2010 ANNUAL REPORT

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VISION

Creating the Improved Standard in Healthcare Sterilization

MESSAGE FROM THE CHAIRMAN OF THE BOARD

In recent years, TSO_3 has faced and addressed significant challenges. For the past two years, the Company has been operating under a new plan outlining aggressive timelines and objectives. Consistent with this plan, TSO_3 achieved both core objectives of enhancing the technology and pursuing a channel partner agreement with a reputable international healthcare player: 3M™.

While we share the disappointment in the recent delays with commercialization, we should not forget how TSO_3 has progressed and repositioned itself for success.

The Board is pleased with the accomplishments and intends to support the Company in growing its business even further. Therefore, new Company objectives have already been established; these include both product and technology developments and integration of outside opportunities. Again, progress towards the new objectives will be closely monitored.

Your Board of Directors is operating to ensure appropriate oversight and governance are in place to assist TSO_3 in its journey. The various Board committees meet routinely to ensure such things as compensation and succession planning are in line and in place; that risks to the business are being evaluated and where appropriate, risk mitigation plans are being established. Scientific and strategic advisory committees meet regularly with management as a means of ensuring adequate attention is given to current as well as future opportunities. The Audit committee meets on a regular basis to ensure that the financial resources the company has been entrusted with and are wisely cared for. The committee also considers resources potentially required for future growth strategies have careful consideration and planning prior to any possible execution.

The future of TSO_3 is not yet fully “written”. However, we stand today with a viable technology platform capable of generating multiple products; each with its own revenue stream. We intend to support management in growing this Company and we will do so based on its technology, its existing expertise and on skills it is building.

As Chairman of the Board, I am very proud to be part of the present and look forward to witnessing the future of the Company. I sincerely believe that TSO_3 has started to position itself to be able to answer the growing market need for better technologies and practices in the healthcare environment.

Germain Carrière
Chairman of the Board

MESSAGE FROM THE PRESIDENT AND CEO

Both Eyes on the Present with an Ear to the Future

Dear Valued Shareholders:

As I write this letter as a means of summarizing the activities of 2010 with its accomplishments, challenges faced and with full realization of the work yet to do, I also think of what's next for our Company. Our vision of "Creating the Improved Standard in Healthcare Sterilization" can also be translated into "enabling better health care".

In 2010, the Company saw a number of achievements, many of them internal improvements mandatory for success, and growth. Amongst our achievements is having been granted the CE Mark for our new generation sterilizer (STERIZONE® 125L+ / 3M™ Optreoz™ 125-Z); a requirement to place products within the European Union and our first regulatory clearance outside North America. We also secured $16 million in new capital through a financing round and these funds are being used to support our operations, as well as to fund the research and development of a new sterilizer targeted specifically at the Operating Room Sub-Sterile Area (OR).

In 2010, with limited commercial effort, the Company took orders for the new generation sterilizer and built a backlog for units to be delivered in 2011.To this end, together with our channel partner 3M™, the Company undertook an ongoing process of complete Verification and Validation (V&V) of the sterilizer and all of its sub-systems. This is necessary in order to document the reliability and the robustness of the product. This process has been arduous at times, but we believe in the result and value 3M™'s support in the process. We are now in the final phase of a three-phase process.

In 2010, we did not make the anticipated progress with the US regulatory process that we had hoped for. After our success in 2009, obtaining 510(k) clearance for superior claims on the initial sterilizer (STERIZONE® 125L), we had expected similar results in 2010 for our new generation sterilizer. Instead, because of a changing US regulatory environment, we were asked to re-file our 510(k) and learned that the agency was in the midst of altering their expectations for all products moving through their 510(k) process.

Meetings were held with the agency during the year and dialogue still remains open as we look to resubmit our file in the months to come. We remain firm in our belief that the new generation sterilizer will successfully clear the US regulatory process but, at this time, are cautious in stating an expected timeline for the clearance, as the regulatory process is being redefined and not within our control.

As we look to 2011 and beyond, we continue to focus on overall process improvement and on recruiting the required skills for our growth. In the short term, we shall finalize the V&V process in order to ship products to Canadian customers later this year. We will drive towards obtaining the US regulatory clearances required to market in that country. We shall also follow our development process for the new OR sterilizer with the expectation of a commercial event in 2012. Still looking towards the future, we will be open to opportunities within our market space of healthcare sterile reprocessing accelerating our growth and supporting our intention of enabling better health care.

In closing this letter, I would like to express my appreciation to the TSO_3 and 3M™ teams, for the collaboration that has taken place over the last year towards a common goal: commercial launch of the 3M™ Optreoz™ 125-Z. I would also like to express my appreciation to our long standing shareholders, as well as those more recently involved and placing their confidence in our team and technology – I firmly believe your confidence is well placed. And lastly, I would like to thank the TSO_3 Board of Directors for their continued counsel and guidance.

Richard M. (Ric) Rumble
President and CEO

OUR INDUSTRY

The need for low temperature sterilization

Sterilization of medical devices is essential to ensure positive surgical outcomes. The use of non-sterile surgical instruments contributes to increased infection rates. These increase patient hospital stays, drive up the cost of care and can lead to increased mortality rates.

While some medical instruments are designed for single use, the majority must be reprocessed between surgical cases and as such, need to be compatible with the sterilization process used. Traditionally, steam was used to sterilize surgical instruments. Today's surgical suite is very different from those of the past. Today, the trend continues towards the practice of minimally invasive surgery (MIS). MIS devices are complex, expensive and delicate, and in many cases, do not tolerate the steam sterilization process.

The growing and aging population worldwide (65 years+) – demanding more OR time - combined with the increase in minimally invasive surgeries (MIS), creates greater and growing demand for efficacious and high-throughput low-temperature sterilization methods.

Today, it is not uncommon to find sterile reprocessing of instruments conducted in three areas of the hospital. These are: the Central Sterile Department (CS), the sub-sterile area of the Operating Room (OR) and the Gastroenterology Department (GI).

Competitive landscape

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 Ethylene Oxide (EtO) and Hydrogen Peroxide (H_2O_2) sterilization systems. These methods offer "terminal sterilization" referring to the instruments being packaged and therefore, remaining sterile until opened at the surgical site.

Ethylene Oxide (EtO)

Location: Central Sterile Department (CS)
Players: 3M™ Company & STERIS Corporation

EtO gas is a very efficacious sterilizing agent; it literally penetrates the materials. However, the gas is a known carcinogen and mutagen. Cycle times of 16 to 30 hours are required including aeration times, in order to liberate the gas from the devices. It is also a known pollutant, requiring systems to prevent operator exposure to the gas as well as systems to treat the gas prior to its release into the atmosphere. Indeed, environmental regulations are moving the market toward total elimination of this gas in healthcare settings.

Hydrogen Peroxide (H_2O_2)

Location: Central Sterile Department (CS) / Operating Room (OR)
Players: Johnson & Johnson (J&J) & STERIS Corporation

H_2O_2 sterilization systems are also used as a low temperature sterilization method. These systems are much faster but have significant loading restrictions and sterilization efficacy limitations. This drives up the cost of the sterilization process and requires that the facilities maintain some use of EtO, as well as other complementary methods in order to meet their daily sterilization needs.

