

MESSAGE FROM THE MANAGEMENT

A STIMULATING BANNER YEAR



GERMAIN CARRIÈRE
Chairman of the Board of Directors

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IN 2005
THE EFFORTS OF THE PAST YEARS WERE CONSOLIDATED, IN ORDER TO PUT IN PLACE ALL THE ELEMENTS NECESSARY FOR THE COMMERCIALIZATION OF OUR FIRST PRODUCT: THE 125L OZONE STERILIZER.

The very first sales of the ozone sterilizers, initially foreseen for the second quarter of 2005, were realized at the end of the year and in January 2006. The introduction of a new sterilization process in hospitals is a complex sales process. The acquisition cycle for a capitalized device in the healthcare sector is at least six to 12 months. That is the minimal cycle that we can expect for a brand-new technology.

Several of the first users are in their acquisition process, having evaluated our device and seen its effectiveness for themselves. That is why, throughout the year 2005, we worked with them in their adaptation to this new technology.

In terms of financing, compatibility and the organizing of the sales team, TSO₃ received much support and made great progress, including, notably, the first firm sale of a 125L Ozone Sterilizer to a North American hospital. This success is very motivating as we have been impatiently waiting for the moment.

SEVERAL EXPRESSIONS OF CONFIDENCE AND POSITIVE REPORTS

More good news came with the closing of the \$10 million private placement, financing that was accomplished under excellent conditions for the shareholders and secures our financial underpinnings.

This latest fiscal year was also positive in terms of the endorsements and comments received from certain referral sites. TSO₃ obtained compatibility endorsements for the 125L Ozone Sterilizer from two leading manufacturers in the field of medical instrumentation, and from three more manufacturers early in 2006.

In addition, two U.S. referral sites have sent us extremely positive reports that confirm our 125L Ozone Sterilizer is economical, easy to use and safe for the patients, the users and the environment.

THE RANGE OF USES KEEPS GROWING

The continued efforts aimed at increasing the number of instruments on our compatibility list were also rewarded with the addition of numerous lumened surgical instruments, thereby confirming the superior capacity of ozone to penetrate the very narrow internal channels of these instruments. The inclusion of these such micro-invasive surgical instruments lengthens considerably the list of instruments compatible with our process and sets us apart even more from our competition, which, we believe, will attract and convince future buyers of our product.

AN EXPERIENCED SALES TEAM

As for our team, TSO₃ has focused mainly on reinforcing the sales sector. In addition to hiring an experienced sales director, we have since filled five new positions as regional sales managers in the United States. Their experience represents a major advantage for the commercial launch of the 125L Ozone Sterilizer.

The visibility that our distributor offered us allowed us to develop a list of prospective customers. However, we realized during 2005 that our distributor was not going to reach the sales objectives we had set. To remedy this situation, we decided to utilize our own sales force to commercialize our products. With a team of eight professionals, we decided, along with our distributor, to rework the agreement so we would take the leadership in sales starting in 2006.

A PROMISING FUTURE

We are extremely encouraged by all of our accomplishments in 2005 and we foresee a very promising future for TSO₃. Our team is working unceasingly to meet each of the challenges we encounter while respecting the deep values that guide us – rigour, transparency and the determination to succeed. These values constitute our strength and represent a guarantee of quality offered to our future customers. We look forward to the next fiscal year with great enthusiasm.

FINANCIAL RESULTS

For the fiscal year ended December 31, 2005, the Company posted a net loss of \$6.4 million or \$0.19 per share, compared to a net loss of \$5.9 million or also \$0.19 per share for the fiscal year 2004.

This slight increase in the net loss is explained by the intensification of the Company's commercial launch efforts, as well as by the increase of R&D expenses, mainly used for compatibility validation and other necessary activities to support the commercial launch.

120 MANUFACTURERS SUPPORT US

Through the cooperation of numerous players in the field of surgical instrumentation, we have obtained convincing results in terms of compatibility. In only a few months we were able to validate a huge number of instruments among the lines most used in surgery today. The number of manufacturers and suppliers of raw materials participating in our Manufacturers Testing Program (MTP) doubled from 60 to 120 in 2005. The numbers are revealing – and very promising.

