' needs for speed and material compatibility. Early in 2009 the R&D team was given the mandate of modifying the sterilization cycles in order to adapt the technology to customers' needs instead of asking the customers to adapt to the TSO_3 technology.

Using the STERIZONE® 125L Sterilizer and its demonstrated superior sterile efficacy as our platform, TSO_3 created three new customer-driven cycles to address the widest range of medical devices. Two of the cycles require less than an hour while the third operates in less then two hours. The new cycles continue to use ozone generated within the sterilizer as the sterilizing agent. In addition, a conditioning agent containing hydrogen peroxide has been added to prepare the load prior to the introduction of the ozone sterilant, which reduces cycle times while significantly increasing compatibility. These quick and gentle cycles allow the sterilization of some of the most challenging medical devices, including simple and complex rigid and flexible endoscopes.

Limitations of existing sterilization systems require hospitals to maintain and support multiple types of sterilizers. Some sterilizers offer short cycles, but restrict the size of the load to be sterilized thus driving up costs associated with the process. Others use toxic, polluting chemistry that require long cycle times, protective attire for workers and treatment of the sterilizing agent before it can be safely exhausted into the environment. TSO_3's target customers want efficacy, compatibility and speed. While engineered as other TSO_3 products to be safe and eco-friendly, the new cycles now offer speed and compatibility combined with already proven high efficacy, for hospitals to sterilize the broadest range of instruments: from simple, to the most complex.

Documentation for these new cycles was filed with the US Regulatory Authorities, Health Canada and with the European Notified Body in December 2009. On December 17, 2009, the Company received Health Canada's approval.

2. Expansion outside North America

On December 29, 2009, the Company filed for the CE Mark on the STERIZONE® 125L+ Sterilizer. This was the first step towards commercializing TSO_3's products outside North America. On March 5, 2010 the Company was notified that it had met all requirements of the European Medical Device Directive (MDD) and that the product could now bare the CE mark, a requirement to place product in Europe.

3. Channel Partner

TSO_3 believed that opportunities existed to establish channel partners as a means of accelerating the adoption of the technology on a regional and global level. During second quarter 2009, discussions started with numerous organizations concerning possible strategic partner opportunities. TSO_3 looked for established market leaders offering credibility, a reputation for quality and reliability and an established sales channel already calling on the targeted customer.

After having completed an extensive and exclusive due diligence covering TSO_3's technology, regulatory and operating systems, 3M™ Infection Prevention Division and TSO_3, signed an agreement on December 16, 2009, giving 3M™ the exclusive global license to supply and distribute the STERIZONE® 125L+ Sterilizer including new cycles with the 3M™ brand, to operating rooms and Central Sterile Departments in acute care facilities. The agreement includes marketing and after-sales service on the product. 3M™ is the world leader in 100% Ethylene Oxide (EtO) sterilization and the leader in Sterility Assurance products which are commonly used by healthcare facilities to measure the effectiveness of the sterilization process. 3M™ has operations in over 60 countries.

This agreement, combined with recent improvements to the sterilizer's performance in both cycle times and device compatibility, represents a significant step in the move to accelerate the product's adoption in the global marketplace.

Competitive Environment

Low temperature sterilization is performed in three distinct areas within acute care hospitals, including: Central Sterilization (CS), Operating Rooms Sterile Processing area (OR), and Gastroenterology departments (GI). All three departments have potential uses for the TSO_3 sterilization technology. The primary target market for the TSO_3 STERIZONE® 125L+ System, is Central Sterilization departments within acute care hospitals. This targeted customer group, by nature, is conservative and the sales cycle is lengthy as result of administrative and budgeting procedures.

These customers are seeking increased throughput via a low temperature sterilization process which is efficacious, compatible and cost-effective, while also being safe for patients, users and the environment. Historically there has not been a sterilization process on the market that offers a complete solution to sterilize the wide variety of instruments used in health care facilities. As a result, end-users use a combination of products and technologies to answer their sterilization needs.

The Company competes in an industry characterized by both multinational and regional companies that market low temperature sterilization technologies. The low temperature gas sterilization methods most commonly used today are the legacy Ethylene Oxide (EtO) and more recently, the Hydrogen Peroxide sterilization systems.

Ethylene Oxide sterilization is a legacy system, the gas is efficacious and compatible with a wide range of instruments. The main drawback of this method is the use of a toxic gas which is carcinogenic, mutagenic and neurotoxic as well as a pollutant, it also requires a lengthy sterilization cycle of between 16 to 30 hours, thus creating the need for additional inventory of expensive medical devices. 3M™ is the leader in the installed base of 100% EtO sterilizers while STERIS Corporation is a close second.

Hydrogen Peroxide (HP) sterilization systems are also used as a low temperature sterilization method. These systems have significant load restrictions, which drive up the cost of the sterilizing process.

Johnson & Johnson, with their STERRAD® product, was the first to offer HP Sterilization and continues to be a strong force with their line of H_2O_2 / Plasma systems. STERIS® recently expanded its product offering utilizing their intellectual property in vapor phased hydrogen peroxide (VHP) and introduced the Amsco V-PRO™ 1 Sterilizer.

Another of STERIS®' products plays an important role in a sub-segment of Low Temperature Sterilization, which is Liquid Sterilization. STERIS's System 1 (SS1), using Liquid Peracetic Acid (LPAA), is located directly in the OR as a just-in-time method to complement the CSD's sterile production. The GI department is also a heavy user of LPAA.

In December 2009, the US FDA issued a notice to healthcare facility administrators and infection control practitioners regarding STERIS' System 1 processors. The notice stated that it has not been determined whether this product is safe/effective or whether the claims in its labeling, including claims that it sterilizes medical devices, are accurate as the product as undergone major changes since its clearance several years ago. As such, the FDA has recommended that users transition to an acceptable alternative within the next 18 months. The TSO_3 STERIZONE® Sterilization System is listed on the FDA's website as an alternative. There are an estimated 23,000 SS1 units in operation in the US and all are affected by the FDA notice.

With the recently developed new cycles, all offering increased compatibility and speed, when cleared we are of the opinion that we are well positioned to meet the needs in healthcare sterile reprocessing offering a single sterilizer that can perform cycles historically completed in EtO, HP or LPAA systems located in the CS department.

Strategies

Looking to 2010 and beyond, our strategies comprise the following initiatives

1. Introduce the STERIZONE® 125L+ Sterilizer and its recently designed cycles through the 3M™ channel on a rolling global basis.

   a) TSO_3 is assisting our channel partner to assume the responsibility of global commercialization. This includes training initiatives for sales and filed service personnel. Along with our channel partner 3M, we are focusing on markets where we expect timely regulatory clearances. Sales activities through the 3M™ channel has already started in Canada following the Health Canada approval. We will begin commercialization in Europe and in the USA once regulatory clearances are achieved.

2. Increase our portfolio based on our technology platform

   The Company believes that its technology has significant value in the OR and GI departments in addition to the current CS market. As such, the Company is defining requirements and developing specifications that would lead to targeted development efforts for each of these segments.

3. Improve profitability

   In 2010 we will initiate supply chain initiatives designed to remove cost from our process. Key elements of this activity are to:

   - Increase reliability of components thus reducing service calls;
   - Improve sourcing of key components driving down procurement cost;
   - Simplify assemblies for reduced assembly time.

Overall Performance

One of the most significant events for the Company during 2009 was the signing of our Agreement with 3M™ for the global distribution of the STERIZONE® 125L+ Sterilizer. This agreement included a licensing revenue payable upfront with additional payments based on milestone completion and minimum purchases defined on an annual basis. An amount of $1,576,500 is included in the balance sheet as of December 31, 2009. This amount includes the upfront fee and one milestone payment. The remaining amount of the licensing revenue will be payable upon milestones that we expect to reach in 2010.

The global recession experienced in 2009 negatively impacted our business. TSO_3 experienced frozen budgets in targeted hospitals, which resulted in delayed purchases. As a result of this, the company sold five units of its first version of the STERIZONE® 125L, compared with 13 units for the year 2008.

The Company responded to this market condition by reallocating resources from Sales and Marketing to the R&D department in order to improve the speed and compatibility of its STERIZONE® Sterilization System. These efforts generated the expected enhancements. The new cycles offer a single solution to the current need for multiple sterilization technologies used in healthcare sterilization departments today.

While revenues decreased in 2009 versus the same period in 2008, expense control contributed to a decrease in the Company's Net Loss. 2009 saw a loss of $9.22M as compared to $9.63M for the same period prior year. Cost reductions in operating, technical service, sales and marketing and administrative fees assisted in overall cost control. During 2009, R&D expenses significantly rose compared to 2008. In 2009, R&D expenses were $3.45M compared with $2.65M in 2008. These expenses were directly related to the development, validation and submission of the new cycles to global regulatory authorities.