Liquid Chemicals

Location: Operating Room (OR) & Gastroenterology Department (GI)
Player: STERIS Corporation

Another method playing an important role in a sub-segment of low temperature sterilization is Liquid Chemical Sterilization. This type of procedure is located directly in the OR as a just-in-time method to complement the CS Department's sterile production. The GI department is also a heavy user of Liquid Chemical Sterilization. Liquid systems are not terminal and require rinsing with extensively treated water that cannot be assured to be sterile. As such, instruments cannot be assured to be sterile when used on a patient.

COMPANY BACKGROUND

TSO_3 was founded in June 1998 in Québec City. The Company's activities encompass research, development, commercialization and licensing of a sterilization process and accessories for heat-sensitive medical devices.

TSO_3 developed a unique sterilization process based on ozone as the sterilizing agent. The first generation STERIZONE® Sterilizer – the 125L – uses only ozone and offers major savings over competing low-temperature sterilization methods, greater safety for both users and patients and is considered a "green" technology. However, it offers limited compatibility and a somewhat longer cycle.

This first generation sterilizer (125L) received regulatory clearances from both Health Canada and the United States Food and Drug Administration. More recently, additional clearances were obtained to expand the STERIZONE® Sterilization System's field of application to a wider range of complex surgical instruments, attesting to the high sterilization efficacy of the TSO_3 STERIZONE® sterilization platform.

A RENEWED COMPANY

2008: A new start

In 2008, TSO_3 welcomed new management team members with extensive experience in the sterilization industry. The team pursued the development of a new generation sterilizer that would benefit from the already proven superior sterile efficacy of the STERIZONE® technology, while offering increased compatibility and speed, matching the market's expectations for high throughput.

The new generation STERIZONE® Sterilizer (125L**+**) developed in 2009 uses a conditioning stage of hydrogen peroxide before the injection of ozone. This significantly increases speed, as well as compatibility with a wide range of instruments - including some of the most complex and delicate instruments used in minimally invasive surgeries (MIS).

The new STERIZONE® 125L**+** Sterilizer offers efficacious and high-throughput, low-temperature sterilization for the high turnover volume requirements of the hospital's CS Department and enables the replacement of a combination of competitive sterilization methods.

The STERIZONE® 125L**+** Sterilizer is under a global license agreement for worldwide commercialization to healthcare settings by 3M™ Infection Prevention Division under the brand **3M™ Optreoz™ 125-Z***.*

2010 ANNUAL REVIEW

Internal growth in processes

After signing a global distribution agreement with 3M™ late in December 2009, for the distribution of its new generation sterilizer (3M™ Optreoz™ 125-Z), in 2010, TSO_3 experienced the global nature of its channel partner.

2010 was a year of tremendous internal activity, focused on the transfer of information, documentation development and exchange as well as training support. After supplying the design documentation to 3M™, later in the year TSO_3 initiated reliability testing procedures, assembly processes and work procedures, and the Verification and Validation process started for the critical components.

This work is continuing in order to meet quality requirements customary in the industry and ensure that units produced and shipped to customers perform consistently and to meet expectations.

Regulatory and commercial activities status

In 2010, backlog started to build for deliveries to Canadian customer locations in 2011.

While TSO_3 received regulatory clearances from both Health Canada and the European Regulatory Body early in the year, the Company did not make the anticipated progress with the US Regulatory Agency it had hoped for, impacting the global roll-out strategy of 3M™ and the ability to upgrade some of the 24 first-generation sterilizers (TSO_3 STERIZONE® 125L) sold to US customers.

Mid-year 2010, the US Regulatory Agency announced it was changing its processes and expectations for products seeking 510(k) clearance and TSO_3, like many others, was caught in the midst of these changes. Since then, the Company has had several productive discussions with the regulators towards a new filing and is confident in the quality of its documentation, as well as in its ability to re-file in a timely fashion.

STRATEGY: 2010 TO 2012

Building structure and skills

In its updated strategic plan presented mid-2010, TSO_3 addressed requirements for the Company's organizational structure over the next few years. TSO_3 set out timelines and approaches to create three fundamental business processes expected to contribute to the Company's ongoing success. These core business processes include the Innovation process, the Supply Chain process and the Customer Capture process.

In 2010, TSO_3 continued its reduction in sales and marketing resources as a result of the commercial agreement with 3M™ and pursued additional talent and skill sets within its R&D and Operations areas, notably welcoming in new senior leadership in both its engineering and supply chain departments.

Moving into 2011, TSO_3 is still pursuing the recruitment of a new CFO as well as other defined talents.

Expanding the portfolio of products

TSO_3 intends to focus on its core competency, which is rapid research and prototyping of sterilization systems for healthcare setting. The Company plans to expand its portfolio with significant revenue generating products.

TSO_3 technology, combining hydrogen peroxide and ozone, enables terminal sterilization and cost-effective throughput of medical devices that can be favourably applied to multiple segments of the low temperature sterilization market.

In 2010, TSO_3 began the market research that is now used to support the next development project: a unit designed for the specific needs of the OR Sub-Sterile Area. The Company's assessment supports its belief that this market is substantial in size and looking for the type of solution TSO_3 can provide with its enhanced sterilization platform.

MANAGEMENT DISCUSSION AND ANALYSIS

This Management Discussion and Analysis (“MD&A”) is intended to help the readers to assess, through the eyes of management, the financial position and the results of operations of TSO_3 Inc. (“TSO_3” or the “Company”), for the twelve-month period ending December 31, 2010. This information is dated March 15, 2011 and should be read in conjunction with the Annual Audited Financial Statements and the accompanying notes. Unless specified otherwise, the amounts are stated in Canadian dollars.

The financial information contained in this 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 MD&A have been reviewed by the Audit Committee of TSO_3 and approved by its Board of Directors.

This MD&A contains forward-looking information. Additional information about the forward-looking information as well as the associated risks and uncertainties can be found on pages 25 to 29 of the report.

FINANCIAL HIGHLIGHTS

Effectively managed financial resources

- **Additional funds secured**
  - In March 2010, TSO_3 completed a financing round of $16M.
  - TSO_3 received an additional $526,250 from 3M™ for milestone achievement (European commercial authorization for the new generation sterilizer).
  - The Company benefited from a Quebec Government R&D tax credit of $371,000.
- **Controlled Expenses**
  - 17% decrease in expenses: $9,176,415 in 2010 compared to $11,010,275 in 2009 amounting to a lower burn rate ($526,292 per month in 2010 compared to $575,861 per month in 2009).
- **Strengthened cash position**
  - Cash, cash equivalents and temporary investments were $19,120,007 as of December 31, 2010 compared to $10,671,845 as of December 31, 2009.