INSTRUMENT MANUFACTURERS: A GROWING COLLABORATION

Thanks to the collaboration of numerous key players in the field of surgical instrumentation, we have obtained convincing results regarding compatibility.

In 2004, we delayed activities related to the commercialization of the sterilizer in order to pursue the research on compatibility, and we successfully met this challenge within the time allocated.

Although the compatibility research began when the Company was founded and we had always devoted every effort possible, a major boost was given to this research in 2005. We were able to validate a huge number of instruments among the lines most used in surgery today. The number of manufacturers and suppliers of raw materials participating in our Manufacturers Testing Program (MTP) doubled from 60 to 120 this year. The numbers are revealing – and very promising.

In fact, our MTP has multiple positive repercussions, because not only do the manufacturers provide us access to their instruments, they do not hesitate to give us their time, notably by sharing their expertise. One of the outcomes of this program is a collaboration that generates such a level of confidence in our sterilization process that several manufacturers are spontaneously showing their interest in offering us their endorsement.

In our area of activity, mainly when a new product is being launched in the market, endorsements are written and signed acknowledgements from manufacturers, who are clarifying their intention to promote the compatibility of their instruments with our sterilization process to our mutual customers.

TSO₃ OBTAINS CLEARANCE FOR NEW CLAIMS FROM HEALTH CANADA

Instruments used in urology, cardiology, ophthalmology and various micro-invasive surgeries are among the instruments whose compatibility has been validated, and they represent only a part of what can currently be sterilized with ozone.

OUR COMPATIBILITY RATE IS SIMILAR TO, AND IN CERTAIN CASES EXCEEDS, THAT OF THE CLOSEST COMPETITOR.

We must point out the supplementary trials successfully carried out in 2005 regarding the fine tubing that is part of the new instruments utilized in micro-invasive surgery. Further testing confirmed the superior capacity of ozone to penetrate in the long, thin tubes of these instruments, which allows the diversity and the volume of the instruments that can be sterilized with the 125L Ozone Sterilizer to be increased. These new claims were approved by Health Canada and a similar request has been filed for the United States.

This planned new usage is the broadest for any low-temperature gaseous sterilization process on the market, which allows us to get ahead of the competition by including in the list of instruments that can be sterilized with ozone, the high-demand surgical instruments with lumens that have smaller diameters and longer lengths.

This is particularly important for the ever-thinner instruments used in micro-invasive surgery as the number of these procedures being conducted continues to increase exponentially. In addition, new lumened devices are being developed for neurological and specialty procedures that will expand the market for the 125L Ozone Sterilizer even further. With the soaring market for such devices, this news is excellent for the future of TSO₃.

THE MANUFACTURERS TESTING PROGRAM HAS LED TO COLLABORATION THAT GENERATES GREAT CONFIDENCE IN OUR STERILIZATION PROCESS. THAT MEANS THAT SEVERAL MANUFACTURERS ARE SHOWING INTEREST IN OFFERING THEIR ENDORSEMENT.

TECHNOLOGICAL SHOWCASES PROVIDE CONCLUSIVE RESULTS

Our commercialization strategy includes gaining recognition for our product in the market through agreements with North American hospitals that act as technological showcases for our new ozone sterilization process.

The [Canadian hospitals](#) that are acting as pilot sites have allowed us to test the device and related accessories in real-life operation situations. Through this, several improvements were made to our product before we crossed the border to the United States in early 2005. Among these pilot sites, several have begun the requisition process in order to purchase the device in 2006.

The American sites, called "[referral sites](#)," are trying out our sterilization process with the aim of reporting on its efficaciousness. The users and professionals working in these hospitals are in a position to see for themselves the numerous advantages of the 125L Ozone Sterilizer, including the lower costs.

THE FIRST SATISFACTION REPORTS FROM TWO U.S. REFERRAL SITES IN DECEMBER 2005 SUPPORT OUR POSITION TO THE EFFECT THAT THE 125L IS A SAFE, SIMPLE AND ECONOMICAL DEVICE FOR HOSPITALS.

