"Creating the Improved Standard in Healthcare Sterilization"

2010 Quarterly Report – Q2
April, May, June

INDEX

MESSAGE FROM THE CHIEF EXECUTIVE OFFICER

Dear Valued Shareholders,

A year ago, in second quarter of 2009, we stated our new direction. Our new plan included, as you know, the core objectives of significantly improving our technology to better meet customer needs, as well as moving from a limited internal sales force to that of a channel partner.

In second quarter of 2010, just a year later, we have shipped our enhanced products offering increased compatibility and speed - now branded 3M™ Optreoz™ 125-Z Sterilizers - to international 3M™ locations for their sales and service training. To date, the locations have been for both US and European requirements. Service training has taken place in Canada and multiple markets have had their first exposure to the new 3M™ Optreoz™ 125-Z Sterilizer in Europe.

Equally important is that we can now say customers are buying into the plan. We are pleased to announce that, over the recent months, Canadian customers have selected the new TSO_3 STERIZONE® sterilization technology for their hospital. We have now received purchase orders for our new unit, as well as purchase orders to upgrade to the new technology from existing customers. Product will ship later in the year per the customer's requests and only then will be recorded as revenue, but we are pleased to say that backlog is building.

We are also very pleased with the collaboration taking place with 3M™. Today, efforts are underway to meet the extensive requirements for additional important markets such as Asia Pacific and Latin America as a means of continuing our march towards globalizing the product. There remains a great deal to do, but the progress is visible and we feel we will be rewarded for our efforts with a strong global position.

Speed bumps

With increased regulatory vigilance in the area of healthcare sterile processing, in Q2 we announced that the US regulatory agency had given us instruction to resubmit for regulatory clearance of our new sterilizer. After review of the request and its rationale, we agreed to do so and announced to that effect. The reviewers have agreed to a timely face to face meeting and we will wait until after we have had the opportunity to meet with them, to file our new submission. Our approach is to assure that we address as many questions as is possible upfront, in the new submission.

Executing and updating the plan

What gets measured gets done. In March 2009, we presented a plan to the Board of Directors that included new cycles and a shift in our channel strategy. We continue to expend a great deal of energy on this strategy and associated tactics in support to the global rollout with 3M™ and obtaining regulatory clearance in the US and other markets. Given the progress made on the original plan, it was time to update said plan and set the next set of goals. To that end, we have just presented the Board with an extension to the plan and received approval to move forward.

In Q2, we began the market research that will be used to support our next development project. This new device will meet the needs of the OR customer while utilizing the recent enhancements in our technology. Our initial assessment supports our belief that this market is large and is looking for the type of solution we can provide.

The updated plan also addresses our organizational structure over the next few years and sets out timelines and approaches to create three fundamental business processes which we believe will contribute positively to our ongoing success. These core business processes include the innovative process, the supply chain process and the customer capture process. Given our recent accomplishments, it is clear that we need to create a structure that will be able to sustain and support our growth.

Along the lines of structural change we announced that Marc Boisjoli, our longstanding CFO and VP of finance, has decided to pursue opportunities outside the Company. Marc has been a valuable member of the management team these past nine years and has contributed significantly to the success of the Company. On behalf of everyone at TSO_3, I would like to thank Marc for his contribution to the Company and wish him all the best in his future endeavours.

Companies reinvent themselves, people and structure change but the vision remains the same... Ours is “To Create the Improved Standard in Healthcare Sterilization” and we remain dedicated in supporting better healthcare practices while growing our business.

As always, I would like to share my appreciation to our dedicated team at TSO_3, as well as to thank our Board Members and Shareholders for their continued support.

R.M. (Ric) Rumble
President and CEO

OUR INDUSTRY

The Need for Low Temperature Sterilization

Sterilization of medical devices is essential to assure 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.

Today's medical devices are expensive and delicate. While some 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 less invasive surgery in which increasingly complex instruments are used; instruments which in many cases do not tolerate the steam sterilization process.

Historically, and to a lesser extent today, low temperature gaseous systems have been used that, while being effective, are slow and possess unfavourable properties requiring special handling and treatment before the gas can be safely released into the atmosphere.

More recently, new sterilization systems have entered the market overcoming some of the historic challenges. However, they too bring with them new limitations. Specifically, these new technologies are expensive to operate, while restricting the types of devices that can be sterilized and the quantity of instruments that can be processed in any given load. The net result is increased cost per instrument sterilized.

The number of surgeries performed each year is growing. The aging population consumes more surgical suite time every year; a trend that is expected to continue for years. As recovery times are generally lower with the use of less invasive procedures, healthcare facilities increasingly rely on these new surgical techniques not only to offer better outcomes, but to optimize the rate of patient turnover in their facilities. More surgeries using increasingly complex medical instruments are driving up the already high demand for low temperature sterilization.

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).

TSO_3 believes that it has developed a solution to today's low temperature sterilization requirement. Our new STERIZONE® 125L+ Sterilizer offers efficacious, compatible, cost effective and high-throughput low-temperature sterilization utility for the high volume requirements of the CS Department. The Company believes that hospitals, historically forced to acquire multiple sterilization systems in order to mix and match

medical devices to compatible sterilization processes, will now have the ability to use a single low temperature system to meet the needs of their facility.

MD&A INTRODUCTORY COMMENTS

The following Management's Discussion and Analysis (MD&A) provides Management's point of view on the financial position and the results of operations of TSO_3 Inc. ("TSO_3" or the "Company"), for the three and six-month periods ending June 30, 2010 and June 30, 2009. This information is dated August 3, 2010, and should be read in conjunction with the quarterly financial statements, the annual audited financial statements and their accompanying notes. Unless specified otherwise, all amounts are stated in Canadian dollars.