SUMMARY OF OPERATING RESULTS

Years ending December 31

	2010	2009
	$	$
Sales	**939,285**	1,324,540
Expenses		
Operating	**1,631,383**	2,350,190
Sales & Marketing	**989,256**	2,130,329
Research & Development	**3,299,446**	3,447,302
Administrative	**3,245,913**	3,058,220
Financial	**10,417**	24,234
	9,176,415	11,010,275
Operating Loss	**8,237,130**	9,685,735
Other income	**563,409**	468,103
Net Loss and Comprehensive Loss	**7,673,721**	9,217,632
Basic and Diluted Net Loss per Share	**0.14**	0.19
Weighted Average Number of Shares Outstanding	**56,281,313**	47,863,626

OPERATING RESULTS ANALYSIS

Sales

For the fiscal year ending December 31, 2010, sales amounted to $939,285 representing the sale of four STERIZONE® 125L+ Sterilizers, accessories and service contracts, compared to $1,324,540 in 2009 representing the sale of five first generation sterilizers (125L), accessories and service contracts, including a large installation contract.

Operating Expenses

For the fiscal year ending December 31, 2010, operating expenses amounted to $1,631,383 compared to $2,350,190 in 2009. Operating expenses are related to manufacturing and after-sales services departments. This decrease between the two periods is due to a write-down of $446,484 for finished goods and $135,225 for raw materials taken in 2009. The variance is also explained by an adjustment of the provision for service contract costs and a decrease in salaries related to customer service and after-sale service.

Sales and Marketing Expenses

For the fiscal year ending December 31, 2010, sales and marketing amounted to $989,256 compared to $2,130,329 in 2009. The variance between the two periods is due to a decrease in salaries, commissions and travelling expenses following a reduction in workforce as these expenses are now the responsibility of our channel partner.

Research and Development Expenses

For the fiscal year ending December 31, 2010, R&D expenses before tax credits amounted to $3,299,446 compared to $3,447,302 in 2009. The variance between the two periods is due to a decrease in material purchases and subcontracting fees. Conversely, regulatory and professional fees, as well as salaries resulting from the addition of employees in the R&D department, increased between the two periods to pursue the work on patents and the filings of the new generation product with agencies. Also, the amortization of the sterilizers used for testing and accounted for as property, plant and equipment increased by $95,180.

Administrative Expenses

For the fiscal year ending December 31, 2010, administrative expenses amounted to $3,245,913 compared to $3,058,220 in 2009. The variance between the two periods is due to a severance payment made, as well as an increase in recruiting fees.

Other Income

For the fiscal year ending December 31, 2010, other income amounted to $563,409 compared to $468,103 in 2009. The variance between the two periods is due to an increase of $201,504 in the amortization of the deferred revenues resulting from the 3M™ agreement. This is partially offset by a write-down of $110,148 taken at the end of 2010 for equipment and tools for production and R&D given the non-utilization of these assets.

Net Loss

For the fiscal year ending December 31, 2010, the Company recorded a net loss of $7,673,721, or $0.14 per share, compared to $9,217,632, or $0.19 per share in 2009.

FINANCIAL SITUATION ANALYSIS

As of December 31

	2010	2009
	$	$
Cash and cash equivalents	**9,107,143**	6,727,088
Temporary investments	**10,012,864**	3,944,757
Accounts receivable	**437,816**	1,333,178
Inventories	**1,460,304**	1,483,810
Property, plant and equipment	**1,120,616**	1,256,339
Intangible assets	**3,400,179**	3,549,189
Accounts payable and accrued liabilities	**1,201,044**	1,488,029
Deferred revenues (short and long term)	**2,263,042**	2,052,333
Share capital and contributed surplus	**98,205,738**	81,322,484
Shareholders' equity	**22,133,348**	14,865,527

Liquid Assets and Financial Situation

As of December 31, 2010, cash, cash equivalents and temporary investments amounted to $19,120,007 compared to an amount of $10,671,845 as of December 31, 2009. The variance is due to the issue of common shares during the first quarter of 2010 partially offset by the net loss for the fiscal year.

Accounts receivable

As of December 31, 2010, accounts receivable amounted to $437,816 compared to $1,333,178 as of December 31, 2009. The variance between the two periods is due to a decrease in tax credits receivable and a decrease in the amount receivable from 3M™ ($0 in 2010 compared to $525,500 in 2009) related to the agreement that was signed.

Inventories

As of December 31, 2010, inventories amounted to $1,460,304 compared to $1,483,810 as of December 31, 2009. The variance between the two periods is explained by a decrease of $95,076 in work in progress inventories slightly offset by an increase of $50,776 in raw materials.

Deferred Revenues

As of December 31, 2010, short and long-term deferred revenues amounted to $2,263,042 compared to $2,052,333 as of December 31, 2009. The variance between the two periods is due to an additional amount of $526,250 received in 2010 from 3M™ for a milestone achievement according to the agreement and accounted for as deferred revenues. Conversely $201,504 of these 3M™ related deferred revenues was amortized and recognized under “Other income” during 2010.

Statement of Cash Flows

	2010	2009
	$	$
Operating Activities	**(5,844,888)**	(6,192,366)
Investing Activities	**(6,563,320)**	3,732,197
Financing Activities	**14,788,263**	1,055

Operating Activities

For the fiscal year ending December 31, 2010, cash flows applied to operating activities amounted to $5,844,888 compared to $6,192,366 in 2009. The variance between the two periods is due to a lower net loss which was offset by a significant decrease in non-cash working capital items. This decrease is mostly related to the deferred revenues related to the 3M™ Agreement.

Investing Activities

For the fiscal year ending December 31, 2010, cash flows used for investing activities amounted to $6,563,320 compared to cash flows of $3,732,197 generated in 2009. The variance between the two periods is due to an increase in the acquisition of short-term investments. Conversely, the acquisitions of property, plant and equipment and intangible assets decreased by $247,357 between the two periods.

Financing Activities

For the fiscal year ending December 31, 2010, cash flows from financing activities amounted to $14,788,263 compared to $1,055 in 2009. The variance between the two periods is due to the closing, in March 2010, of a public offering of 10,000,000 common shares for cash proceeds of $16,000,000 ($14,678,538 net of expenses) and a larger volume of options exercised in 2010 for a cash consideration of $109,725.

SUMMARY OF QUARTERLY RESULTS

(Unaudited)

This table shows the quarterly evolution of sales, other income as well as net losses and net losses per share:

($000 except loss/share)	2010				2009			
	Q4	**Q3**	**Q2**	**Q1**	Q4	Q3	Q2	Q1
Sales	**178**	**123**	**494**	**144**	155	126	511	533
Other Income	**141**	**189**	**86**	**147**	219	71	54	124
Net Loss	**1,700**	**2,033**	**1,907**	**2,034**	2,680	2,288	2,263	1,987
Net Loss per share (basic and diluted)	**0.03**	**0.04**	**0.03**	**0.04**	0.05	0.05	0.05	0.04

FOURTH QUARTER ANALYSIS

(Unaudited)

Three-month period ending December 31, 2010, compared to the three-month period ending December 31, 2009.