2010 Outlook

In fiscal year 2010, the Company intends to:

1) With its 3M™ partner, initiate the commercial process for the new STERIZONE® 125L+ globally under the 3M™ brand, via sequential market introductions based on timing of regulatory clearances.

2) Continue to aggressively invest in R&D, in order to develop new products utilizing our existing technology targeted at the OR and GI markets.

3) Invest in Supply Chain initiatives that will produce significant profit enhancement as we grow our portfolio and volume in the future.

SUMMARY OF OPERATING RESULTS
Fiscal years ended December 31

	2009	2008
SALES	**$1,324,540**	$2,235,101
EXPENSES		
Operating	**2,350,190**	2,778,983
Sales and Marketing	**2,130,329**	3,681,424
Research and Development	**3,447,302**	2,649,267
Administrative	**3,058,220**	3,691,879
Financial	**24,234**	23,099
	11,010,275	12,824,652
OPERATING LOSS	**9,685,735**	10,589,551
Other revenues	**468,103**	955,747
NET LOSS AND COMPREHENSIVE LOSS	**9,217,632**	9,633,804
BASIC AND DILUTED NET LOSS PER SHARE	**$0.19**	$0.20
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING	**47,863,626**	47,863,402

OPERATING RESULTS ANALYSIS

Sales

For the fiscal year ending December 31, 2009, Sales amounted to $1,324,540, compared to $2,235,101 in 2008. During the fiscal year 2009, the Company completed the sale of five sterilizers and related accessories, compared to 13 sterilizers and accessories in 2008.

Operating

For the fiscal year ending December 31, 2009, Operating Expenses amounted to $2,350,190, compared to $2,778,983 in 2008. Operating Expenses are related to the Production and After-Sales Service department as well as the costs of manufacturing the devices. Having sold fewer devices during 2009, the variance between the two periods is explained by a decrease in the cost of goods sold. This variance is also explained by a decrease in salaries related to operating and after-sale service. Conversely, installation charges and inventory write-off experienced an increase between the two periods. In 2009, Operating expenses include a write-down of $446,484 for finished goods and $135,225 for raw materials. This write-off was taken due to the Company’s intention of adjusting existing inventory so that all finished goods would be consistent with the new sterilizer including the new cycles. Also at the end of 2009, the Company reviewed its estimates for the provision for obsolescence and a reversal of $135,485 was recorded.

Sales and Marketing

For the fiscal year ending December 31, 2009, sales and marketing amounted to $2,130,329 compared to an amount of $3,681,424 in 2008. The variance between the two periods is mainly the result of a decrease in salaries, bonus, commissions and expenses due to a reorganization of the sales department. Conversely, marketing salaries experienced an increase between the two periods, due to the hiring of a new Global Marketing Vice-President in early 2009. The variation can also be explained by a decrease in the payment of severances and in professional fees.

Research and Development

For the fiscal year 2009, R&D expenses before tax credits amounted to $3,447,302 compared to $2,649,267 in 2008. The difference between the two periods is mainly due to material and instrument purchases in order to accelerate ongoing work on compatibility. The gap between the two periods is also explained by an increase in sub-contracting fees as well as an increase in salaries resulting from the addition of employees in R&D to pursue the development of new cycles and filings with regulatory agencies. Conversely, expenses related to work on the prions decreased between the two periods.

Administrative

For the fiscal year ending December 31, 2009, administration expenses amounted to $3,058,220 compared to $3,691,879 in 2008. The variance between the two periods is explained by a decrease in the payment of severances, in professional fees, in capital tax and in the expenses related to *Stock-based Compensation.* Conversely, expenses related to salaries, bonuses as well as patent fees, increased between the two periods.

Other Revenues

For the fiscal year ended December 31, 2009, other revenues amounted to $468,103 compared to $955,747 in 2008. The variance between the two periods is due to a decrease in investment revenues due to the Company’s use of its liquidity to finance its operation and to lower interest rate on its investment. The variance is also due to an increase in foreign exchange loss. Conversely, R&D tax credits and government grants increased between the two periods.

Net Loss

The Company recorded for the period ending December 31, 2009, a net loss of $9,217,632, or $0.19 per share, compared to a net loss of $9,633,804, or $0.20 per share, in 2008.

FINANCIAL SITUATION ANALYSIS
As of December 31

	2009	2008
Cash, Cash equivalents and Temporary investments	**$10,671,845**	$17,718,470
Accounts Receivable	**$1,333,178**	$820,318
Inventories	**$1,483,810**	$2,548,075
Property, Plant and Equipment	**$1,256,339**	$675,810
Intangible Assets	**$3,549,189**	$3,642,126
Deferred Revenues (short and long term)	**$2,052,333**	$388,958
Share Capital and Contributed Surplus	**$81,322,484**	$81,111,234
Shareholders' Equity	**$14,865,527**	$23,871,909

Liquid Assets and Financial Situation

The Company preserved an adequate position of liquidity in 2009. As of December 31, 2009, cash and temporary investments amounted to $10,671,845 compared to $17,718,470 as of December 31, 2008.

Accounts Receivable

As of December 31, 2009, accounts receivable amounted to $1,333,178 compared to $820,318 for the same period in 2008. The difference between the two periods is due to an increase in the tax credit receivable and by an amount of $525,500 from a milestone payment for licensing revenue. Conversely, the accounts receivable from customers decreased between the two periods.

Inventories

As of December 31, 2009, current assets showed inventory valued at $1,483,810 compared to $2,548,075 as of December 31, 2008. The variance is explained by a decrease in the inventory of sterilizers resulting from the sale of devices between the two periods. It is also resulting from the transfer of materials and sterilizers to the R&D department in order to accelerate the work we have been conducting on compatibility of medical devices and to pursue the development of the new sterilization cycles. The variance is also explained by the total write-down of $581,709 and the reversal of $135,485.

Deferred Revenues

As of December 31, 2009, the short and long term deferred revenues amounted to $2,052,333 compared to an amount of $388,958 as of December 31, 2008. The item *Deferred Revenues* reflects financial transactions related to parts, warranties, licensing revenues and service contracts not yet recognized as revenues. The variance between the two periods is mainly explained by the amount of $1,576,500 received from the 3M™ Agreement. Starting in 2010, this amount will be amortized and recognized as revenue over the duration of the Agreement on a straight-line basis.

Statements of Cash Flow

	2009	2008
Operating Activities	**($6,192,366)**	($7,898,553)
Investing Activities	**$3,732,197**	($4,996,972)
Financing Activities	**$1,055**	$ -

Cash flow required from operating activities decrease $1,706,187 to reach $6,192,366 for the fiscal year ended December 31, 2009 compared to $7,898,553 for the corresponding period in 2008. This variance is mainly explained by an increase in non-cash working capital, mostly due to an increase in deferred revenues related to the 3M agreement.

For the fiscal year ended December 31, 2009, cash flows generated from investing activities amounted to $3,732,197 compared to a use of $4,996,972 for the fiscal year ended December 31, 2008. This variance is mainly explained by a decrease of the net difference between the acquisition and disposal of investments. Conversely, there was an increase between the two periods in the acquisition of property, plant and equipment, due to instrument purchases in order to accelerate ongoing work on compatibility.

For the fiscal year ended December 31, 2009 cash flows from financing activities amounted to $1,055 from the exercise of options, compared to zero in 2008.

CONTRACTUAL COMMITMENTS

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

	2010	2011	2012	2013	2014
Operating leases and service contracts	**$346,876**	$25,515	$15,538	$1,220	$0

SUMMARY OF QUARTERLY RESULTS
(Unaudited)

($000 except loss/share)	2009				2008			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Sales	155	126	511	533	382	725	1,037	91
Other Revenues	219	71	54	124	247	204	203	302
Net Loss	2,680	2,288	2,263	1,987	2,898	1,848	2,728	2,160
Net Loss per share (basic and diluted)	0.05	0.05	0.05	0.04	0.06	0.04	0.05	0.05

This figure shows the quarterly evolution of sales and other income as well as losses.

FOURTH QUARTER ANALYSIS

Three-month period ended December 31, 2009, compared to the three-month period ended December 31, 2008.

	FOURTH QUARTER	
	2009	2008
SALES	**$154,264**	$381,517
EXPENSES		
Operating	**819,923**	914,347
Sales & Marketing	**349,960**	762,351
Research & Development	**1,057,029**	778,860
Administrative	**817,222**	1,065,345
Financial	**7,847**	4,790
	3,051,981	3,525,693
OPERATING LOSS	**2,897,717**	3,144,176
Other Revenues	**218,603**	246,795
NET LOSS AND COMPREHENSIVE LOSS	**$2,679,114**	$2,897,381
BASIC AND DILUTED NET LOSS PER SHARE	**$0.05**	$0.06
AVERAGE NUMBER OF OUTSTANDING SHARES	**47,864,298**	47,863,402

Sales

For the three-month period ending December 31, 2009, Sales amounted to $154,264 representing the sale of accessories and service contracts compared to $381,517 for the corresponding period in 2008 from the sale of two sterilizers and accessories.