A true trial program, this allows TSO₃ to directly obtain user reports, observations, comments and referrals that feed our customer sales approach. The first satisfaction reports submitted by two U.S. referral sites in December 2005 clearly indicate that the users are very satisfied and confirm that the 125L is safe, simple and economical for hospitals.

POSITIVE REPORTS

One sterilization manager summarized the experience by saying, "The 125L is certainly simple to operate, with only one choice of cycle, and no need to purchase or handle chemical sterilants. For us, though, the simplicity is not as important as the issue of safety for staff and patients, and the advantages of saving so much money as compared with our old EtO sterilizer". He added, "The 125L has been very reliable. It has been a strong complementary addition to our options for sterilization of heat-sensitive devices".

"The impact for us was significant", says a Urology Nurse Manager. "Because of the faster instrument turnaround time, we noticed that our instruments are more readily available in the OR storage area when we need them. From a standpoint of the devices themselves, we noticed they looked shinier and more like new than they did when they were sterilized in ethylene oxide".

AT THE TIME OF THE WRITING OF THE SATISFACTION REPORTS, MORE THAN 300 STERILIZATION CYCLES HAD BEEN RUN IN EACH 125L OZONE STERILIZER AT THESE HOSPITALS; THE NUMBER OF PATIENTS WHOSE INSTRUMENTS HAVE BEEN STERILIZED IN OZONE HAS EXCEEDED 2,000. BIOLOGICAL INDICATORS WERE RUN WITH EVERY CYCLE, AND ALL CONFIRMED THAT ALL MICROORGANISMS HAD BEEN COMPLETELY KILLED.

With a cost of well under US\$1.00 per cycle for the water, oxygen and electricity used to make the sterilant, the cost of operation for a 125L will be less than US\$1,000 annually. Savings from reduced sterilant purchases are expected to be significant.

A NEW REALITY WITH A GREAT FUTURE

Since the beginning of operations, TSO₃ has implemented a sales strategy that utilizes a double-pronged approach – a recognized and competent distributor and the internal implementation of an effective sales team. We therefore decided to choose the best distributor for our product, while negotiating a distribution agreement with sufficient safeguards and objectives to maintain a close rein over the sales process. Our sales team supported our distributor.

This strategy allowed us to obtain both great credibility for our product among users and great visibility at trade shows. This also gave us the opportunity to develop a list of several hundred prospective customers for our device, at minimal cost. The advantages were therefore numerous. However, we had to admit that our distribution network was not fully achieving the sales objectives that were set.

The team at the distribution company has vast experience in the sale of commodity products that are already well known and target mainly ORs. But as the 125L Ozone Sterilizer is a new, innovative product that targets central sterilization departments, the customer approach requires different expertise and the sales team must be completely dedicated to the product.

These learnings in 2005 led us to reconsider the organization of our sales and marketing department, and we made the decision to consolidate our team internally. We therefore met with our distributor to negotiate a transition contract for 2006, which will allow us to both profit from any sales to accounts that were already visited by our distributor, and to assume the leadership in our sales efforts to new customers, now and in the future.

Our current team of sales professionals are dedicating 100% of their efforts to selling the 125L Ozone Sterilizer. This new approach allows us to save the equivalent of the discount to the distributor and, thereby, to substantially increase our margins and reach profitability faster.

ADDITIONAL RESOURCES: A STRONG AND ACTIVE TEAM

The sales and marketing department was greatly reinforced in 2005, doubling the number of employees from eight to 16. The team was added a person in charge of business development, two clinical specialists, a sales director for the U.S. market and four U.S. regional sales managers.

The team in place can now profit from the contribution of eight sales professionals who have extensive experience working with capital equipment sales, for both operating rooms and central sterilization departments in hospitals. These professionals were meticulously selected for having already successfully introduced a new sterilization process in hospitals.

Thanks to this team and new approach, we are better equipped to meet our sales objectives in 2006.

SECURING OUR FINANCIAL POSITION WITH A \$10 MILLION PRIVATE PLACEMENT

In 2005, TSO₃ displayed prudent management by obtaining \$10 million in financing to ensure the Company has the necessary financial resources for its activities.

As part of this financing on a firm underwritten basis, the syndicate of underwriters led by Canaccord Adams and completed by Dundee Securities and Clarus Securities, formally agreed to acquire the entire issue at a predetermined price. The syndicate was therefore very confident in the institutional interest and their involvement in the transaction, because it thereby assumed the risks of the market.