	Fourth Quarter	
	2010	2009
	$	$
Sales	**177,945**	154,264
Expenses		
Operating	**449,760**	819,923
Sales & Marketing	**114,075**	349,960
Research & Development	**819,238**	1,057,029
Administrative	**632,762**	817,222
Financial	**2,704**	7,847
	2,018,539	3,051,981
Operating Loss	**1,840,594**	2,897,717
Other income	**140,710**	218,603
Net Loss and Comprehensive Loss	**1,699,884**	2,679,114
Basic and Diluted Net Loss per Share	**0.03**	0.05
Weighted Average Number of Shares Outstanding	**58,020,364**	47,864,298

Sales

For the three-month period ending December 31, 2010, sales amounted to $177,945 representing the sale of accessories and service contracts, compared to $154,264 representing the sale of fewer accessories and service contracts for the corresponding period in 2009. There were no sale of sterilizers during this quarter in 2010 and 2009.

Operating Expenses

For the three-month period ending December 31, 2010, operating expenses amounted to $449,760 compared to $819,923 for the same period in 2009. The variance between the two periods is due to a write-down of $446,484 for finished goods and $135,225 for raw materials taken in December 2009. The variance is also explained by an adjustment of the provision for service contracts.

Sales and Marketing Expenses

For the three-month period ending December 31, 2010, sales and marketing expenses amounted to $114,075 compared to $349,960 for the same period in 2009. The variance between the two periods is due to the decrease in salaries, commissions and travelling expenses following a reduction in workforce as these expenses are now the responsibility of our channel partner.

Research and Development Expenses

For the three-month period ending December 31, 2010, research and development expenses before tax credits amounted to $819,238 compared to $1,057,029 for the same period in 2009. The variance between the two periods is due to important material and subcontracting expenditures in 2009 (non-recurring in 2010) in order to accelerate ongoing work on device compatibility. Conversely, salaries slightly increased as well as regulatory fees and amortization of sterilizers used for testing and accounted for as fixed assets compared to the same period in 2009.

Administrative Expenses

For the three-month period ending December 31, 2010, administrative expenses amounted to $632,762 compared to $817,222 for the same period in 2009. The variance between the two periods is explained by a decrease of the bonus accrued and expensed.

Other Income

For the three-month period ending December 31, 2010, other income amounted to $140,710 compared to $218,603 for the same period in 2009. The variance between the two periods is explained by a decrease of $50,000 for government grants and a write-down of $110,148 taken at the end of 2010 for equipment and tools for production and R&D given the non-utilization of these assets. Conversely, the amortization of the deferred revenues and the investment revenues increased respectively by $52,569 and $51,695 between the two periods.

Net Loss

For the three-month period ending December 31, 2010, the Company recorded a net loss of $1,699,884, or $0.03 per share, compared to a net loss of $2,679,114 or $0.05 per share for the same period in 2009.

Statement of Cash Flow

	2010	2009
	$	$
Operating Activities	**(1,130,800)**	(811,386)
Investing Activities	**2,818,013**	465,555
Financing Activities	**4,880**	1,055

Operating Activities

For the three-month period ending December 31, 2010, cash flows used for operating activities amounted to $1,130,800 compared to $811,386 for the same period in 2009. The variance between the two periods is due to a lower net loss which was offset by a significant decrease in non-cash working capital items. This decrease is mostly related to the deferred revenues related to the 3M™ Agreement.

Investing Activities

For the three-month period ending December 31, 2010, cash flows generated from investing activities amounted to $2,818,013 compared to $465,555 for the same period in 2009. The variance between the two periods is due to the disposal of temporary investments in the last quarter of 2010 in order to meet short-term liquidity requirements.

Financing Activities

For the three-month period ending December 31, 2010, cash flows generated from financing activities amounted to $4,880 compared to $1,055 for the same period in 2009. The variance between the two periods is due to larger volume of options exercised in 2010.

TRANSACTIONS WITH RELATED PARTIES

During 2010, the Company has made severance payments to some of its managers for a total of $334,954 ($0 in 2009).

The Company carried out the following transactions with a company controlled by certain shareholders of TSO_3:

	2010	2009
	$	$
Rent	**63,170**	62,793
Other Rent-related Expenses	**82,615**	80,175
	145,785	142,968

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 company. As was the case in 2009, no amount was included in accounts payable with respect to transactions with this related company as at December 31, 2010.

SEGMENTED INFORMATION

The Company is structured as a single operating segment.

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

	Fourth Quarter				**Twelve Months**			
	2010		2009		**2010**		2009	
	$	**%**	$	%	**$**	**%**	$	%
Canada	**68,237**	**38**	74,760	48	**237,554**	**25**	357,057	27
US & Others	**109,708**	**62**	79,504	52	**701,731**	**75**	967,483	73
	177,945	**100**	154,264	100	**939,285**	**100**	1,324,540	100

The Company earns an important part of its revenues from a customer with which a commercial agreement was signed. For 2010, these revenues represented 43% of the Company's annual sales (0% in 2009), in addition to other income totalling $201,504 ($0 in 2009) as disclosed in note 21 of the financial statements.

CONTRACTUAL COMMITMENTS

As of December 31, 2010, the contractual commitments in the fiscal years to come are as follows:

	2011	2012	2013	2014	2015
	$	$	$	$	$
Operating leases and service contracts	89,331	16,380	2,063	843	843

OFF-BALANCE SHEET TRANSACTION

The Company made no off-balance sheet transaction during the fiscal year 2010.

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. 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.

For the twelve-month period ending December 31, 2010, the monthly burn rate was $526,292. For 2009 the burning rate was $575,861 which included an amount of $1,576,500 received from 3M™. At the actual pace, the Company believes that its current liquid assets will be sufficient to finance its activities into 2013.

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

The Company invests its liquidities in highly-liquid, short and medium term investments as defined in its Investment Policy (see section on Risk Factors). These securities are chosen according to the schedule of foreseen expenses and according to interest rates.

As of December 31, 2010, the number of outstanding shares was 58,022,451.

ACCOUNTING POLICIES

The financial statements have been prepared in accordance with Canadian generally accepted accounting principles (GAAP) and reflect the following 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

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 presented under "Other Income" 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 presented under "Other Income" in the statement of earnings.

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.

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.

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 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 tools for production 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 Income."

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.

Share issue expenses

Expenses related to share issue are recognized in deficit during the year they are incurred.

Revenue recognition

The Company generates revenue from the sale of sterilization units, parts, supplies and accessories related to these units. For such sales, 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.

The Company also generates license revenue from a commercial agreement with 3M™ (see note 12).

In addition, the Company earns revenue from service contracts that is recognized using the straight-line method over the term of each contract.

During 2009, the Company was committed under revenue arrangements with multiple deliverables that included the sale and delivery of units and their related warranties. These revenues were proportionally divided based on the fair market value of each component. The revenue from the sale of units, parts, supplies and accessories was recognized when the units were delivered, whereas revenue from warranties was recognized using the straight-line method over the term of the warranty.