Operating

For the three-month period ending December 31, 2009, operating expenses were $819,923 compared to $914,347 for the same period in 2008. Having sold fewer devices during the forth quarter of 2009 compared with the same period in 2008, the variance is explained by a decrease in the cost of goods sold. This variance is also explained by a decrease in salaries related to operating and after-sale service. Conversely, installation charges and inventory write-off experienced an increase between the two periods.

Sales and Marketing

Sales and marketing expenses amounted to $349,960 for the three-month period ending December 31, 2009 compared to $762,351 for the same period in 2008. The variance between the two periods is mainly the result of a decrease in salaries, bonus, commissions and expenses. The variation can also be explained by a decrease in the payment of severances and by a decrease in professional fees expenses. Conversely, marketing salaries experienced an increase between the two periods due to the hiring of a new global marketing Vice President in 2009.

Research and Development

For the three-month period ending December 31, 2009, research and development expenses before tax credits amounted to $1,057,029 compared to $778,860 for the same period in 2008. The difference between the two periods is mainly due to material and instrument purchases in order to accelerate ongoing work on device compatibility and by an increase in sub-contracting fees as well as an increase in salaries and bonuses resulting from the addition of employees in R&D. Conversely, expenses related to work on the prions decrease between the two periods.

Administrative

Administrative expenses for the three-month period ending December 31, 2009, amounted to $817,222 compared to $1,065,345 for the same period in 2008. The variance between the two periods is explained by a decrease in the payment of severances, professional fees, capital tax and the expenses related to Stock-based Compensation. Conversely, expenses related to salaries, bonuses and patent fees increased between the two periods.

Other Revenues

For the last quarter of 2009, the Company realized *Other Revenues* of $218,603 compared to $246,795 for the same period in 2008. The variance between the two periods is due to a decrease in investment revenues. Conversely, government grants increased between the two periods.

Net Loss

The Company recorded, for the fourth quarter of 2009, a net loss of $2,679,114, or $0.05 per share, compared to a net loss of $2,897,381 for the same period in 2008, or $0.06 per share.

Statements of Cash Flow

	2009	2008
Operating Activities	**($811,386)**	($765,827)
Investing Activities	**$465,555**	($8,397,292)
Financing Activities	**$1,055**	$ -

Cash flows used for operating activities increased $45,559 to reach $811,386 for the three-month period ending December 31, 2009 compared to $765,827 for the corresponding period in 2008. This variance is mainly explained by an increase in non-cash working capital, mostly due to an increase in deferred revenues related to the 3M™ agreement.

For the three-month period ending December 31, 2009, cash flows generated from investing activities amounted to $465,555 compared to a use of $8,397,292 for the same period in 2008. This variance is mainly explained by a decrease of the net difference between the acquisition and disposal of investments. Conversely, there was an increase, between the two periods, in the acquisition of property, plant and equipment, due to instrument purchases in order to accelerate ongoing work on compatibility.

For the three-month periods ending December 31, 2009, cash flows from financing activities amounted to $1,055 from the exercise of options, compared to zero in 2008.

CAPITAL RESOURCES

The Company principally uses its capital to finance operating expenses, commercialization expenses, marketing expenses, R&D expenses, administrative expenses, working capital and capital expenditures. Historically, the Company has funded its activities through several rounds of public and private financing, as well as from various government subsidies. Since its inception in June 1998, the Company has raised more than $70,000,000 from the sale of its equity. When possible, the Company tries to optimize its liquidity position through non-dilutive sources, including investment tax credits, grants, interest income as well as licensing revenues.

For the twelve-month period ending December 31, 2009, the monthly burn-rate was approximately $576,000 or a total of $6,910,337 for the fiscal year 2009. Excluding the liquidity brought by the 3M agreement, the monthly burn rate would have been $707,000, or a total of $8,486,837.

Moreover on March 2, 2010, the Company announced the conclusion of financing with respect to a public offering of 10,000,000 common shares for gross proceeds to the Company of $16 million CAD. As additional consideration for services rendered, the Underwriters have been granted by the Company with 750,000 warrants. Each warrant will entitle holders to subscribe to one common share of the Company at a price of $1.60 for a period of 18 months following the closing date of the deal.

The Company believes that its current liquid assets are sufficient to finance its activities into 2013.

The Company has a line of credit with which it can obtain advances up to a maximum of $350,000.

The Company invests its liquidities in short and medium term fixed-income securities offered by governmental, paragovernmental and municipal entities as well as from companies that have high credit ratings. These securities are chosen according to the schedule of foreseen expenses and according to interest rates.

As of December 31, 2009, the number of outstanding shares before the financing in March 2010 was 47,867,568.

OFF-BALANCE SHEET TRANSACTION

During the fiscal year 2009, the Company made no off-balance sheet transaction.

TRANSACTIONS WITH RELATED PARTIES

The Company rents premises from a company held by its related parties. These operations were carried out during the normal course of business and were measured at the exchange value, which is the amount of the consideration agreed to and accepted by the Company and the related party. As was the case in 2008, no amount was included in accounts payable with respect to transactions with this related party as at December 31, 2009. Over the last two complete fiscal years, the Company has made the following transactions, assessed with this related party:

	2009	2008
Rent	**$62,793**	$61,561
Other Rent-related Expenses	**80,175**	71,138
	$142,968	$132,699

ACCOUNTING POLICIES

The financial statements have been prepared in accordance with Canadian generally accepted accounting principles (GAAP) and reflect the following significant accounting policies. Please refer to the Audited Financial Statements dated December 31, 2009, for the complete disclosure of the accounting policies (Note 2, page 6).

Use of Estimates

The preparation of financial statements in accordance with Canadian GAAP 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.

Financial Instruments

Financial assets and financial liabilities are initially recognized at fair value and subsequent measurement depends on how they are classified, which is described below. Their classification depends on the purpose for which the financial instruments were acquired or issued, their characteristics, and the designation made by the Company. Settlement date accounting is used.

Classification

Cash and cash equivalents	Held for trading
Temporary investments	Held for trading
Accounts receivable	Loans and receivables
Accounts payable and accrued liabilities	Other liabilities

Cash and Cash Equivalents

Cash and cash equivalents include cash, bonds with maturities of three months or less and money market funds. The Company has classified these instruments as held for trading. These investments are highly liquid and are held for the purpose of meeting short-term cash commitments. They are recorded at fair value. Increases and decreases in fair value are recognized as investment income and presented under “Other revenues” in the statement of earnings.

Temporary Investments

Temporary investments are designated as instruments held for trading, effective as of the recognition date. These investments are recorded at fair value. Increases and decreases in fair value are recognized as investment income and presented under “Other revenues” in the statement of earnings.

Effective Interest Method

The Company uses the effective interest method to recognize interest income or expense, which includes transaction costs as well as the fees, premiums or discounts earned or incurred for financial instruments.

Fair Value

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

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

Inventories

The cost of inventories is essentially determined using the first in, first out method. The cost of work in progress and finished goods comprises the cost of raw materials and an applicable share of the cost of labour and manufacturing overhead based on normal production capacity. Inventories are valued at the lower of cost and net realizable value.

When an impairment is recognized, a new assessment of net realizable value is performed in each subsequent period. When the circumstances that justified writing down the inventories below cost no longer exist, or when there is a clear indication of an increase in net realizable value due to a change in the economic situation, the amount of the write-down is reversed such that the new carrying amount is the lower of the cost or the revised net realizable value.

Property, Plant and Equipment

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

Office furniture, stand, equipment and production tools and R&D	20%
Computer equipment and lift truck	30%
Leasehold improvements	Lease term
Hospital equipment	3 years

Intangible Assets

Intangible assets are recorded at cost. Amortization is calculated using the straight-line method over their estimated useful lives, as follows:

Technology and patents	20 years
Licence	16 years
Software and website	3 years
Trademarks	10 and 15 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, non-monetary assets and liabilities are translated at historical rates, revenues and expenses are translated at the exchange rates in effect at the time of the transaction and exchange 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 expenses 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 the tax credits for scientific research and experimental development costs, is presented 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 earnings only if their realization is considered more likely than not.

Revenue Recognition

The Company generates revenue mainly from the sale of ozone sterilization units, parts, supplies and accessories related to these units and service and maintenance contracts for the units. The Company is generally committed under revenue arrangements with multiple deliverables that include delivery of units, installation, warranty, maintenance, customer service and consulting services. 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. Revenue related to service contracts offered to clients is deferred and recognized using the straight-line method over the term of the contract.

Revenue earned on the units sold, the parts and accessories related to these units and the installation and consulting services are recognized upon delivery of the service and the client’s acceptance of the services received. Maintenance and service contracts and warranties are recognized using the straight-line method over the term of the contract.