The financial information contained in this MD&A and in the Company's quarterly financial statements has been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). The quarterly financial statements and the MD&A have been reviewed by the Audit Committee of TSO_3 and approved by its Board of Directors. The quarterly financial statements have not been subject to an external audit.

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.

EtO gas is a very efficacious sterilizing agent; it literally penetrates the materials. The gas is a known carcinogen and mutagen, and increased cycle times of up to 16 to 30 hours are required including aeration times, in order to liberate the gas from the devices, depending on the material being sterilized. 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.

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.

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 can not be assured to be sterile. As such, instruments cannot be assured to be sterile when used on a patient.

TSO_3 believes its technology, combining hydrogen peroxide and ozone, unable superior efficacy, material compatibility and cost effective throughput, allowing the Company to compete in all segments of the low temperature sterilization market.

Key Competitors:

1. 3M™

   3M™ is the leader in the installed base of 100% EtO sterilizers.

2. Advanced Sterilization Products (ASP) a division of Johnson & Johnson Company.

   ASP, with its STERRAD® product, was the first to offer hydrogen peroxide sterilization and continues to be a strong force with their line of H_2O_2 / Plasma systems.

3. STERIS®

   STERIS® offers the following products:

   - EtO Sterilizers
   - Amsco V-PRO™ a technology based on hydrogen peroxide
   - Liquid Chemical Sterilant: STERIS® System 1 (SS1), and STERIS® 1E (SS1E)

TSO_3's Positioning

TSO_3 strength resides in the proven, superior sterile efficacy and compatibility of its STERIZONE® Sterilization Technology, in its high loading capacity, as well as its safety and low environmental impact.

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

The plan described the following core objectives and included aggressive timelines:

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

2. Increase market opportunity via expansion outside North America (expand regulatory filings);

3. Develop relationships leading to a strategic channel partner.

Product Utility

Thereafter, the R&D team was given the mandate of modifying the existing sterilization platform in order to better adapt the technology to customers' needs. Using the STERIZONE® 125L Sterilizer and its demonstrated superior sterile efficacy as our platform, we created three new customer-driven cycles to address the widest possible range of medical devices. The new cycles continue to use ozone generated within the sterilizer as the sterilizing agent. In addition, a conditioning agent containing hydrogen peroxide (H_2O_2) has been added to prepare the load prior to the introduction of the ozone sterilizing agent. This significantly reduces cycle times (moving from a 4.5 hours cycle to 46, 56 and 100 minute cycles) and increases compatibility. While still being safe and eco-friendly, these new gentler and faster cycles allow the sterilization of some of the most challenging medical devices, including simple and complex rigid and flexible endoscopes.

The Company believes that its unique sterilizer is a true replacement to EtO sterilization, while also addressing the needs currently unmet by other low temperature sterilization methods. TSO_3's product features not only enable the replacement of multiple sterilization methods, but also better support healthcare practices; moving from Liquid Chemical Sterilization, to terminal sterilization. The TSO_3 sterilization platform also offers competitive operating costs, while providing the business with a recurring revenue stream from the use of dedicated consumables.

Regulatory Filings

The Company filed for regulatory clearances in the US, Canada and Europe in December 2009. On December 17, 2009, the Company received Health Canada's approval. Earlier this year, on March 4, 2010 the Company was notified that it had met all requirements of the European Medical Device Directive (MDD) and that the product could now bear the CE Mark; a requirement to place products in Europe, and a first for TSO_3, for its products to be sold outside North America. As for the US regulatory clearance, late second quarter 2010, the Company was given instructions to re-submit for 510(k) clearance and provide additional data to better establish the link between the sterilizer and a variety of accessory products used in the sterilizer, also subjected to 510(k) clearance and which have been previously submitted.

Channel Partner

Opportunities existed to establish channel partners as a means of accelerating the adoption of the technology's applications on a regional and global level. After having completed extensive due diligence covering TSO_3's technology, regulatory and operating systems, 3M™ Infection Prevention Division and TSO_3 signed a multi-year agreement on December 16, 2009, giving 3M™ the exclusive global license to supply and distribute the new generation STERIZONE® Sterilizer (125L+) under the 3M™ brand, to Central Sterile Departments in acute care facilities. The agreement includes marketing, sales and after-sales service on the product.

Our Strategy

The 3M™ global agreement, combined with recent improvements to the sterilizer's performance, represent a significant step in the Company's move to accelerate the technology's adoption in the global marketplace. The Company is also devoting resources in working closely with leading instrument manufacturers in order to grow its instrument manufacturer support base.

To further expand its business, TSO_3 is planning to add depth to its product portfolio by adapting its sterilization platform to address adjacent healthcare market segments with different sized units, such as the OR departments.

Additional Opportunity

In December 2009, the US Food and Drug Administration (FDA) issued a notice to healthcare facility administrators and infection control practitioners regarding STERIS' System 1 (SS1) processors. The notice stated that the FDA has not determined whether this product is safe/effective or whether the claims regarding its labelling, including claims that it sterilizes medical devices, are accurate, as the product has undergone major changes since its clearance several years ago. As such, the FDA has recommended that users transition to an acceptable alternative within 18 months. The TSO_3 first generation STERIZONE® Sterilization System (125L) is listed on the FDA's website as an alternative and TSO_3 is currently working to obtain the US regulatory body's clearance on its new generation Sterilization System (125L+). There are an estimated 23,000 SS1 units presently in operation in the United States alone, of which we estimate 50% are located in the OR and 50% in the GI. All units are affected by the FDA notice.