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 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

The Company will be required to use International Financial Reporting Standards (IFRS) for its interim and annual financial statements beginning on January 1, 2011 and to provide a restated comparative statement in accordance with IFRS.

To prepare for the adoption of IFRS, the Company has developed an IFRS conversion plan. The Company completed the diagnostic phase in 2009, 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 was completed by the end of 2010, allowed the Company to evaluate the detailed consequences of the transition and helped the Company to implement the required changes to its information systems and internal control mechanisms. In fact, no major changes were required to the Company's information systems and internal control mechanisms.

The last phase, which consists of preparing the opening balance sheet, the financial results (current and comparative), reconciliation notes as well as additional notes under IFRS, started at the end of 2010 and will be completed during the first quarter of 2011.

The following are some of our key changes in accounting policies and their impacts with respect to the recognition and measurement of certain balance sheet and income statement items. Unless otherwise indicated, all changes in accounting policy will be applied retrospectively and the cumulative significant impact will affect opening balance of deficit as of January 1, 2010.

Standard	*International standards*	*Management's comments*
IFRS 2 *Share-based Payment*	*Entities must estimate at the end of each period the number of equity instruments expected to vest and revise that estimate, if necessary.*	*Historical information by employee class was collected to support estimates of future vesting and integrated in our calculations.* *At the date of transition, TSO_3 determined that there was no significant financial impact.*
IAS 16 *Property, Plant and Equipment*	*Parts of an item must be depreciated separately, each over the length of its useful life.*	*Management performed an analysis of the company's property, plant and equipment and none of the assets is considered to have significant parts with a specific useful life. Also, the Company is presently reviewing its depreciation methods for its assets and their estimated useful lives. Determination of the financial impact of these changes is in progress.*

The following table present certain choices made by management pertaining to the Standard IFRS 1 (First-time adoption of IFRS).

Standard	*Topic*	*International standards*	*Management's comments*
IFRS 1 *First-time Adoption of International Financial Reporting Standards*	*Deemed cost of property, plant and equipment*	*An entity may elect to measure an item of property, plant and equipment at the date of transition to IFRS at its fair value and use that fair value as its deemed cost at that date.*	*Given the type of capital assets held, management plans to account for them as at the transition date at their depreciated cost in accordance with IFRS rather than at their fair value on this date.*
	Stock option costs	*A first-time adopter is encouraged, but not required, to apply IFRS 2 to equity instruments that were granted after November 7, 2002 and that vested before the date of transition to IFRS.*	*Management intends to make this choice in order to avoid revising calculations of equity instruments on which the rights were vested before January 1, 2010.*
	Designation of financial instruments	*Possibility of re-designating financial instruments on the transition date*	*Management reviewed the classification of its temporary investments and decided to maintain its prior designation after the transition.*
IAS 16 *Property, Plant and Equipment*	*Revaluation model*	*Following initial recognition, property, plant and equipment may be carried at their depreciated cost or their fair value in accordance with the accounting policy adopted by management.*	*Given the nature of the capital assets, management plans to use the depreciated cost model. Management does not believe that presentation at fair value has significant benefits, given the difficulties associated with determining fair value and managing fair value in accounting systems*

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.

Risk associated with Commercial Operations

TSO_3 has a commercial agreement with 3M™ Infection Prevention Division for the marketing, sales and service of its new generation sterilizer. While the agreement outlines roles, responsibilities and expectations of both TSO_3 and 3M™, 3M™ retains all responsibility concerning customers. The schedules, difficulties to meet the requirements of regulatory authorities, changes in foreign trade policies, fluctuations of foreign exchanges rates, political instability could, amongst others, negatively affect the commercial activities and the agreement between TSO_3 and 3M™.

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 STERIZONE® 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 cannot guarantee the success of its 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 has reviewed its 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, and potentially our channel partner. 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 license, 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.

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 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 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.

Interest rate risk

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

On December 31, 2010, if the base rate on that date had been 0.5% lower, and all other variables held constant, the net loss and comprehensive loss would have been $29,662 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 on that date had been 0.5% higher, all other variables held constant, the net loss and comprehensive loss would have been $29,438 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 and comprehensive loss therefore have 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 and a second credit rating agency. 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 of December 31, 2010, 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. As of December 31, 2010, 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 cannot 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.

On December 31, 2010, if the Canadian dollar had weakened 10 percent against the US dollar with all other variables held constant, the net loss and comprehensive loss would have been $25,007 lower. Conversely, if the Canadian dollar had strengthened 10 percent against the US dollar with all other variables held constant, the net loss and comprehensive loss would have been $25,007 higher.

Fair value

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

Under fair value hierarchy of 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.

DISCLOSURE CONTROLS AND PROCEDURES

The Chief Executive Officer and the Acting 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 Acting Chief Financial Officer have evaluated, or caused to be evaluated under their supervision, the Company’s Disclosure Controls and Procedures as of December 31, 2010 and have concluded that these controls and procedures are effective.

INTERNAL CONTROL OVER FINANCIAL REPORTING

The Chief Executive Officer and the Acting 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 Acting 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, 2010 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 year ending December 31, 2010 that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting.

FORWARD LOOKING STATEMENTS

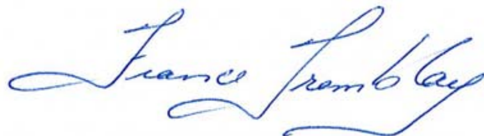
This annual report and the MD&A contained herein, include certain statements that are considered "forward-looking information" within the meaning of applicable securities legislation. Furthermore, the words "will", "may", "could", "should", "outlook", "believe", "plan", "envisage", "anticipate", "expect" 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 this information 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 "Risk factors" 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 Discussion and Analysis has been prepared as of March 15, 2011. 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.



France Tremblay
Acting Chief Financial Officer

March 15, 2011

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. It contains 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

France Tremblay
Acting Chief Financial Officer

March 15, 2011

FINANCIAL STATEMENTS OF TSO_3 INC.

DECEMBER 31, 2010 AND 2009

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Independent auditor's report

To the shareholders of
TSO_3 inc.

We have audited the accompanying financial statements of TSO_3 inc., which comprise the balance sheets as of December 31, 2010 and December 31, 2009, and the statements of earnings and comprehensive loss, contributed surplus, deficit and cash flows for the years then ended, and a summary of significant accounting policies and other explanatory information.