Per agreement with 3M™ maintenance and service of sterilizers sold by 3M™ will be supported by 3M™. As such, we anticipate revenues on service contracts will diminish over time.

Provision for Warranties

The Company offers a standard 12-month warranty to its clients. The estimated cost of the warranty is based on the following: the Company’s history with defective ozone sterilization units and the parts and accessories for these units, the probability that these defects will arise and the costs to repair them.

Stock-based Compensation

The Company uses the fair value method to measure compensation expense at the date of grant of stock options to employees. Fair value 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.

Future accounting changes

In February 2008, the Canadian Accounting Standards Board confirmed that Canadian publicly accountable enterprises would be required to adopt IFRS when preparing financial statements for years beginning on or after January 1, 2011. The Company will therefore be required to transition to IFRS for its interim and annual financial statements beginning on or after January 1, 2011 and provide a restated comparative statement in accordance with IFRS.

Since the Company will adopt IFRS on January 1, 2011, the new Canadian GAAP standards that will come into effect on or after January 1, 2011 will not be presented as future accounting changes, as these will never be applied by the Company.

To prepare for the adoption of IFRS, the Company has developed an IFRS conversion plan. The Company has completed the diagnostic phase, which involved a high-level review of the differences between current Canadian GAAP and IFRS, as well as a review of the alternatives available on adoption. Phase 2 of the plan, which will be completed by the end of 2010, will allow the Company to evaluate the consequences of the transition. Once completed, the Company will evaluate the impact of IFRS on the other key elements of the conversion plan, which include changes to information systems, training requirements, internal control mechanisms over financial reporting and impacts on business activities. The final phase will be to prepare the opening balance sheet, the financial results (current and comparative), reconciliation notes as well as additional notes under IFRS and their initial adoptions.

RISK FACTORS

Investors should understand that the Company operates in a high risk industry. The Company has identified the following risks and uncertainties that may have a material adverse effect on its business, financial condition or operating results. Investors should carefully consider the risks described below before purchasing securities of the Company. The risks described below are not the only ones the Company faces. Additional risks not presently known to the Company or that the Company currently believes are immaterial may also significantly impair its business operations. The Company's business could be harmed by any of these risks.

Risks associated with International Operations

TSO_3 must carry out the majority of its sales outside of Quebec and Canada, primarily in the United States. The necessity of marketing on an international scale puts the Company in a position of direct competition with firms that possess networks and resources greater than its own. Nothing guarantees that the marketing campaigns implemented 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 negatively affected by factors such as Canadian and United States foreign trade policies, 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. Conversely, the Company can not guarantee the success of its different research and development projects.

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. The Management expects to review the Succession Plan in 2010 of all senior level management.

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 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 guarantees that these measures will be sufficient to protect any illegal appropriation or infringement of its technology by a third party.

Competition Risks

The Company's products face intense competition. Many of our competitors have greater financial resources and marketing capabilities than our own. TSO_3's competitors and potential competitors may succeed in developing products and processes that are more effective and less expensive to use than any products or processes the Company may develop or licence, or that may render TSO_3's products or processes obsolete. The high level of competition in the sterilization industry could force the Company to reduce the price at which it sells its products or require TSO_3 to spend more time and money to market its products.

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.

Regulatory Approvals

Sterilizers are subject to regulatory clearances within individual markets. As such they are evaluated for compliance with established consensus standards. When a new technology is involved, there is no such standard. In such a case, a manufacturer must identify an existing "predicate" device from which to compare the new technology. The Corporation has effectively demonstrated such "predicate" devices in the past concerning the STERIZONE® 125L Sterilizer. While the Corporation believes that it is taking all appropriate steps to support existing and future submissions for regulatory clearance, it can not guarantee when, or if, such clearances will be received.

Financial Instruments

The Company is exposed to various risks, including the risks related to holding financial instruments. To manage the risk related to the use of financial instruments contained in the various investments that make up cash equivalents and temporary investments, controls have been implemented, in particular the Investment Policy. The Policy aims primarily to optimize returns from cash flow while reducing the Company's main risk exposures, which are described below:

Market Risk

Market risk is the risk that the value of a financial instrument will fluctuate as a result of changes in the parameters underlying their measurement, particularly interest rates and market prices. Interest rate risks exist when interest rate fluctuations modify the cash flows of the Company's investments.

At December 31, 2009, if the base rate at that date had been 0.5% lower, all other variables held constant, the after-tax loss and other comprehensive items for the year would have been $11,292 lower, arising mainly as a result of an increase in the fair value of fixed rate financial assets classified as held for trading. If the base rates at that date had been 0.5% higher, all other variables held constant, the after-tax loss and other comprehensive items for the year would have been $12,829 higher, arising mainly as a result of a decrease in the fair value of fixed rate financial assets classified as held for trading. The net loss therefore has a similar sensitivity to interest rate increases and interest rate decreases because of investments with capped interest rates.

Credit Risk

The use of financial instruments can create a credit risk in which there is a risk of financial loss resulting from a counterparty's inability or refusal to fully meet its contractual obligations. The Company has established an investment policy that addresses credit risk management and includes the authorization to perform investment transactions with the Canadian federal or provincial governments, crown corporations, municipalities or financial institutions, either in money market funds, guaranteed investment certificates or bonds with credit ratings of a minimum of A- or more according to Standard and Poor's or other credit rating agencies. This policy defines credit risk limits based on the characteristics of the counterparties. Therefore, the Company manages credit risk by complying with its established investment policy. As at December 31, 2009, the Company's investments were rated by two recognized agencies, and they respected the Company's investment policy.

Concentration Risk

Concentration risk exists when investments are made with multiple entities that share similar characteristics or when a large investment is made with a single entity. At December 31, 2009, in accordance with the Company's investment policy, there were no investments totalling more than 30% that did not provide a government guarantee.

Liquidity Risk

Liquidity risk represents the possibility of the Company not being able to raise the funds needed to meet financial commitments at the appropriate time and under reasonable conditions. The Company manages this risk by maintaining permanent and sufficient liquidity to meet current and future financial obligations, under both normal and exceptional circumstances. The funding strategies used to manage this risk include turning to capital markets to carry out issues of equity and debt securities. The Company can not guarantee that it will be able to put in place such financing.

Currency Risk

The risk related to the exchange rate on financial instruments exists when monetary assets or liabilities are denominated in foreign currencies.

At December 31, 2009, if the Canadian dollar had weakened 10 percent against the US dollar with all other variables held constant, the after-tax loss and other comprehensive items for the year would have been lower than $115,118. Conversely, if the Canadian dollar had strengthened 10 percent against the US dollar with all other variables held constant, the after-tax loss and other comprehensive items for the year would have been higher than $115,118.

SEGMENTED INFORMATION

Operating revenues are allocated between geographic areas based on the location of the client and are as follows for the years ended December 31:

	2009		2008	
Canada	**$357,057**	**27%**	$1,192,921	53%
United States	**967,483**	**73%**	1,042,180	47%
	$1,324,540	**100%**	2,235,101	100%

DISCLOSURE CONTROLS AND PROCEDURES

The Chief Executive Officer and the Chief Financial Officer of the Company are responsible for establishing the Company's Disclosure Controls and Procedures. As required by Securities Legislation, the Chief Executive Officer and the Chief Financial Officer have evaluated, or caused to be evaluated under their supervision, the Company's Disclosure Controls and Procedures as of December 31, 2009 and have concluded that these controls and procedures are effective.

INTERNAL CONTROL OVER FINANCIAL REPORTING

The Chief Executive Officer and the Chief Financial Officer of the Company are responsible for establishing and maintaining the Company's internal control over financial reporting. As required by Securities Legislation, the Chief Executive Officer and the Chief Financial Officer have evaluated, or caused to be evaluated under their supervision, the Company's internal control over financial reporting as of December 31, 2009 and have concluded that internal control over financial reporting is effective.

There were no changes in our internal controls over financial reporting that occurred during the quarter ended December 31, 2009 that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting.

FORWARD LOOKING STATEMENTS

This annual report and the MD&A contained herein, include certain statements that are considered "forward-looking information" within the meaning of applicable securities legislation. Furthermore, the words "will", "may", "could", "should", "outlook", "believe", "plan", "envisage", "anticipate", "expect" and "estimate", or the negatives of these terms or variations of them and the use of the conditional tense as well as similar expressions denote forward-looking information.

Forward-looking information is based upon a number of assumptions and is subject to a number of risks and uncertainties, many of which are beyond the Company's control that could cause actual results to differ materially from those that are disclosed in or implied by such forward-looking information. These risks and uncertainties are described under the section "Risks and Uncertainties" above.

Although the forward-looking information contained in this MD&A is based upon what the Company believes are reasonable assumptions, investors are cautioned against placing undue reliance on this information since actual results may vary from the forward-looking information. Consequently, all of the forward-looking information contained in this MD&A are qualified by the foregoing cautionary statements, and there can be no guarantee that the results or developments anticipated by the Company will be realized or, even if substantially realized, that they will have the expected consequences or effects on the Company, its business, financial condition or results of operation.
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.