Capability to Deliver Results

TSO_3 currently has all the required resources to achieve its set goals. The Company has a strong commercial partner in 3M's™ Infection Prevention

Division; one able to introduce and commercialize its new generation sterilizer to Central Sterilization Departments globally. 3M™ leads the market in 100% Ethylene Oxide (EtO) sterilization systems and is the world leader in Sterility Assurance products commonly used by healthcare facilities to measure the effectiveness of the sterilization processes. 3M™ has operations in over 60 countries and maintains relationships with the same customer base targeted by our new sterilizer.

TSO_3 has the scientific and technical resources in place and a proven track record to manipulate its sterilization platform in order to develop new products, as well as to obtain the required certifications in the targeted markets.

The Company can rely on a strong cash position from an additional $16M bought-deal financing round completed in first quarter of 2010. This provides the Company with the required working capital to execute its business plan in supporting new generation sterilizer commercialization through 3M™, as well as in new product development.

Key Performance Drivers and Recent Activities

Key performance drivers are:

- Commercial success with new generation sterilizer through 3M™ channel

- Capability to answer increased demand in production

- Capability to obtain appropriate certifications in the targeted markets

- Development of new applications for adjacent markets.

Since the signing of the agreement with 3M™, TSO_3 has been dedicated in supporting 3M™ in the transition of the new STERIZONE® 125L+ product line to the 3M™ systems. This support enables 3M™ to initiate the international commercial launch of the newly branded 3M™ sterilizer: the 3M™ Optreoz™ 125-Z. The transition to 3M™ distribution covers documentation of all functional areas of the Company including regulatory, quality, production, marketing and field service.

TSO_3 has also been very active in developing plans to assemble devices at rates not previously experienced by the Company. Each function is being documented and components thoroughly tested for reliability.

In second quarter of 2010, TSO_3 initiated the shipment of units to worldwide 3M™ locations for training and service purposes. Both companies keep working closely towards increased commercial activities in the second half of 2010.

TSO_3 has met the milestones of securing a license from Health Canada on its sterilizer as well as meeting the requirements to label with the CE Mark for Europe. The Company continues to pursue US regulatory clearance. Presently the Company is preparing to re-submit its regulatory submission to the US Agency having received instructions form the Agency to re-submit with the new document addressing specific questions. The US regulators and TSO_3 have agreed to meet in person at the earliest possible occasion in an attempt to address any lingering questions or receive any additional guidance prior to re-submission. The Company remains confident in its ability to obtain US regulatory clearance for the new generation product.

As our current product offering addresses the needs of the Central Sterilization Department in healthcare facilities, the Company continues to document the potential use of its technology in alternate configurations while focusing on the needs of the OR. Initial market studies show that there is a significant market opportunity in the OR Sterile Reprocessing Area for a flexible endoscope sterilization solution that would offer both speed and terminal sterilization.

SUMMARY OF OPERATING RESULTS

Periods ending June 30 (Unaudited)

	SECOND QUARTER		SIX MONTH	
	2010	2009	**2010**	2009
SALES	**$494,353**	$510,626	**$638,581**	$1,044,114
EXPENSES				
Operating	**588,576**	576,719	**929,912**	1,170,992
Sales & Marketing	**298,466**	644,068	**611,824**	1,255,621
Research & Development	**865,306**	775,099	**1,623,650**	1,514,155
Administrative	**732,495**	826,848	**1,642,288**	1,522,676
Financial	**2,688**	5,591	**4,841**	9,899
	2,487,531	2,828,325	**4,812,515**	5,473,343
OPERATING LOSS	**1,993,178**	2,317,699	**4,173,934**	4,429,229
Other income	**86,413**	54,236	**233,237**	178,422
NET LOSS AND COMPREHENSIVE LOSS	**$1,906,765**	$2,263,463	**$3,940,697**	$4,250,807
BASIC AND DILUTED NET LOSS PER SHARE	**$0.03**	$0.05	**$0.07**	$0.09
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING	**57,919,254**	47,863,402	**54,647,266**	47,863,402

OPERATING RESULTS ANALYSIS

Three and six-month periods ending June 30, 2010, compared to the three and six-month periods ending June 30, 2009.

Sales

Sales for the three-month period ending June 30, 2010 amounted to $494,353 representing the sale of four STERIZONE® 125L+ Sterilizers, accessories and service contracts, compared to $510,626 representing the sale of two of its first generation ozone sterilizers, the STERIZONE® 125L Sterilizer, accessories and service contracts, including a large installation contract, for the same period in 2009. For the six-month period ending June 30, 2010, sales amounted to $638,581 representing the sale of four STERIZONE® 125L+ Sterilizers, accessories and service contracts, compared to $1,044,114 representing the sale of five sterilizers, accessories and service contracts for the same period in 2009.

Operating

For the three-month period ending June 30, 2010 operating expenses amounted to $588,576 compared to $576,719 for the same period in 2009. Operating expenses are related to production, manufacturing and after-sales service departments. Having sold more devices, the sterilizer's cost of goods sold increased between the two periods. Conversely, costs related to service contracts and salaries related to customer service and after-sales service, decreased between the two periods. For the six-month period ending June 30, 2010, operating expenses amounted to $929,912 compared to $1,170,992 for the same period in 2009. Having sold fewer devices, the variance between the two periods is the result of a decrease in the cost of goods sold. This variance is also explained by a decrease in costs related to service contracts and in salaries related to customer service and after-sales service.

Sales and Marketing

Sales and Marketing expenses amounted to $298,466 for the three-month period ending June 30, 2010 compared to $644,068 for the same period in 2009. The variance between the two periods is mainly the result of a decrease in salaries, commissions and expenses due to a reduction in workforce in the sales department. This variance can also be explained by a decrease in expenses related to exhibitions and trade shows. Conversely, provision for bonuses increased due to a new accounting practice to accrue bonuses over a twelve-month period. For the six-month period ending June 30, 2010, Sales and Marketing expenses amounted to $611,824 compared to $1,255,621 for the same period in 2009. The variance between the two periods is also the result of a decrease in salaries, commissions, and expenses as well as a decrease in expenses related to trade shows. Conversely, the provision for bonuses increases between the two periods. We anticipate our Sales and Marketing expenses to decrease going forward since these expenses are now the responsibility of our channel partner.