Management's responsibility for the financial statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

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 standards. Those standards require that we comply with ethical requirements and plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of TSO_3 inc. as of December 31, 2010 and December 31, 2009 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Deloitte & Touche s.e.n.c.r.l.[1]

March 15, 2011
Québec, Canada

[1] Chartered accountant auditor permit no. 16162

Statements of earnings and comprehensive loss

Years ended December 31

	2010	2009
	$	$
SALES	**939,285**	1,324,540
EXPENSES		
Operating	**1,631,383**	2,350,190
Sales and marketing	**989,256**	2,130,329
Research and development	**3,299,446**	3,447,302
Administrative	**3,245,913**	3,058,220
Financial	**10,417**	24,234
	9,176,415	11,010,275
OPERATING LOSS	**8,237,130**	9,685,735
OTHER INCOME (Note 21)	**563,409**	468,103
NET LOSS AND COMPREHENSIVE LOSS	**7,673,721**	9,217,632
Basic and diluted net loss per share (Note 20)	**0.14**	0.19

References:

Amortization of property, plant and equipment (Note 9)
Amortization of intangible assets (Note 10)
Interest (Note 15)
Research and development tax credits (Note 18)
Foreign exchange loss (Note 21)

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

Statements of contributed surplus

Years ended December 31

	2010	2009
	$	$
Balance at beginning	**8,110,388**	7,900,943
Compensation warrants to underwriters (Note 13)	**620,250**	-
Options exercised (Note 13)	**(67,158)**	(750)
Stock-based compensation (Note 13)	**153,279**	210,195
Balance at end	**8,816,759**	8,110,388

Statements of deficit

Years ended December 31

	2010	2009
	$	$
Balance at beginning	**66,456,957**	57,239,325
Share issue expenses	**1,321,462**	-
Compensation warrants to underwriters (Note 13)	**620,250**	-
Net loss	**7,673,721**	9,217,632
Balance at end	**76,072,390**	66,456,957

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

Balance sheets
As of December 31

	2010	2009
	$	$
CURRENT ASSETS		
Cash and cash equivalents (Note 5)	**9,107,143**	6,727,088
Temporary investments (Note 6)	**10,012,864**	3,944,757
Accounts receivable (Note 7)	**437,816**	1,333,178
Inventories (Note 8)	**1,460,304**	1,483,810
Prepaid expenses	**58,512**	111,528
	21,076,639	13,600,361
PROPERTY, PLANT AND EQUIPMENT (Note 9)	**1,120,616**	1,256,339
INTANGIBLE ASSETS (Note 10)	**3,400,179**	3,549,189
	25,597,434	18,405,889
CURRENT LIABILITIES		
Accounts payable and accrued liabilities	**1,201,044**	1,488,029
Deferred revenues	**572,071**	633,483
	1,773,115	2,121,512
LONG-TERM DEFERRED REVENUES (Note 12)	**1,690,971**	1,418,850
	3,464,086	3,540,362
SHAREHOLDERS' EQUITY		
Share capital (Note 13)	**89,388,979**	73,212,096
Contributed surplus	**8,816,759**	8,110,388
Deficit	**(76,072,390)**	(66,456,957)
	22,133,348	14,865,527
	25,597,434	18,405,889

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

Approved by the Board

Director Director

Statements of cash flows
Years ended December 31

	2010	2009
	$	$
OPERATING ACTIVITIES		
Net loss	**(7,673,721)**	(9,217,632)
Adjustments for:		
Amortization of property, plant and equipment (Note 9)	**315,642**	245,618
Amortization of intangible assets (Note 10)	**328,294**	318,753
Change in the value of temporary investments (Note 21)	**24,627**	138,343
Stock-based compensation (Note 13)	**153,279**	210,195
Loss on disposal of property, plant and equipment (Note 21)	**1,235**	3,374
Write-down of property, plant and equipment (Notes 9 and 21)	**110,148**	-
	(6,740,496)	(8,301,349)
Change in non-cash operating working capital items (Note 15)	**895,608**	2,108,983
Cash flows applied to operating activities	**(5,844,888)**	(6,192,366)
INVESTING ACTIVITIES		
Acquisition of temporary investments	**(28,021,611)**	(14,891,836)
Disposal of temporary investments	**21,928,877**	19,341,004
Acquisition of property, plant and equipment	**(291,330)**	(492,155)
Acquisition of intangible assets	**(179,284)**	(225,816)
Disposal of property, plant and equipment	**28**	1,000
Cash flows from (applied to) investing activities	**(6,563,320)**	3,732,197
FINANCING ACTIVITIES		
Options exercised (Note 13)	**109,725**	1,055
Share issue expenses	**(1,321,462)**	-
Share issue	**16,000,000**	-
Cash flows from financing activities	**14,788,263**	1,055
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	**2,380,055**	(2,459,114)
CASH AND CASH EQUIVALENTS AT BEGINNING	**6,727,088**	9,186,202
CASH AND CASH EQUIVALENTS AT END	**9,107,143**	6,727,088

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

Notes to the financial statements

Years ended December 31, 2010 and 2009

1. Description of business

The Company was incorporated on June 10, 1998 under Part 1A of the Companies Act (Quebec). Its activities encompass research, development and commercialization and licensing of a sterilization process for heat-sensitive medical instruments.

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 on 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 presented under “Other income” in the statement of earnings.

Notes to the financial statements
Years ended December 31, 2010 and 2009

2. Accounting policies (cont'd)

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 presented under "Other income" in the statement of earnings.

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.

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.

Notes to the financial statements
Years ended December 31, 2010 and 2009

2. Accounting policies (cont'd)

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 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 tools for production 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

Notes to the financial statements

Years ended December 31, 2010 and 2009

2. Accounting policies (cont'd)

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 income."

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.

Share issue expenses

Expenses related to share issue are recognized in deficit during the year they are incurred.

Notes to the financial statements

Years ended December 31, 2010 and 2009

2. Accounting policies (cont'd)

Revenue recognition

The Company generates revenue from the sale of sterilization units, parts, supplies and accessories related to these units. For such sales, 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.

The Company also generates license revenue resulting from a commercial agreement with 3M™ (see note 12).

In addition, the Company earns revenue from service contracts that is recognized using the straight-line method over the term of each contract.

During 2009, the Company was committed under revenue arrangements with multiple deliverables that included the sale and delivery of units and their related warranty. These revenues were proportionally divided based on the fair market value of each component. The revenue from the sale of units, parts, supplies and accessories was recognized when the units were delivered, whereas revenue from warranties was recognized using the straight-line method over the term of the warranty.

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 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.

Notes to the financial statements

Years ended December 31, 2010 and 2009

3. Changes in accounting policies

Future accounting changes

The Company will be required to use International Financial Reporting Standards (IFRS) for its interim and annual financial statements beginning on January 1, 2011 and to 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 January 1, 2011 will not be presented as future accounting changes, as these will never be applied by the Company.

4. 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 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.

Interest rate risk

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

On December 31, 2010, if the base rate on that date had been 0.5% lower, and all other variables held constant, the net loss and comprehensive loss would have been $29,662 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 on that date had been 0.5% higher, all other variables held constant, the net loss and comprehensive loss would have been $29,438 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 and comprehensive loss therefore have a similar sensitivity to interest rate increases and interest rate decreases because of investments with capped interest rates.

Notes to the financial statements

Years ended December 31, 2010 and 2009

4. Financial instruments (cont'd)

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 and a second credit rating agency. 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 of December 31, 2010, 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. As of December 31, 2010, 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 cannot 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.