This Management Report has been prepared as of March 11, 2010. Additional information on the Company is available through regular filing of press releases, annual reports, quarterly financial statements and the Annual Information Form on the SEDAR website (www.sedar.com).

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

March 11, 2010

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 and Risk Management 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 and Risk Management 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 and Risk Management 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,

Richard M. Rumble
President and CEO

Marc Boisjoli
Vice President, Finances and
Chief Financial Officer

March 11, 2010

DIRECTORS

Richard M. Rumble
President and Chief Executive Officer, TSO_3

Simon Robitaille
Vice president, Operations / R&D,
Chief Scientific Officer and Co-Founder, TSO_3

Jean-François Bureau 1)
Senior Vice President and CFO
DiagnoCure

Germain Carrière 1) 2) 3) 4)
Corporate Director

André de Villers 2) 4)
President
CEMA

Pierre Désy 1) 3) 4)
Corporate Director

James Husman 4)
Corporate Director

Jacques Marcotte 2) 3)
President
HWY Finance Inc.

W. Barry McDonald 4)
Consultant and Corporate Director

1) Member of the Audit and Risk Management Committee
2) Member of the Human Resources/Compensation Committee
3) Member of the Corporate Governance Committee
4) Member of the Ad Hoc Strategic Committee

SCIENTIFIC ADVISORY BOARD

Charles O. Hancock, RAC
(Regulatory Affairs Professionals)
Regulatory Affairs Consultant, New York

Dr James R. Husman
Corporate Director

Bernard Legube, Ph.D.
Professor in Environmental Chemistry
University of Poitiers, France

Paul S. Malchesky, D. Eng.
Chief Scientific Officer
EnviroSystems, Inc. CA

Richard Marchand, M.D.
Microbiologist and Infections Specialist
Consultant, Montréal

Gregg A. Mosley
President
Biotest Laboratories Minneapolis, MN

INVESTORS' INFORMATION

Ticker Symbol: TOS
Listing: TSX

Computershare Trust Company of Canada
1500, Rue University, suite 700
Montréal (Québec) H5A 3S8
Telephone: 514 982-7888
Fax: 514 982-7580

Auditors
Samson Bélair Deloitte & Touche s.e.n.c.r.l.
925, Grande-Allée Ouest, suite 400
Québec (Québec) G1S 4Z4
Telephone: 418 624-3333
Fax: 418 624-0414

Corporate Solicitors
Lavery, de Billy, LLP

Intellectual Property Solicitors
Borden Ladner Gervais LLP, Ottawa

Bank
National Bank of Canada

INVESTORS' INFORMATION

Annual Shareholder Meeting
Thursday, April 29, 2010 at 10:00 am
Musée national des beaux-arts du Québec
Auditorium
1, avenue Wolfe-Montcalm
Québec (Québec) G1R 5H3

Communications and Investor Relations
Caroline Côté
2505, avenue Dalton
Québec (Québec) G1P 3S5
Telephone: 418 651-0003 extension 237
Fax: 418 653-5726
Courriel: ccote@tso3.com or ir@tso3.com

Financial statements of

TSO_3 inc.

December 31, 2009 and 2008

TSO_3 inc.

Table of contents

Deloitte.

Samson Bélair/Deloitte & Touche s.e.n.c.r.l.
925, Grande Allée Ouest
Bureau 400
Québec QC G1S 4Z4
Canada

Tél. : 418-624-3333
Téléc. : 418-624-0414
www.deloitte.ca

Auditors' report

To the shareholders of
TSO_3 inc.

We have audited the balance sheets of TSO_3 inc. as at December 31, 2009 and 2008 and the statements of earnings and comprehensive loss, 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 statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of TSO_3 inc. as at December 31, 2009 and 2008 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.[1]

Chartered Accountants

Québec, February 19, 2010

[1] Chartered accountant auditor permit no. 16162

TSO_3 inc.

Statements of earnings and comprehensive loss

Years ended December 31	2009	2008
SALES	**$ 1,324,540**	$ 2,235,101
EXPENSES		
Operating	**2,350,190**	2,778,983
Sales and marketing	**2,130,329**	3,681,424
Research and development	**3,447,302**	2,649,267
Administrative	**3,058,220**	3,691,879
Financial	**24,234**	23,099
	11,010,275	12,824,652
OPERATING LOSS	**9,685,735**	10,589,551
OTHER INCOME (Note 18)	**468,103**	955,747
NET LOSS AND COMPREHENSIVE LOSS	**$ 9,217,632**	$ 9,633,804
Basic and diluted net loss per share (Note 17)	**$ 0.19**	$ 0.20

References:

Amortization of property, plant
and equipment and intangible assets (Notes 7 and 8)
Interest (Note 12)
Research and development tax credits (Note 15)
Foreign exchange (loss) gain (Note 18)

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

TSO_3 inc.

Statements of contributed surplus
Years ended December 31

	2009	2008
Balance at beginning	**$ 7,900,943**	$ 7,471,369
Options exercised (Note 10)	**(750)**	-
Stock-based compensation (Note 10)	**210,195**	429,574
Balance at end	**$ 8,110,388**	$ 7,900,943

Statements of deficit
Years ended December 31

	2009	2008
Balance at beginning	**$ 57,239,325**	$ 47,640,464
Change in accounting policies	-	(34,943)
Restated deficit	**57,239,325**	47,605,521
Net loss	**9,217,632**	9,633,804
Balance at end	**$ 66,456,957**	$ 57,239,325

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

TSO$_3$ inc.

Balance sheets
As at December 31

	2009	2008
CURRENT ASSETS		
Cash and cash equivalents (Note 4)	**$ 6,727,088**	$ 9,186,202
Temporary investments (Note 4)	**3,944,757**	8,532,268
Accounts receivable (Note 5)	**1,333,178**	820,318
Inventories (Note 6)	**1,483,810**	2,548,075
Prepaid expenses	**111,528**	114,848
	13,600,361	21,201,711
PROPERTY, PLANT AND EQUIPMENT (Note 7)	**1,256,339**	675,810
INTANGIBLE ASSETS (Note 8)	**3,549,189**	3,642,126
	$ 18,405,889	$ 25,519,647
CURRENT LIABILITIES		
Accounts payable and accrued liabilities	**$ 1,488,029**	$ 1,258,780
Deferred revenues	**633,483**	388,958
	2,121,512	1,647,738
LONG-TERM DEFERRED REVENUES (Note 20)	**1,418,850**	-
	3,540,362	1,647,738
SHAREHOLDERS' EQUITY		
Share capital (Note 10)	**73,212,096**	73,210,291
Contributed surplus	**8,110,388**	7,900,943
Deficit	**(66,456,957)**	(57,239,325)
	14,865,527	23,871,909
	$ 18,405,889	$ 25,519,647

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

Approved by the Board

Director

Director

TSO_3 inc.

Statements of cash flows

Years ended December 31	2009	2008
OPERATING ACTIVITIES		
Net loss	**$ (9,217,632)**	$ (9,633,804)
Adjustments for:		
Amortization of property, plant and equipment (Note 7)	**245,618**	154,144
Amortization of intangible assets (Note 8)	**318,753**	285,008
Change in the value of temporary investments (Note 18)	**138,343**	102,856
Stock-based compensation (Note 10)	**210,195**	429,574
Gain on disposal of investments	**-**	(91,722)
Loss (gain) on disposal of property, plant and equipment (Note 18)	**3,374**	(8,124)
	(8,301,349)	(8,762,068)
Change in non-cash operating working capital items (Note 12)	**2,108,983**	863,515
Cash flows applied to operating activities	**(6,192,366)**	(7,898,553)
INVESTING ACTIVITIES		
Acquisition of temporary investments	**(14,891,836)**	(21,143,577)
Disposal of temporary investments	**19,341,004**	16,723,622
Acquisition of property, plant and equipment	**(492,155)**	(356,040)
Acquisition of intangible assets	**(225,816)**	(229,406)
Disposal of property, plant and equipment	**1,000**	8,429
Cash flows applied to investing activities	**3,732,197**	(4,996,972)
FINANCING ACTIVITIES		
Options exercised (Note 10)	**1,055**	-
Cash flows from financing activities	**1,055**	-
DECREASE IN CASH AND CASH EQUIVALENTS	**(2,459,114)**	(12,895,525)
CASH AND CASH EQUIVALENTS AT BEGINNING	**9,186,202**	22,081,727
CASH AND CASH EQUIVALENTS AT END	**$ 6,727,088**	$ 9,186,202

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

TSO_3 inc.

Notes to the financial statements
Years ended December 31, 2009 and 2008

1. Description of business

The Company was incorporated on June 10, 1998 under Part 1A of the Companies Act (Quebec). 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 (GAAP) and reflect the following significant accounting policies:

Use of estimates

The preparation of financial statements in accordance with Canadian GAAP 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.