Research and Development

For the second quarter of 2010, Research and Development expenses amounted to $865,306, compared to $775,099 for the same period in 2009. The difference between the two periods is due to an increase in professional fees as well as in salaries resulting from the addition of employees in the R&D department to pursue the work on patents and the filings of the new cycles with agencies. Conversely, material purchases and sub-contracting fees decreased between the two periods. For the six-month period ending June 30, 2010, Research and Development expenses amounted to $1,623,650 compared to $1,514,155 for the same period in 2009. The difference is also due to an increase in professional fees, regulatory fees as well as in salaries. Conversely, material purchases and sub-contracting fees also decreased between the two periods.

Administrative

Administrative expenses amounted to $732,495 for the three-month period ending June 30, 2010, compared to $826,848 for the same period in 2009. The variance between the two periods is explained by a decrease in expenses related to Stock-based Compensation, representation and professional fees. Conversely, director's fees increased. For the six-month period ending June 30, 2010, administrative expenses amounted to $1,642,288 compared to $1,522,676 for the same period in 2009. The variance is explained by an increase in salaries as well as in professional fees. The variance is also explained by a provision for bonuses, by an increase in director's fees and professional fees mainly related to the review as well as tests performed on internal controls. Conversely, expenses related to Stock-based Compensation decreased between the two periods.

Other Income

For the three-month period ending June 30, 2010, the Company realized other revenues of $86,413 compared to $54,236 for the same period in 2009. The variance is mainly due to the amortization of the deferred revenues from the 3M™ agreement. In the second quarter of 2010, an amount of $51,251 was amortized. Conversely, the foreign exchange loss increased between the two periods. For the six-month period ending June 30, 2010, other revenues amounted to $233,237 compared to $178,422 for the same period in 2009. The variance is due to an increase in the amortization of the deferred revenues from the 3M™ agreement and in R&D tax credit. Conversely, investment income decreased.

Net Loss

The Company recorded a net loss of $1,906,765 for the second quarter of 2010, or $0.03 per share compared to a net loss of $2,263,463 or $0.05 for the same period in 2009. For the six-month period ending June 30, 2010, the net loss amounted to $3,940,697, or $ 0.07 per share, compared to $4,250,807, or $0.09 per share for the same period in 2009.

FINANCIAL SITUATION ANALYSIS

	JUNE 30 (Unaudited)		DECEMBER 31 (Audited)	
	2010	2009	2009	2008
Cash, Cash equiv. and Temporary Investments	**$22,177,974**	$13,740,386	$10,671,845	$17,718,470
Accounts Receivable	**$1,108,827**	$1,184,546	$1,333,178	$820,318
Inventories	**$1,497,231**	$2,042,951	$1,483,810	$2,548,075
Property, Plant and Equipment	**$1,244,198**	$970,424	$1,256,339	$675,810
Intangible Assets	**$3,448,885**	$3,569,054	$3,549,189	$3,642,126
Deferred Revenues (Short and long term)	**$2,381,687**	$629,964	$2,052,333	$388,958
Share Capital and Contributed Surplus	**$98,081,069**	$81,233,217	$81,322,484	$81,111,234
Shareholders' Equity	**$25,741,342**	$19,743,085	$14,865,527	$23,871,909

Liquid Assets and Financial Situation

As of June 30, 2010, cash, cash equivalents and temporary investments amounted to $22,177,974 compared to an amount of $13,740,386 as of June 30, 2009.

Inventories

Inventories, as of June 30, 2010, amounted to $1,497,231 compared to a total amount of $2,042,951 for the corresponding period in 2009. The variance is explained by a decrease in the inventory of sterilizers resulting from the sale of devices. The variance is also resulting from the transfer of materials to the R&D department and by a net write-down of $441,668 taken between the two periods.

Deferred Revenues

Short and long term deferred revenues, as of June 30, 2010, amounted to $2,381,687 compared to $629,964 as of June 30, 2009. The item "deferred revenues" reflects financial transactions related to parts, warranties, license revenue and service contracts not yet recognized as revenue. The variance between the two periods is mainly explained by the amount of $2,102,750 received due to the 3M™ Agreement. Since the beginning of the year, deferred revenues have been amortized and recognized as revenue over the duration of the Agreement on a straight-line basis. As of June 30, 2010, the remaining deferred revenues to amortize were $2,031,612.

Also, as per agreement with 3M™ maintenance and service of sterilizers sold by 3M™ will be supported by 3M™. As such, we anticipate that the Company's revenues for service contracts will decrease over time.

Statements of Cash Flow

	SECOND QUARTER		SIX MONTHS	
	2010	2009	**2010**	2009
Operating Activities	**($1,905,378)**	($2,072,010)	**($3,019,596)**	($3,695,728)
Investing Activities	**($9,673,249)**	$4,296,760	**$8,223,658**	$6,738,215
Financing Activities	**($72,603)**	$ -	**$14,741,023**	$ -

Operating Activities

Cash flow used for operating activities amounted to $1,905,378 for the second quarter of 2010, compared to $2,072,010 for the same period in 2009. This variance is mainly explained by the decrease in the net loss between the two periods. Conversely, the cash flow used for non-cash working capital increase. For the six-month period ending June 30, 2010, cash flow used for operating activities amounted to $3,019,596 compared to $3,695,728 for the same period in 2009. This variance is also mainly explained by a decrease in the net loss and in the cash flow used for non-cash working capital.