On December 31, 2010, if the Canadian dollar had weakened 10 percent against the US dollar with all other variables held constant, the net loss would have been $25,007 lower. Conversely, if the Canadian dollar had strengthened 10 percent against the US dollar with all other variables held constant, the net loss would have been $25,007 higher.

Notes to the financial statements

Years ended December 31, 2010 and 2009

4. Financial instruments

Fair value

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

Under fair value hierarchy of 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.

5. Cash and cash equivalents

	2010	2009
	$	$
Cash	**1,470,708**	1,528,375
Short-term investments less than three months		
Bond maturing in March 2011 and having a yield of 0.90%	**2,991,846**	2,997,931
Money market funds	**4,644,589**	2,200,782
	9,107,143	6,727,088

As of December 31, 2010, the bond held was rated A+ (AA- as at December 31, 2009) and money market funds held were rated AA- (A+ as at December 31, 2009).

6. Temporary investments

	2010	2009
	$	$
Bonds,		
Maturing at various dates through December 2011 and having an average yield of 1.21%.	**10,012,864**	3,944,757

As of December 31, 2010, bonds held were rated AAA and A+ (A+ as at December 31, 2009).

Notes to the financial statements

Years ended December 31, 2010 and 2009

7. Accounts receivable

	2010	2009
	$	$
Accounts receivable	**62,106**	591,284
Tax credits receivable	**305,000**	607,234
Other	**70,710**	134,660
	437,816	1,333,178

As of December 31, 2010 and 2009, the Company estimated there was no need to record an allowance for doubtful accounts.

8. Inventories

	2010	2009
	$	$
Raw materials	**978,963**	928,187
Work in progress	**373,528**	468,604
Finished goods	**107,813**	87,019
	1,460,304	1,483,810

Operating expenses include a cost of goods sold charge of $594,421 ($1,232,969 in 2009), including a write-down of raw materials of $84,523 ($446,484 for finished goods and $135,225 for raw materials in 2009).

During 2010, the Company reviewed its estimate for the provision for obsolescence and an additional provision of $63,371 (reversal of $135,485 in 2009) was recorded and is included in the cost of goods sold.

Notes to the financial statements

Years ended December 31, 2010 and 2009

9. Property, plant and equipment

	Cost	Accumulated Amortization	Net book value 2010	2009
	$	$	$	$
Equipment and tools for production and R&D	**1,640,860**	**733,332**	**907,528**	986,835
Hospital equipment	**24,694**	**12,347**	**12,347**	20,578
Computer equipment	**491,176**	**392,951**	**98,225**	126,544
Office furniture	**185,970**	**121,341**	**64,629**	80,787
Lift truck	**14,115**	**13,423**	**692**	988
Stand	**22,734**	**14,806**	**7,928**	9,910
Leasehold improvements	**195,598**	**166,331**	**29,267**	30,697
	2,575,147	**1,454,531**	**1,120,616**	1,256,339

Amortization of property, plant and equipment for the year 2010 totalled $315,642 ($245,618 in 2009).

At the end of 2010, the Company took a write-down for an amount of $110,148 ($0 in 2009) for its equipment and tools for production and R&D given the non-utilization of these assets.

10. Intangible assets

	Cost	Accumulated Amortization	Net book value 2010	2009
	$	$	$	$
Technology	**2,978,874**	**893,662**	**2,085,212**	2,234,155
License	**991,063**	**433,590**	**557,473**	619,414
Patents	**743,871**	**113,858**	**630,013**	539,244
Trademarks	**76,641**	**13,290**	**63,351**	32,607
Software	**520,375**	**461,552**	**58,823**	114,923
Website	**54,691**	**49,384**	**5,307**	8,846
	5,365,515	**1,965,336**	**3,400,179**	3,549,189

Amortization of intangible assets for the year 2010 totalled $328,294 ($318,753 in 2009).

Notes to the financial statements
Years ended December 31, 2010 and 2009

11. 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 of December 31, 2010.

12. Long-term deferred revenues

The long-term deferred revenues result from a commercial agreement with 3M™ to distribute the STERIZONE® 125L+ worldwide. This agreement includes license revenue that was paid upon signing, and additional payments based on achieving certain objectives. These deferred revenues are recognized on a straight-line basis over the term of the agreement.

During 2010, the Company recognized $201,504 ($0 in 2009) under "Other income" (Amortization of long-term deferred revenues). As of December 31, 2010, an amount of $1,690,971 ($1,418,850 in 2009) is presented in the long-term deferred revenues and an amount of $210,275 ($157,650 in 2009) is included in short-term deferred revenues.

13. 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

Issued and paid –		**2010**		2009
Common	**Number**	**$**	Number	$
Balance at beginning	**47,867,568**	**73,212,096**	47,863,402	73,210,291
New issue	**10,000,000**	**16,000,000**	-	-
Options exercised	**154,883**	**176,883**	4,166	1,805
Balance at end	**58,022,451**	**89,388,979**	47,867,568	73,212,096

Notes to the financial statements

Years ended December 31, 2010 and 2009

13. Share capital (cont'd)

On March 2, 2010, the Company closed a financing of $16,000,000 from the sale of 10,000,000 shares.

In 2010, holders exercised certain options; they subscribed for 154,883 shares for a cash consideration of $109,725. During 2009, they subscribed for 4,166 shares for a cash consideration of $1,055.

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.

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 as at December 31, 2010 is 4,394,524. 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 2010, the Company awarded 78,000 stock options to its employees and directors at a weighted average exercise price of $1.47. The weighted average fair value of these stock options was $1.17 per option.

The stock-based compensation expense pertaining to the options granted has been amortized using the graded vesting method, giving rise to a total stock-based compensation expense of $153,279 in 2010 ($210,195 in 2009) presented in "Administrative expenses." Stock options granted from 2007 to 2010 will also involve additional compensation expenses of $102,716 in 2011, $40,375 in 2012, and $6,274 in 2013.

Notes to the financial statements

Years ended December 31, 2010 and 2009

13. Share capital (cont'd)

The fair value of the stock options granted in 2010 was estimated using the Black-Scholes option pricing model under the following weighted average assumptions:

Risk free interest rate	*3.12%*
Expected volatility	*72%*
Life	*10 years*
Expected dividend yield	*0%*

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.