Financial instruments

Financial assets and financial liabilities are initially recognized at fair value and subsequent measurement depends on how they are classified, which is described below. Their classification depends on the purpose for which the financial instruments were acquired or issued, their characteristics, and the designation made by the Company. Settlement date accounting is used.

Classification

Cash and cash equivalents	Held for trading
Temporary investments	Held for trading
Accounts receivable	Loans and receivables
Accounts payable and accrued liabilities	Other liabilities

2. Accounting policies (continued)

Cash and cash equivalents

Cash and cash equivalents include cash, bonds with maturities of three months or less and money market funds. The Company has classified these instruments as held for trading. These investments are highly liquid and are held for the purpose of meeting short-term cash commitments. They are recorded at fair value. Increases and decreases in fair value are recognized as investment income and presented under "Other revenues" in the statement of earnings.

Temporary investments

Temporary investments are designated as instruments held for trading, effective as of the recognition date. These investments are recorded at fair value. Increases and decreases in fair value are recognized as investment income and presented under "Other revenues" in the statement of earnings.

Held-for-trading assets are recorded at fair value. Under Section 3862, "Financial Instruments – Disclosures" of the CICA Handbook, bonds are classified as level 2 and money market funds and cash are classified as level 1.

Loans and receivables

Loans and receivables are accounted for at amortized cost using the effective interest method.

Other liabilities

Other liabilities are recorded at amortized cost using the effective interest method and include all financial liabilities other than derivative instruments.

Transaction costs

Transaction costs related to held-for-trading financial assets are expensed as incurred. Transaction costs related to other liabilities and to loans and receivables are added to the carrying value of the asset or are netted against the carrying value of the liability and are then recognized over the expected life of the instrument using the effective interest method.

2. Accounting policies (continued)

Effective interest method

The Company uses the effective interest method to recognize interest income or expense, which includes transaction costs as well as the fees, premiums or discounts earned or incurred for financial instruments.

Fair value

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

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

Inventories

The cost of inventories is essentially determined using the first in, first out method. The cost of work in progress and finished goods comprises the cost of raw materials and an applicable share of the cost of labour and manufacturing overhead based on normal production capacity. Inventories are valued at the lower of cost and net realizable value.

When an impairment is recognized, a new assessment of net realizable value is performed in each subsequent period. When the circumstances that justified writing down the inventories below cost no longer exist, or when there is a clear indication of an increase in net realizable value due to a change in the economic situation, the amount of the write-down is reversed such that the new carrying amount is the lower of the cost or the revised net realizable value.

TSO_3 inc.

Notes to the financial statements
Years ended December 31, 2009 and 2008

2. Accounting policies (continued)

Property, plant and equipment

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

Office furniture, stand, equipment and production tools and R&D	20%
Computer equipment and lift truck	30%
Leasehold improvements	Lease term
Hospital equipment	3 years

Intangible assets

Intangible assets are recorded at cost. Amortization is calculated using the straight-line method over their estimated useful lives, as follows:

Technology and patents	20 years
Licence	16 years
Software and website	3 years
Trademarks	10 and 15 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.

2. Accounting policies (continued)

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, non-monetary assets and liabilities are translated at historical rates, revenues and expenses are translated at the exchange rates in effect at the time of the transaction and exchange 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 expenses 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 the tax credits for scientific research and experimental development costs, is presented 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 earnings only if their realization is considered more likely than not.

TSO_3 inc.

Notes to the financial statements
Years ended December 31, 2009 and 2008

2. Accounting policies (continued)

Revenue recognition

The Company generates revenue mainly from the sale of ozone sterilization units, parts, supplies and accessories related to these units and service and maintenance contracts for the units. The Company is generally committed under revenue arrangements with multiple deliverables that include delivery of units, installation, warranty, maintenance, customer service and consulting services. 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. Revenue related to service contracts offered to clients is deferred and recognized using the straight-line method over the term of the contract.

Revenue earned on the units sold, the parts and accessories related to these units and the installation and consulting services are recognized upon delivery of the service and the client’s acceptance of the services received. Maintenance and service contracts and warranties are recognized using the straight-line method over the term of the contract.

Provision for warranties

The Company offers a standard 12-month warranty to its clients. The estimated cost of the warranty is based on the following: the Company’s history with defective ozone sterilization units and the parts and accessories for these units, the probability that these defects will arise and the costs to repair them.

Stock-based compensation

The Company uses the fair value method to measure compensation expense at the date of grant of stock options to employees. Fair value 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.

3. Changes in accounting policies

Impact of adopting the new accounting standards

a) Goodwill and intangible assets

In February 2008, the CICA issued a new Section 3064, “Goodwill and Intangible Assets” which replaces Section 3062, “Goodwill and Other Intangible Assets” as well as Section 3450, “Research and Development Costs.” The new Section 3064 states that upon initial identification, intangible assets are to be recognized as assets only if they meet the definition of an intangible asset and the asset recognition criteria. Section 3064 also provides further information on the recognition of internally generated intangible assets (including research and development costs). As for subsequent measurement of intangible assets, goodwill and disclosure, Section 3064 essentially carries forward unchanged the recommendations of former Section 3062. This section applies to interim and annual financial statements relating to fiscal years beginning on or after January 1, 2009. Adoption of this section did not have a material impact on the Company’s financial statements.

b) Credit risk and the fair value of financial assets and financial liabilities

On January 20, 2009, the CICA issued Abstract No. 173 of the Emerging Issues Committee, “Credit Risk and the Fair Value of Financial Assets and Financial Liabilities” EIC-173, which should be applied retrospectively without restatement of prior periods to all financial assets and liabilities measured at fair value in financial statements issued after this date. EIC-173 requires that the Company’s own credit risk and the credit risk of the counterparty should be taken into account in determining the fair value of financial assets and financial liabilities, including derivative instruments. The Company adopted EIC-173 during 2009. Adoption of this new abstract did not have a material impact on the Company’s financial statements.

TSO_3 inc.

Notes to the financial statements
Years ended December 31, 2009 and 2008

3. Changes in accounting policies (continued)

Impact of adopting the new accounting standards (continued)

c) Financial instruments

In August 2009, the Canadian Accounting Standards Board issued changes to Section 3855, “Financial Instruments – Recognition and Measurement.” These changes resulted in a change in the definition of loans and receivables as well as a change in the definition of a financial asset or financial liability held for trading. Changes were also made to Section 3025, “Impaired Loans” to include held-to-maturity investments in the scope of this section. These changes did not have an impact on the Company’s financial statements.

Future accounting changes

In February 2008, the Canadian Accounting Standards Board confirmed that Canadian publicly accountable enterprises would be required to adopt IFRS when preparing financial statements for years beginning on or after January 1, 2011. The Company will therefore be required to transition to IFRS for its interim and annual financial statements beginning on or after January 1, 2011 and provide a restated comparative statement in accordance with IFRS.

Since the Company will adopt IFRS on January 1, 2011, the new Canadian GAAP standards that will come into effect on or after January 1, 2011 will not be presented as future accounting changes, as these will never be applied by the Company.

To prepare for the adoption of IFRS, the Company has developed an IFRS conversion plan. The Company has completed the diagnostic phase, which involved a high-level review of the differences between current Canadian GAAP and IFRS, as well as a review of the alternatives available on adoption. Phase 2 of the plan, which will be completed by the end of 2010, will allow the Company to evaluate the consequences of the transition. Once completed, the Company will evaluate the impact of IFRS on the other key elements of the conversion plan, which include changes to information systems, training requirements, internal control mechanisms over financial reporting and impacts on business activities. The final phase will be to prepare the opening balance sheet, the financial results (current and comparative), reconciliation notes as well as additional notes under IFRS and their initial adoptions.

TSO_3 inc.

Notes to the financial statements
Years ended December 31, 2009 and 2008

4. Financial instruments

Cash equivalents and temporary investments

	2009	2008
Bonds, maturing at various dates through August 2010 and having an average yield of 0.64%	**$ 6,942,688**	$ 11,900,859
Money market funds	**2,200,782**	1,918,236
	$ 9,143,470	$ 13,819,095
Distributed as follows:		
Cash equivalents	**$ 5,198,713**	$ 5,286,827
Temporary investments	**3,944,757**	8,532,268
	$ 9,143,470	$ 13,819,095

As at December 31, 2009, securities held were rated A+ or better and money market funds held were rated R1 or better.

Cash equivalents are presented on the balance sheet under line item “Cash and cash equivalents.” This item consists of $1,528,375 in cash ($3,899,375 in 2008) and $5,198,713 ($5,286,827 in 2008) in cash equivalents, for a total amount of $6,727,088 ($9,186,202 in 2008).