Investing Activities

For the second quarter of 2010, cash flows used for investing activities amounted to $9,673,249 compared to an amount of cash flows from investing activities of $4,296,760 for the same period in 2009. This variance is mainly explained by an increase of the net difference between the acquisition and disposal of investments and by an increase of acquisition of property, plant and equipment. For the six-month period ending June 30, 2010, cash flows used for investing activities amounted to $8,223,658 compared to an amount of cash flows from investing activities of $6,738,215 for the same period in 2009. This variance is mainly explained by an increase in the net difference between the acquisition and disposal of investments. Conversely, the acquisition of property, plant and equipment decreased between the two periods.

Financing Activities

For the second quarter of 2010, cash flows used for financing activities amounted to $72,603 compared to none for the same period in 2009. The variation is due to capitalized expenses related to the last financing which were booked in the second quarter. For the six-month period ending June 30, 2010, cash flows from financing activities amounted to $14,741,023 compared to none for the same period in 2009. This variance is explained by the closing, in March 2010, of a public offering of 10,000,000 common shares for cash proceeds of $16,000,000 ($14,678,177 net of expenses).

CONTRACTUAL COMMITMENTS

As of June 30, 2010, the contractual commitments in the fiscal years to come are as follows:

	2010	2011	2012	2013	2014
Operating leases and service contracts	**$289,978**	$25,515	$15,538	$1,220	$0

SUMMARY OF QUARTERLY RESULTS
(Unaudited)

	2010		2009				2008		
($000 except loss/share)	**Q2**	Q1	Q4	Q3	Q2	Q1	Q4	Q3	Q2
Sales	**494**	144	155	126	511	533	382	725	1,037
Other Income	**86**	147	219	71	54	124	247	204	203
Net Loss	**1,907**	2,034	2,680	2,288	2,263	1,987	2,898	1,848	2,728
Net Loss per share (basic and diluted)	**0.03**	0.04	0.05	0.05	0.05	0.04	0.06	0.04	0.05

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

CAPITAL RESOURCES

The Company principally uses its capital to finance operating expenses, commercialization expenses, marketing expenses, R&D expenses, administrative expenses, working capital and capital expenditures. Historically, the Company has funded its activities through several rounds of public and private financing, as well as from various government subsidies. Since its inception in June 1998, the Company has raised more than $89,000,000 from the sale of its equity. When possible, the Company tries to optimize its liquidity position through non-dilutive sources, including investment tax credits, grants, interest income as well as licensing revenues.

For the second quarter of 2010, the monthly burn-rate was approximately $683,000. The Company believes that its current liquid assets are sufficient to finance its activities into 2013.

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

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

As of June 30, 2010, the number of outstanding shares was 57,939,451.

OFF-BALANCE SHEET TRANSACTION

The Company made no off-balance sheet transaction during the second quarter of 2010.

TRANSACTIONS WITH RELATED PARTIES

The Company rents premises from a company held by its related parties. These operations were carried out during the normal course of business and were measured at the exchange value, which is the amount of the consideration agreed to and accepted by the Company and the related party. As of June 30, 2010, no amount was included in accounts payable for transactions made with this related party compared to the same as of June 30, 2009.

As of June 30, 2010 and 2009 and during the last two complete fiscal years, the Company made the following transactions with this related party:

	JUNE 30		DECEMBER 31	
	2010	2009	2009	2008
Rent	**$31,585**	$31,396	$62,793	$61,561
Other Rent-related Expenses	**41,680**	46,174	80,175	71,138
	$73,265	$77,570	$142,968	$132,699

ACCOUNTING POLICIES

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

Use of Estimates

The preparation of financial statements in accordance with Canadian GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities 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 recognized as investment income and presented under “Other Revenues” in the statement of earnings.

Temporary Investments

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

Effective Interest Method

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

Fair Value

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

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

Inventories

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

When 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 revenues."

Revenue Recognition

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

Revenue from revenue arrangements with multiple deliverables are divided into separate units of accounting when the Company has reliable evidence. Revenue related to service contracts offered to clients and from license revenue, are deferred and recognized using the straight-line method over the term of the contract.

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

Provision for Warranties

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

Stock-based Compensation

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

Future Accounting Changes

In February 2008, the Canadian Accounting Standards Board confirmed that Canadian publicly accountable enterprises would be required to adopt International Financial Reporting Standards (IFRS) when preparing financial statements for years beginning on or after January 1, 2011. The Company will therefore be required to transition to IFRS for its interim financial statements ending on March 31, 2011 and 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 has completed in 2009 the diagnostic phase, which involved a high-level review of the differences between current Canadian GAAP and IFRS, as well as a review of the alternatives available on adoption. Phase 2 of the plan, which will be completed by the end of 2010, allows the Company to evaluate the detailed consequences of the transition. This part of the plan will permit us to implement subsequently the required changes to our information systems and internal control mechanisms. The next phase will be to prepare the opening balance sheet, the financial results (current and comparative), reconciliation notes as well as additional notes under IFRS and their initial adoptions.

The following are some of our key changes in accounting policies, which we expect would have 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.

Standard	International standards	Management's comments
IFRS 2 Share-based Payment	Entities must estimate the number of equity instruments expected to vest and revise that estimate, if necessary.	Historical information by employee class is being collected to support estimates of future vesting and integrate it to our calculations.
IAS 16 Property, Plant and Equipment	Parts of an item must be depreciated separately, each over the length of its useful life.	Management is performing an analysis of the major parts of the company's property, plant and equipment.

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 also encouraged, but not required, to apply IFRS 2 to equity instruments that were granted after November 7, 2002 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.
	Redesignation of financial instruments on the transition date	Management is currently reviewing the classification of its temporary investments in order to make the most appropriate decision.	
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.