Stock options varied as follows:

	2010 Number	**2010 Weighted average exercise price $**	2009 Number	2009 Weighted average exercise price $
Outstanding at beginning	**4,179,544**	**1.20**	4,225,786	1.33
Granted	**78,000**	**1.47**	258,000	0.55
Exercised	**(154,883)**	**0.71**	(4,166)	0.24
Expired	**(584,491)**	**1.85**	-	-
Forfeited	**(179,755)**	**2.09**	(300,076)	2.30
Outstanding at end	**3,338,415**	**1.05**	4,179,544	1.20
Exercisable at end	**2,548,815**	**1.20**	2,629,889	1.58

Notes to the financial statements
Years ended December 31, 2010 and 2009

13. Share capital (cont'd)

The following table summarizes certain information regarding the stock options of the Company as of December 31, 2010:

	Outstanding options		Exercisable options	
Exercise price	**Number**	**Average remaining contractual life (years)**	**Number**	**Average remaining contractual life (years)**
$0.24 to $1.94	2,937,156	6.02	2,162,974	5.37
$2.20 to $2.90	271,485	5.97	256,067	5.90
$3.10 to $3.45	129,774	4.05	129,774	4.05
	3,338,415	5.96	2,548,815	5.38

c) Warrants and compensation warrants

Warrants and compensation warrants varied as follows:

	2010		2009	
	Number	**Exercise price $**	Number	Exercise price $
Outstanding at beginning	**-**	**-**	4,600,000	3.00
Granted	**750,000**	**1.60**	-	-
Expired	**-**	**-**	(4,600,000)	3.00
Outstanding at end	**750,000**	**1.60**	-	-
Exercisable at end	**750,000**	**1.60**	-	-

Following the round of financing of March 2, 2010, as additional consideration for services rendered, the underwriters have been granted 750,000 warrants by the Company. Each warrant can be used to purchase 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 fair value of these stock warrants was $0.83 per warrant. The fair value of the warrants at the grant date was estimated using the Black-Scholes option pricing model under the following assumptions:

Notes to the financial statements
Years ended December 31, 2010 and 2009

13. Share capital (cont'd)

Risk free interest rate	*1.34%*
Expected volatility	*110%*
Life	*1.5 year*
Expected dividend yield	*0%*

14. 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.

For the twelve-month period ending December 31, 2010, the monthly burn rate was $526,292 ($575,861 in 2009).

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 of December 31, 2010, the Company was in compliance with these ratios.

Notes to the financial statements
Years ended December 31, 2010 and 2009

15. Additional information relating to cash flows

	2010	2009
	$	$
Change in non-cash operating working capital items		
Decrease (increase) in current assets		
Accounts receivable	**895,362**	(512,860)
Inventories	**23,506**	1,064,265
Prepaid expenses	**53,016**	3,320
Increase (decrease) in liabilities		
Accounts payable and accrued liabilities	**(286,985)**	229,249
Deferred revenues	**210,709**	1,663,375
	895,608	2,447,349
Non-cash item transferred to R&D	**-**	(338,366)
	895,608	2,108,983
Interest		
Received	**101,985**	375,046
Research and development tax credits		
Received	**371,096**	-

16. Related party transactions

During 2010, the Company has made severance payments to some of its managers for a total of $334,954 ($0 in 2009).

The Company carried out the following transactions with a company controlled by certain shareholders of TSO_3:

	2010	2009
	$	$
Rent	**63,170**	62,793
Other rent-related expenses	**82,615**	80,175
	145,785	142,968

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 company. As was the case in 2009, no amount was included in accounts payable with respect to transactions with this related company as of December 31, 2010.

Notes to the financial statements

Years ended December 31, 2010 and 2009

17. Income taxes

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

As of December 31, 2010, the accumulated tax losses that can be carried forward are as follows:

Expiry date	Loss carry-forwards	
	Federal	Provincial
	$	$
2030	6,487,000	6,486,000
2029	7,418,000	7,399,000
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
	43,273,000	44,119,000

As of December 31, 2010, in addition to these tax losses carried forward, the Company has unclaimed research and development expenses ($10,940,000 at the federal level and $14,765,000 at the provincial level) and $1,579,000 in financing costs that can be carried forward to reduce future taxable income. The unrealized tax benefit, estimated at $15,564,000 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 $627,000, which has not been recorded.

In addition, as of December 31, 2010, the Company has $2,765,000 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 $17,000.

Furthermore, the cost of intangible assets for tax purposes was $564,000 (net book value of $3,400,179) 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 $526,000 and resulting from the difference between the carrying value and the tax value of intangible assets have not been recorded.

Notes to the financial statements

Years ended December 31, 2010 and 2009

17. Income taxes (cont'd)

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.

18. Research and development tax credits

For tax credit purposes, research and development expenditures incurred during the year 2010 totalled $2,196,825 ($2,261,001 in 2009); of these research and development expenditures, an amount of $255,050 as of December 31, 2010 ($716,940 in 2009) is related to property, plant and equipment.

Some of these expenses qualify for refundable scientific research tax credits amounting to $305,000 as of December 31, 2010 ($300,000 in 2009).

The tax credits claimed for the year ending on December 31, 2009 have not been reviewed by the tax authorities. Consequently, the amount of tax credits that will be awarded could differ from the ones already recorded.

19. Segmented information

The Company is structured as a single operating segment.

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

	2010		2009	
	$	**%**	$	%
Canada	**237,554**	**25**	357,057	27
United States and others	**701,731**	**75**	967,483	73
	939,285	**100**	1,324,540	100

The Company earns an important part of its revenues from a customer with which a commercial agreement was signed. During 2010, these revenues represented 43% of the Company's annual sales (0% in 2009), in addition to other income totalling $201,504 ($0 in 2009) as disclosed in Note 21.

Notes to the financial statements
Years ended December 31, 2010 and 2009

20. Loss per share

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

	2010	2009
	$	$
Net loss		
Basic and diluted	**7,673,721**	9,217,632
Number of shares		
Weighted average number of outstanding shares[1]	**56,281,313**	47,863,626
Loss per share		
Basic	**0.14**	0.19
Diluted[2]	**0.14**	0.19

[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 loss per share still had an anti-dilutive effect.

21. Other income

	2010	2009
	$	$
Investment income	**101,985**	233,125
Change in the value of investments held as cash and cash equivalents	**54,612**	30,111
Change in the value of temporary investments	**(24,627)**	(138,343)
Research and development tax credits	**376,096**	335,788
Foreign exchange loss	**(47,426)**	(59,857)
Amortization of long-term deferred revenues (Note 12)	**201,504**	-
Loss on disposal of property, plant and equipment	**(1,235)**	(3,374)
Write-down of property, plant and equipment (Note 9)	**(110,148)**	-
Grants	**5,860**	57,500
Other	**6,788**	13,153
	563,409	468,103

Notes to the financial statements
Years ended December 31, 2010 and 2009

22. Commitments

Under its operating leases and service contracts, the Company is committed to pay $89,331 in 2011, $16,380 in 2012, $2,063 in 2013, $843 in 2014 and $843 in 2015.

23. Comparative figures

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

DIRECTORS

Germain Carrière [1) 2) 3) 4)]
Chairman of the Board of Directors
Corporate Director

Jean-François Bureau [1) 2)]
Vice President and Chief Risk Officer
PSP Investments

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 [1) 3) 4)]
Consultant and Corporate Director

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

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

Dr James R. Husman
Chairman of the Scientific Advisory Board
Corporate Director

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

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

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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
Wednesday, May 11, 2010 at 3:00 pm
Musée McCord d'histoire canadienne
Théâtre Bombardier
690, rue Sherbrooke Ouest
Montréal (Québec) H3A 1E9

Communications and Investor Relations
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Licensed under U.S. Pat. No. 6,387,241 by Lynntech.
Other patents pending

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Ticker Symbol: **TOS (TSX)**