As the demand was strong during this financing, the units were placed in the hands of excellent institutional investors, a large portion of which are outside Québec, thereby allowing the advantageous solidification and diversification of the TSO₃ shareholders base.

We also have the possibility of obtaining an additional \$6.25 million that would be generated by the exercise of the warrants issued with this private placement. Each warrant can be exercised at \$2.50 any time until July 7, 2007.

A FURTHER SIGN OF CONFIDENCE FROM THE FINANCIAL COMMUNITY.

MAJOR SUPPORT

In 2005, the Health Protection Agency (HPA) in the United Kingdom decided to award a grant in the amount of CAN\$710k (£327k) to study the effectiveness of the 125L Ozone Sterilizer for the inactivation of prions, the infectious proteins that cause Creutzfeldt-Jakob disease (CJD). This program will extend over a period of about three years. We are also working with international regulatory authorities to ensure the recognition of the protocols that have been set up.

The British interest in our technology confirms both the need for a sterilization method that will inactivate prions and ozone's potential for being the solution.

This project is one of the most exciting that we have undertaken until now and confirms, yet again, the very great efficaciousness of ozone sterilization.

"The potential transmission of CJD from patient to patient via contaminated surgical instruments has been a concern worldwide for a number of years", said Dr. Neil Raven, research project manager at the HPA. "The data from the preliminary tests conducted by TSO₃ lead us to believe that the ozone sterilizer could be a significant part of the solution to the problem of variant CJD (vCJD), the human form of mad cow disease".

A SOLID FOUNDATION ON WHICH TO BUILD A PROMISING FUTURE

After having devoted the past few years to building the collaborations necessary to our success tomorrow and deepening our understanding and knowledge of the end-users, we are now in a position to offer the market the low-temperature solution it has been waiting for.

Our solution to sterilization problems and our expertise give us the opportunity to accompany hospitals in their transition towards ozone sterilization. To this offer, it is important to add that it is not only the proven effectiveness of the 125L Ozone Sterilizer that makes our product so attractive – the fact that we are the only firm to put on the market a sterilization device that will be self-financing through the savings generated by its utilization, must also be considered.

It is also important to mention that increasingly strict Canadian regulations oblige hospitals to reduce ethylene oxide emissions by 99% starting in January 2007. Ethylene oxide is the gas most used for low-temperature sterilization in hospitals, a gas that is highly toxic and carcinogenic.

These regulations support the arrival of an environment-friendly technology such as the one we have developed, and the numerous ethylene oxide sterilizers that are still in operation in hospitals all represent sales opportunities for ozone sterilizers.

2006 WILL BE A YEAR FOCUSED MAINLY ON SALES

The whole of our operations in 2005, as well as the sales team we have in place, were geared to generating the expected sales and build on a solid base in terms of development during fiscal 2006. Moreover, we will continue to build our list of potential customers and hire talented new resources for our team. The outlook for 2006 is very promising, particularly as it will be a very active year in terms of sales of 125L Ozone Sterilizers.

MORE SIGNS OF CONFIDENCE TO REAP

We also have the firm intention to maintain the pace and multiply the list of our collaborations for compatibility and endorsements.

TSO₃ has brought together all the ingredients necessary to be the master of its destiny and make 2006 a memorable year.

ACKNOWLEDGEMENTS

Notably, fiscal 2005 allowed TSO₃ to increase its visibility among the clientele, to realize major advances and to consolidate its sales force. The outlook is very stimulating for the whole team who give their utmost every day to build this business. We want to thank the whole team for their determination and competence in the service of TSO₃.

We thank all of our partners in North America and overseas, as well as the referral sites that have accepted to share their enthusiasm for the performance of our device for the benefit of future users.

We also thank all the members of our Board of Directors who let TSO₃ benefit from their vast experience, as well as the members of our Scientific Committee for their outstanding contributions.

Thanks also to our shareholders who believe in the immense potential of TSO₃ and have confidence in the future.

Germain Carrière



Chairman of the Board

Jocelyn Vézina



Chief Executive Officer