The Company is actually evaluating the monetary impacts of the conversion, and these impacts will be the subject of a detailed disclosure when all work has been completed.

RISK FACTORS

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

Risks Associated with International Operations

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

Compatibility, Biocompatibility and Research and Development Projects

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

Dependency on Key Personnel

TSO_3 believes that its success will continue to depend on its ability to attract and retain qualified managers and other key personnel. Losing a key employee could have a major negative impact on TSO_3. The Management expects to review the Succession Plan in 2010 of all senior level management.

Management of Business Growth

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

Intellectual Property and Counterfeiting Risks

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

Competition Risks

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

Product Liability Issues

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

Regulatory Approvals

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

Financial Instruments

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

Market Risk

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

As of June 30, 2010 if the base rate at that date had been 0.5% lower, all other variables held constant, the after-tax loss and other comprehensive items for the six-month period would have been $54,060 lower, arising mainly as a result of an increase in the fair value of fixed rate financial assets classified as held for trading. If the base rates at that date had been 0.5% higher, all other variables held constant, the after-tax loss and other comprehensive items for the six-month period would have been 53,629 higher, arising mainly as a result of a decrease in the fair value of fixed rate financial assets classified as held for trading. The net loss therefore has a similar sensitivity to interest rate increases and interest rate decreases because of investments with capped interest rates.

Credit Risk

The use of financial instruments can create a credit risk in which there is a risk of financial loss resulting from a counterpart'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 another credit rating agencies. This policy defines credit risk limits based on the characteristics of the counterparties. Therefore, the Company manages credit risk by complying with its established investment policy. As of June 30, 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 June 30, 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 can not guarantee that it will be able to put in place such financing.

Currency Risk

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

As of June 30, 2010, if the Canadian dollar had weakened 10 percent against the US dollar with all other variables held constant, the after-tax loss and other comprehensive items for the six-month period would have been lower than $66,232. Conversely, if the Canadian dollar had strengthened 10 percent against the US dollar with all other variables held constant, the after-tax loss and other comprehensive items for the six-month period would have been higher than $66,232.

SEGMENTED INFORMATION

Operating revenues are allocated between geographic areas based on the location of the client and are as follows for the three and six-month periods ending June 30:

	SECOND QUARTER				SIX MONTHS			
	2010		2009		**2010**		2009	
Canada	**$52,930**	**11%**	$57,284	11%	**$113,443**	**18%**	$215,476	21%
US & Others	**441 423**	**89%**	453,342	89%	**525,138**	**82%**	828,638	79%
	$494,353	**100%**	$510,626	100%	**$638,581**	**100%**	$1,044,114	100%

INTERNAL CONTROL OVER FINANCIAL REPORTING

There has been no changes in the Company's internal control over financial reporting that occurred during the Company's most recent quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal controls over financial reporting.

FORWARD LOOKING STATEMENTS

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

Forward-looking information is based upon a number of assumptions and is subject to a number of risks and uncertainties, many of which are beyond the Company's control that could cause actual results to differ materially from those that are disclosed in or implied by such forward-looking information. These risks and uncertainties are described under the section "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 August 3, 2010. Additional information on the Company is available through regular filing of press releases, annual reports, quarterly financial statements and the Annual Information Form on the SEDAR website www.sedar.com.

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

August 3, 2010

TSO_3 Inc.

QUARTERLY FINANCIAL STATEMENTS
June 30, 2010

Q2

Notice from Management

The quarterly financial statements have not been subject to an external audit.

STATEMENTS OF EARNINGS AND COMPRENSIVE LOSS (Unaudited)

Periods ending June 30

	SECOND QUARTER		SIX MONTHS	
	2010	2009	**2010**	2009
SALES	**$494,353**	$510, 626	**$638,581**	$1,044,114
EXPENSES				
Operating	**588,576**	576,719	**929,912**	1,170,992
Sales and Marketing	**298,466**	644,068	**611,824**	1,255,621
Research and Development	**865,306**	775,099	**1,623,650**	1,514,155
Administrative	**732,495**	826,848	**1,642,288**	1,522,676
Financial	**2,688**	5,591	**4,841**	9,899
	2,487,531	2,828,325	**4,812,515**	5,473,343
OPERATING LOSS	**1,993,178**	2,317,699	**4,173,934**	4,429,229
Other Income	**86,413**	54,236	**233,237**	178,422
NET LOSS AND COMPREHENSIVE LOSS	**$1,906,765**	$2,263,463	**$3,940,697**	$4,250,807
BASIC AND DILUTED NET LOSS PER SHARE (NOTE 10)	**$0.03**	$0.05	**$0.07**	$0.09

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

STATEMENTS OF CONTRIBUTED SURPLUS (Unaudited)
Periods ending June 30

	SECOND QUARTER		SIX MONTHS	
	2010	2009	**2010**	2009
Balance, beginning of period	**$8,749,615**	$7,956,899	**$8,110,388**	$7,900,943
Options exercised	**(10,852)**	-	**(30,249)**	-
Warrants granted	**-**	-	**620,250**	-
Stock-based compensation	**37,116**	66,027	**75,490**	121,983
Balance, end of period	**$8,775,879**	$8,022,926	**$8,775,879**	$8,022,926

STATEMENTS OF DEFICIT (Unaudited)
Periods ending June 30

	SECOND QUARTER		SIX MONTHS	
	2010	2009	**2010**	2009
Balance, beginning of period	**$70,344,166**	$59,226,669	**$66,456,957**	$57,239,325
Share issue expenses	**88,796**	-	**1,321,823**	-
Compensation warrants to underwriters	**-**	-	**620,250**	-
Net loss	**1,906,765**	2,263,463	**3,940,697**	4,250,807
Balance, end of period	**$72,339,727**	$61,490,132	**$72,339,727**	$61,490,132