The Company is exposed to various risks, including the risks related to holding financial instruments. To manage the risk related to the use of financial instruments contained in the various investments that make up cash equivalents and temporary investments, controls have been implemented, in particular the investment policy. The measures aim primarily to optimize returns from cash flow while reducing the Company’s main risk exposures, which are described below.

Market risk

Market risk is the risk that the value of a financial instrument will fluctuate as a result of changes in the parameters underlying its measurement, particularly interest rates and market prices.

TSO$_3$ inc.

Notes to the financial statements
Years ended December 31, 2009 and 2008

4. Financial instruments (continued)

Interest rate risk

Interest rate risk exists when interest rate fluctuations modify the cash flows of the Company's investments.

At December 31, 2009, if the base rate at that date had been 0.5% lower, all other variables held constant, the after-tax loss and other comprehensive items for the year would have been $11,292 lower, arising mainly as a result of an increase in the fair value of fixed rate financial assets classified as held for trading. If the base rates at that date had been 0.5% higher, all other variables held constant, the after-tax loss and other comprehensive items for the year would have been $12,829 higher, arising mainly as a result of a decrease in the fair value of fixed rate financial assets classified as held for trading. The net loss therefore has a similar sensitivity to interest rate increases and interest rate decreases because of investments with capped interest rates.

Credit risk

The use of financial instruments can create a credit risk in which there is a risk of financial loss resulting from a counterparty's inability or refusal to fully meet its contractual obligations. The Company has established an investment policy that addresses credit risk management and includes the authorization to perform investment transactions with the Canadian federal or provincial governments, crown corporations, municipalities or financial institutions, either in money market funds, guaranteed investment certificates or bonds with credit ratings of a minimum of A- or more according to Standard and Poor's or other credit rating agencies. This policy defines credit risk limits based on the characteristics of the counterparties. Therefore, the Company manages credit risk by complying with its established investment policy. As at December 31, 2009, the Company's investments were rated by two recognized agencies, and they respected the Company's investment policy.

Concentration risk

Concentration risk exists when investments are made with multiple entities that share similar characteristics or when a large investment is made with a single entity. At December 31, 2009, in accordance with the Company's investment policy, there were no investments totalling more than 30% that did not provide a government guarantee.

4. Financial instruments (continued)

Liquidity risk

Liquidity risk represents the possibility of the Company not being able to raise the funds needed to meet financial commitments at the appropriate time and under reasonable conditions. The Company manages this risk by maintaining permanent and sufficient liquidity to meet current and future financial obligations, under both normal and exceptional circumstances. The funding strategies used to manage this risk include turning to capital markets to carry out issues of equity and debt securities.

Currency risk

The risk related to the exchange rate on financial instruments exists when monetary assets or liabilities are denominated in foreign currencies.

At December 31, 2009, if the Canadian dollar had weakened 10 percent against the US dollar with all other variables held constant, the after-tax loss and other comprehensive items for the year would have been lower than $115,118. Conversely, if the Canadian dollar had strengthened 10 percent against the US dollar with all other variables held constant, the after-tax loss and other comprehensive items for the year would have been higher than $115,118.

5. Accounts receivable

	2009	2008
Accounts receivable	**$ 591,284**	$ 479,546
Tax credits receivable	**607,234**	285,052
Other	**134,660**	55,720
	$ 1,333,178	$ 820,318

TSO$_3$ inc.

Notes to the financial statements
Years ended December 31, 2009 and 2008

6. Inventories

	2009	2008
Raw materials	$ **928,187**	$ 1,013,681
Work in progress	**468,604**	61,952
Finished goods	**87,019**	1,472,442
	$ **1,483,810**	$ 2,548,075

Operating expenses include a cost of goods sold charge of $1,232,969, including a write-down of $446,484 for finished goods and $135,225 for raw materials.

At the end of 2009, the Company reviewed its estimate for the provision for obsolescence and a reversal of $135,485 was recorded and is included in the cost of goods sold.

7. Property, plant and equipment

	Cost	Accumulated amortization	Net book value 2009	Net book value 2008
Equipment and production tools and R&D	**$ 1,565,063**	$ **578,228**	$ **986,835**	$ 358,885
Hospital equipment	**24,694**	**4,116**	**20,578**	-
Computer equipment	**484,966**	**358,422**	**126,544**	160,937
Office furniture	**185,970**	**105,183**	**80,787**	100,983
Lift truck	**14,115**	**13,127**	**988**	1,412
Stand	**22,734**	**12,824**	**9,910**	7,354
Leasehold improvements	**232,316**	**201,619**	**30,697**	46,239
	$ 2,529,858	$ **1,273,519**	$ **1,256,339**	$ 675,810

Amortization of property, plant and equipment for the year totalled $245,618 ($154,144 in 2008).

TSO_3 inc.

Notes to the financial statements
Years ended December 31, 2009 and 2008

8. Intangible assets

	Cost	Accumulated amortization	Net book value 2009	Net book value 2008
Technology	**$ 2,978,874**	**$ 744,719**	**$ 2,234,155**	$ 2,383,099
Licence	**991,063**	**371,649**	**619,414**	681,356
Patents	**617,789**	**78,545**	**539,244**	387,855
Trademarks	**40,627**	**8,020**	**32,607**	30,647
Software	**503,187**	**388,264**	**114,923**	159,169
Website	**54,691**	**45,845**	**8,846**	-
	$ 5,186,231	**$ 1,637,042**	**$ 3,549,189**	$ 3,642,126

Amortization of intangible assets for the year totalled $318,753 ($285,008 in 2008).

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 2%. 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, 2009.

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

TSO$_3$ inc.

Notes to the financial statements
Years ended December 31, 2009 and 2008

10. Share capital (continued)

Issued and paid – Common	**2009** Number		2008 Number	
Balance at beginning	**47,863,402**	**$ 73,210,291**	47,863,402	$ 73,210,291
Options exercised	**4,166**	**1,805**	-	-
Balance at end	**47,867,568**	**$ 73,212,096**	47,863,402	$ 73,210,291

In 2009, holders exercised certain options; they subscribed for 4,166 shares for a total cash consideration received of $1,055. During 2008, no options or warrants were exercised.

Stock-based compensation and other stock-based payments

a) Employee stock purchasing plan

On May 2, 2007, the Company set up an employee stock purchasing plan for employees and executives. Eligible participants may contribute, in the form of payroll deductions, up to 5% of their basic salary. The Company contributes an amount equal to 50% of the participant's total monthly contribution.

Every month, the participant and Company contributions are remitted to a brokerage firm that uses the entire balance of the contributions to purchase, on the open market and on the last day of the month, shares to the nearest whole number.

TSO$_3$ inc.

Notes to the financial statements
Years ended December 31, 2009 and 2008

10. Share capital (continued)

Stock-based compensation and other stock-based payments (continued)

b) Stock option plan

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 4,549,407. 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 2009, the Company awarded 258,000 stock options to its employees, directors and suppliers at a weighted average exercise price of $0.55. The weighted average fair value of these stock options was $0.42 per option.

The stock-based compensation expense pertaining to the options granted has been amortized using the graded vesting method, giving rise to a stock-based compensation expense of $210,195 in 2009 ($429,574 in 2008) presented in "Administrative expenses." Stock options granted from 2007 to 2009 will also involve additional compensation expenses of $139,056 in 2010, $63,760 in 2011, and $20,852 in 2012.

The fair value of the stock options granted in 2009 is estimated using the Black-Scholes option pricing model under the following weighted average assumptions:

Risk free interest rate	*3.38 %*
Expected volatility	*72 %*
Life	*9.4 years*
Expected dividend yield	*0 %*

TSO_3 inc.

Notes to the financial statements
Years ended December 31, 2009 and 2008

10. Share capital (continued)

Stock-based compensation and other stock-based payments (continued)

b) Stock option plan (continued)

The Black-Scholes option 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 highly subjective valuations and include the expected stock price volatility of the underlying shares. Any changes in the assumptions can materially affect the fair value estimates.

The following table summarizes the stock option activity:

	2009		2008	
	Number	**Weighted average exercise price**	Number	Weighted average exercise price
Outstanding at beginning	**4,225,786**	**$ 1.33**	2,494,430	$ 2.18
Granted	**258,000**	**0.55**	2,116,224	0.51
Exercised	**(4,166)**	**0.24**	-	-
Forfeited	**(300,076)**	**2.30**	(384,868)	2.37
Outstanding at end	**4,179,544**	**$ 1.20**	4,225,786	$ 1.33
Exercisable at end	**2,629,889**	**$ 1.58**	2,077,624	$ 1.98

TSO_3 inc.