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

BALANCE SHEETS
As of

	JUNE 30 2010 (Unaudited)	DECEMBER 31 2009 (Audited)
CURRENT ASSETS		
Cash and cash equivalents (Note 4)	**$10,224,857**	$6,727,088
Temporary investments (Note 5)	**11,953,117**	3,944,757
Accounts receivable	**1,108,827**	1,333,178
Inventories	**1,497,231**	1,483,810
Prepaid expenses	**119,018**	111,528
	24,903,050	13,600,361
PROPERTY, PLANT AND EQUIPMENT	**1,244,198**	1,256,339
INTANGIBLE ASSETS	**3,448,885**	3,549,189
	$29,596,133	$18,405,889
CURRENT LIABILITIES		
Accounts payable and accrued liabilities	**$1,473,104**	$1,488,029
Deferred revenues	**560,350**	633,483
	2,033,454	2,121,512
LONG-TERM DEFERRED REVENUES (Note 7)	**1,821,337**	1,418,850
	3,854,791	3,540,362
SHAREHOLDERS' EQUITY		
Share capital (Note 8)	**89,305,190**	73,212,096
Contributed surplus	**8,775,879**	8,110,388
Deficit	**(72,339,727)**	(66,456,957)
	25,741,342	14,865,527
	$29,596,133	$18,405,889

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

STATEMENTS OF CASH FLOWS (Unaudited)

Periods ending June 30

	SECOND QUARTER		SIX MONTHS	
	2010	2009	**2010**	2009
OPERATING ACTIVITIES				
Net Loss	**($1,906,765)**	($2,263,463)	**($3,940,697)**	($4,250,807)
Adjustment for:				
Amortization of property, plant and equipment	**77,272**	53,578	**148,407**	100,540
Amortization of intangible assets	**82,008**	79,365	**162,398**	156,755
Change in the value of temporary investments	**(1,535)**	(18,762)	**16,939**	130,464
Stock-based compensation	**37,116**	66,027	**75,490**	121,983
Loss (gain) on disposal of property, plant and equipment	**-**	(1,000)	**-**	3,374
	(1,711,904)	(2,084,255)	**(3,537,463)**	(3,737,691)
Changes in non-cash operating working capital items	**(193,474)**	12,245	**517,867**	41,963
Cash flows applied to operating activities	**(1,905,378)**	(2,072,010)	**(3,019,596)**	(3,695,728)
INVESTING ACTIVITIES				
Acquisition of property, plant and equipment	**(115,478)**	(63,429)	**(136,266)**	(228,951)
Acquisition of intangible assets	**(28,640)**	(58,773)	**(62,094)**	(83,683)
Disposal of temporary investments	**2,440,598**	9,948,156	**15,944,431**	12,580,043
Acquisition of temporary investments	**(11,969,729)**	(5,530,194)	**(23,969,729)**	(5,530,194)
Disposal of property, plant and equipment	**-**	1,000	**-**	1,000
Cash flows applied to investing activities	**(9,673,249)**	4,296,760	**(8,223,658)**	6,738,215
FINANCING ACTIVITIES				
Options exercised	**16,193**	-	**62,846**	-
Share issue expenses	**(88,796)**	-	**(1,321,823)**	-
Share issue	**-**	-	**16,000,000**	-
Cash flows from financing activities	**(72,603)**	**-**	**14,741,023**	**-**
INCREASE IN CASH AND CASH EQUIVALENTS	**(11,651,230)**	2,224,750	**3,497,769**	3,042,487
CASH AND CASH EQUIVALENTS AT THE BEGINNING	**21,876,087**	10,003,939	**6,727,088**	9,186,202
CASH AND CASH EQUIVALENTS AT THE END	**$10,224,857**	$12,228,689	**$10,224,857**	$12,228,689
Comprised of:				
Cash	**1,769,065**	1,270,154	**1,769,065**	$1,270,153
Cash equivalents	**8,455,792**	10,958,535	**8,455,792**	10,958,536
CASH AND CASH EQUIVALENTS	**$10,224,857**	$12,228,689	**$10,224,857**	$12,228,689

The accompanying notes are in integral part of the financial statements.

NOTES TO THE FINANCIAL STATEMENTS (Unaudited)
Periods ending June 30

1. Description of Business

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

2. Accounting Policies

The unaudited financial statements are prepared in accordance with Canadian generally accepted accounting principles for interim financial statements and do not include all the information required for complete financial statements. Quarterly results may not necessarily be indicative of results anticipated for the entire year. Moreover, they do not include all the information presented in the annual financial statements. The unaudited financial statements are consistent with the policies outlined in the Company's audited financial statements for the year ending December 31, 2009.

The quarterly financial statements and accompanying notes should be read in conjunction with the Company's audited financial statements for the year ending December 31, 2009.

3. Changes in Accounting Policies

Future Accounting Changes

In February 2008, the Canadian Accounting Standards Board confirmed that Canadian publicly accountable enterprises would be required to adopt IFRS when preparing financial statements for years beginning on or after January 1, 2011. The Company will therefore be required to transition to IFRS for its interim financial statements ending March 31, 2011 and provide a restated comparative statement in accordance with IFRS.

4. Cash and Cash Equivalents

	JUNE 30 2010	DECEMBER 31 2009
Cash and cash equivalents are composed of:		
Cash	**$1,769,065**	$1,528,375
Short-term investments less than three months		
Bonds	**2,441,101**	2,997,931
Money market funds	**6,014,691**	2,200,782
	$10,224,857	$6,727,088

Bonds maturing at various dates through August 2011 and having an average yield of 0.46%. As of June 30, 2010, bonds held were rated A+ and money market funds held were rated R1.

5. Temporary Investments

	JUNE 30 2010	DECEMBER 31 2009
Temporary investments are composed of:		
Bonds	**$11,953,117**	$3,944,757

Bonds maturing at various dates through December 2011 and having an average yield of 1.12%. As of June 30, 2010, bonds held were rated A+.

6. Credit Facilities

The Company has a line of credit to obtain advances up to a maximum of $350,000. As of June 30, 2010, this line of credit was undrawn.

7. 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 the second quarter of 2010, the Company recognized $51,251 under other income (3M™ License revenue amortization). On June 30, 2010, $2,031,612 is recorded in the deferred revenues, including an amount of $210,275 in short-term.

8. Share-Capital

	JUNE 30 2010		DECEMBER 31 2009	
Issued and paid	**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	**71,883**	**93,094**	4,166	1,805
Balance at end	**57,939,451**	**$89,305,190**	47,867,568	$73,212,096

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 71,883 shares for a book value of $93,094. During 2009, they subscribed for 4,166 shares for a book value of $1,805.

Stock Options and Warrants

a) Stock Options

In March 2010, the Company awarded 28,000 stock options to its directors, at a weighted average exercise price of $1.55. The weighted fair value of these stock options was $1.24 per option.

The fair value of the options at the grant date is estimated using the Black-Scholes option pricing model under the following weighted average assumptions for the options granted since the beginning of the three-month period:

Risk free interest rate	**3.44 %**
Expected volatility	**73 %**
Life	**10 years**
Expected dividend yield	**0 %**

The Black-Scholes options pricing model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable, a practice significantly different from how stock options are granted by the Company. In addition, option pricing models require 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.

During the six-month period ending June 30, 2010, Stock Options varied as follows:

	SIX MONTHS	
Stock Options	**Number**	**Weighted Average Exercice Price**
Outstanding at the beginning of six month period	**4,179,544**	**$1.20**
Granted	**28,000**	**$1.55**
Exercised	**(71,883)**	**$0.87**
Forfeited	**(37,511)**	**$1.56**
Outstanding at the end of period	**4,098,150**	**$1.19**
Exercisable at the end of period	**2,705,923**	**$1.56**

b) Warrants and Compensation

During the six-month period ending June 30, 2010, Warrants varied as follows:

	SIX MONTHS	
Warrants	**Number**	**Weighted Average Exercice Price**
Outstanding at the beginning of six month period	**-**	**-**
Granted	**750,000**	**$1.60**
Outstanding at the end of period	**750,000**	**$1.60**
Exercisable at the end of period	**750,000**	**$1.60**

Following the round of financing, 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 weighted fair value of these stock warrants was $0.83 per warrant.

The fair value of the warrants at the grant date is estimated using the Black-Scholes option pricing model under the following weighted average assumptions for the options granted since the beginning of the six-month period:

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

9. 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.

For the three-month period ending June 30, 2010, the monthly burn-rate was approximately $683,000. In the current conditions, the Company believes that its current liquid assets are sufficient to finance its activities into 2013.

10. Earnings per Share

The following table reconciles the basic and the diluted earnings per share for the three and six-month periods ending June 30:

	SECOND QUARTER		SIX MONTHS	
	2010	2009	**2010**	2009
Net Loss				
Basic and Diluted	**$1,906,765**	$2,263,463	**$3,940,697**	$4,250,807
Number of shares				
Weighted average number of outstanding shares (1)	**57,919,254**	47,863,402	**54,647,266**	47,863,402
Loss per Share				
Basic	**$0.03**	$0.05	**$0.07**	$0.09
Diluted (2)	**$0.03**	$0.05	**$0.07**	$0.09

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

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

11. Financial Instruments

The Company is exposed to various types of risks, including those related to the use of financial instruments. To manage the risks 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 their measurement, particularly interest rates and market prices. Interest rate risks exist when interest rate fluctuations modify the cash flows of the Company's investments.

As of June 30, 2010, if the base rate at that date had been 0.5% lower, all other variables held constant, the after-tax loss and other comprehensive items for the six-month period would have been $54,060 lower, arising mainly as a result of an increase in the fair value of fixed rate financial assets classified as held for trading. If the base rates at that date had been 0.5% higher, all other variables held constant, the after-tax loss and other comprehensive items for the six-month period would have been $53,629 higher, arising mainly as a result of a decrease in the fair value of fixed rate financial assets classified as held for trading. The net loss therefore has a similar sensitivity to interest rate increases and interest rate decreases because of investments with capped interest rates.

Credit Risk

The use of financial instruments can create a credit risk in which there is a risk of financial loss resulting from a counterpart's inability or refusal to fully meet its contractual obligations. The Company has established an investment policy that addresses credit risk management and includes the authorization to perform investment transactions with the Canadian federal or provincial governments, crown corporations, municipalities or financial institutions, either in money market funds, guaranteed investment certificates or bonds with credit ratings of a minimum of A- or more according to Standard and Poor's or other credit rating agencies. This policy defines credit risk limits based on the characteristics of the counterparties. Therefore, the Company manages credit risk by complying with its established investment policy. As of June 30, 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 June 30, 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 can not guarantee that it will be able to put in place such financing.

Currency risk

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

As of June 30, 2010, if the Canadian dollar had weakened 10 percent against the US dollar with all other variables held constant, the net loss, for the six-month period, would have been $66,232 lower. Conversely, if the Canadian dollar had strengthened 10 percent against the US dollar with all other variables held constant, the net loss, for the six-month period, would have been $66,232 higher.

12. Comparative Figures

Certain comparative figures have been reclassified to conform to the current period.