Notes to the financial statements
Years ended December 31, 2009 and 2008

10. Share capital (continued)

Stock-based compensation and other stock-based payments (continued)

b) Stock option plan (continued)

The following table summarizes certain information regarding the stock options of the Company as at December 31, 2009:

	Outstanding options		**Exercisable options**	
Exercise price	**Number**	**Average remaining contractual life (years)**	**Number**	**Average remaining contractual life (years)**
\$0.24 to \$1.94	3,626,870	5.92	2,165,537	4.13
\$2.16 to \$2.99	370,829	6.79	282,507	6.48
\$3.10 to \$3.45	181,845	5.02	181,845	5.02
	4,179,544	5.95	2,629,889	4.44

c) Warrants and compensation

Upon the issuance of 9,200,000 units on March 8, 2007, 4,600,000 warrants were granted. These warrants, which were used to purchase one common share of the Company at a price of \$3.00, expired on March 8, 2009.

Warrants and other options varied as follows:

	2009		2008	
	Number	**Weighted average exercise price**	Number	Weighted average exercise price
Outstanding at beginning	**4,600,000**	**\$ 3.00**	5,060,000	\$ 2.95
Expired	**(4,600,000)**	**3.00**	(460,000)	2.50
Outstanding at end	**-**	**\$ -**	4,600,000	\$ 3.00
Exercisable at end	**-**	**\$ -**	4,600,000	\$ 3.00

11. Capital management

The Company needs capital primarily to finance its research and development activity, its operating, administrative and marketing expenses, its working capital and its capital expenditures. In the past, the Company has financed its activities through various rounds of public and private financing as well as through government grants.

Depending on its capacities and prevailing market conditions, the Company could finance all or a portion of its long-term assets through long-term debt.

The monthly burn rate was approximately $576,000 as at December 31, 2009 ($707,000 as at December 31, 2008).

The Company has a line of credit that it can use to obtain advances up to a maximum of $350,000. To maintain this credit line, the Company must comply with two financial ratios: the working capital ratio and the net worth ratio. Although the credit line has not been drawn, the Company reviews these ratios every month. As at December 31, 2009, the Company was in compliance with these ratios.

The Company reviews its loss-per-share ratio quarterly. Its goal is to improve this ratio. This ratio has been maintained over the years.

TSO_3 inc.

Notes to the financial statements
Years ended December 31, 2009 and 2008

12. Additional information relating to cash flows

		2009		2008
Change in non-cash operating working capital items				
Decrease (increase) in current assets				
Accounts receivable	**$**	**(512,860)**	$	154,693
Inventories		**1,064,265**		483,277
Prepaid expenses		**3,320**		24,562
Increase (decrease) in liabilities				
Accounts payable and accrued liabilities		**229,249**		(42,097)
Deferred revenues		**1,663,375**		243,080
		2,447,349		863,515
Non-cash item transferred to R&D		**(338,366)**		-
	$	**2,108,983**	$	863,515
Interest				
Received	**$**	**375,046**	$	89,127
Research and development tax credits				
Received	**$**	**-**	$	283,817

13. Related party transactions

The Company rents premises from a company held by its related parties.

During 2009, the Company carried out the following transactions with this related company:

		2009		2008
Rent	**$**	**62,793**	$	61,561
Other rent-related expenses		**80,175**		71,138
	$	**142,968**	$	132,699

These transactions were carried out during the normal course of business and were measured at the exchange amount, which is the amount of the consideration agreed to and accepted by the Company and the related party. As was the case in 2008, no amount was included in accounts payable with respect to transactions with this related party as at December 31, 2009.

TSO_3 inc.

Notes to the financial statements
Years ended December 31, 2009 and 2008

14. Income taxes

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

As at December 31, 2009, the accumulated tax losses that can be carried forward are as follows:

Expiry date	Loss carry-forwards Federal	Provincial
2029	$7,410,000	$7,390,000
2028	8,053,000	8,040,000
2027	6,224,000	6,822,000
2026	5,481,000	5,820,000
2015	5,009,000	4,961,000
2014	4,601,000	4,591,000
2010	4,406,000	4,317,000
	$41,184,000	$41,941,000

As at December 31, 2009, in addition to these tax losses carried forward, the Company has unclaimed research and development expenses ($9,716,000 at the federal level and $13,189,000 at the provincial level) and $891,000 in financing costs that can be carried forward to reduce future taxable income. The unrealized tax benefit, estimated at $14,436,000, and related to these losses carried forward and unclaimed 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 $526,000, which has not been recorded.

In addition, as at December 31, 2009, the Company has $2,397,000 in additional tax credits, representing the outstanding and unrecorded portion of the federal tax credit receivable.

The Company also has a capital loss balance creating future income tax assets of $16,000.

Furthermore, the cost of intangible assets for tax purposes was $564,000 (net book value of $3,425,420) 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 $544,000 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 unclaimed 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.

TSO_3 inc.

Notes to the financial statements
Years ended December 31, 2009 and 2008

15. Research and development tax credits

For tax credit purposes, research and development expenditures incurred during the year totalled $2,261,001 ($1,210,237 in 2008); of these research and development expenditures, an amount of $716,940 as at December 31, 2009 ($51,325 in 2008) is related to property, plant and equipment.

Some of these expenses qualify for refundable scientific research tax credits amounting to $300,000 as at December 31, 2009 ($270,000 in 2008).

The tax credit claimed for the year ended December 31, 2008 has not been reviewed by the tax authorities. Consequently, the amount of tax credits that will be awarded could differ from the one already recorded.

16. Segmented information

Operating revenues are allocated between geographic areas based on the location of the client and are as follows for the years ended December 31:

	2009		2008	
Canada	**$ 357,057**	**27%**	$ 1,192,921	53%
United States	**967,483**	**73%**	1,042,180	47%
	$ 1,324,540	**100%**	$ 2,235,101	100%

TSO$_3$ inc.

Notes to the financial statements
Years ended December 31, 2009 and 2008

17. Earnings per share

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

	2009	2008
Net loss		
Basic and diluted	**$ 9,217,632**	$ 9,633,804
Number of shares		
Weighted average number of outstanding shares[1]	**47,863,626**	47,863,402
Loss per share		
Basic	**$ 0.19**	$ 0.20
Diluted[2]	**$ 0.19**	$ 0.20

[1] The weighted average number of outstanding shares is calculated using the number of common shares according to a weighted average based on the fraction of the period during which they were outstanding.

[2] The weighted average number of outstanding shares remains unchanged for the calculation of the diluted loss per share given that the inclusion of potential common shares in computing the diluted earnings (loss) per share still had an anti-dilutive effect.

18. Other income

	2009	2008
Investment income	**$ 233,125**	$ 248,868
Change in the value of investments held as cash and cash equivalents	**30,111**	427,500
Change in the value of temporary investments	**(138,343)**	(102,856)
Research and development tax credits	**335,788**	252,465
Foreign exchange (loss) gain	**(59,857)**	24,609
Gain on disposal of investments	**-**	91,722
(Loss) gain on disposal of property, plant and equipment	**(3,374)**	8,124
Grants	**57,500**	3,955
Other	**13,153**	1,360
	$ 468,103	$ 955,747

TSO$_3$ inc.

Notes to the financial statements
Years ended December 31, 2009 and 2008

19. Commitments

Under its operating leases and service contracts, the Company is committed to pay $346,876 in 2010, $25,515 in 2011, $15,538 in 2012 and $1,220 in 2013.

20. Sales agreement

During the year, the Company entered into a commercialization agreement to distribute 125L + worldwide. This agreement includes licence revenue payable in part upon signing the agreement and additional payments based on achieving certain objectives. Licence revenue will be recognized on a straight-line basis over the term of the agreement. No revenue has been recognized during the year with respect to this agreement. An amount of $1,576,500 is recorded in "Deferred revenues" for December 31, 2009, including an amount of $157,650 at short-term. An amount of $525,500 is recorded in accounts receivable.

21. Subsequent events

a) On February 10, 2010, the Company entered into an agreement to sell, on a bought deal basis, 10,000,000 shares at a price of $1.60 each for gross investment proceeds of $16,000,000.

   Moreover, as additional consideration for services rendered, the Underwriters have been granted by the Company with a number of warrants equal to 750,000 options. Each warrant will entitle holders to subscribe to one common share of the Company at a price of $1.60 for a period of 18 months following the closing date of the deal.

b) On February 16, 2010, the Company filed a preliminary prospectus to sell 10,000,000 shares at a price of $1.60 each for gross investment proceeds of $16,000,000. The Company also agreed to an option for an additional allocation whereby the purchase of additional shares representing 15% of the issued shares would be included in the investment.

   The closing date of the investment should be on or about March 2, 2010, and is subject to certain conditions, including that of obtaining the required regulatory approval from authorities such as the TSX.

22. Comparative figures

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

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Ticker Symbol: **TOS (TSX)**

TSO_3 STERIZONE® Sterilizer U.S. Pat. No. 7,128,872 / 7,582,257 / 7,588,720 / 7,608,217
TSO_3 STERIZONE® Chemical Indicator U.S. Pat. No. 6,589,479
Licensed under U.S. Pat. No. 6,387,241 by Lynntech.
Other patents pending