2013

Annual Report

ANNUAL REPORT 2013

Message from the Chairman of the Board

Dear Shareholders,

TSO_3 continues to pursue its vision of "Creating the Improved Standard in Healthcare Sterile Reprocessing™". To that end, during the year, the Company continued to advance the development and enhancement of its technology while also regaining full control of its innovation, free from any lingering dispute with its former channel partner. In addition, even as the Company remained confident in its ability to secure market clearance for US commercialization, contingency plans were implemented should the process generate further delays.

The Board of Directors continues to fully support Management, while rigorously monitoring the Company so as to ensure appropriate oversight of strategic decisions and that key governance procedures are in place and being followed. The various Board committees, namely the Advisory Committee, Corporate Governance and Nomination Committee, Human Resources Committee and Audit Committee, met on a regular basis throughout the past year. Key activities, this year, have been around, strategy review, risk assessment, board member review, incentives review and succession plan. Collectively, the Board has challenged and supported management in its pursuit of the core goals.

During fiscal 2013, the Company resolved the year-long dispute over its termination on June 15, 2012 of its Distribution and Supply Agreement with its former channel partner, the 3M Company. While the Company maintains that it had all of the rights to terminate that agreement, the settlement of the dispute places TSO_3 in unchallenged control of its own technology and its own future. Throughout the year the Company focused its efforts on obtaining regulatory clearance to market its products in the USA. Such clearance did not occur during the year. As a result, plans were executed in a timely fashion early in 2014 in order to preserve the resources of the Company, thus maximizing the opportunity to obtain such clearance without further diluting the ownership interest of the shareholders of the Company.

As Chairman of the Board, I remain committed to the objectives outlined by management. I have witnessed the activity and commitment of the team to achieve their stated goals. With the forward progress made in 2013, I look forward to the Company and its shareholders seeing the rewards of obtaining the long pursued US market clearance. This pivotal event will open opportunities not only in the United States but will shape the direction of the Company's future.

Germain Carrière

Message from the president and CEO

Dear valued shareholders:

The lack of US-regulatory clearance in 2013 should not be considered a lack of progress towards obtaining the long sought-after 510(k) clearance which would allow commercialization activities to commence in the US market. We did participate in a number of technical meetings with the US Regulatory Authorities and ended the year with a clearer understanding of their expectations and requirements for our file.

Throughout the year, we have kept you informed as to the progress of our regulatory filings:

- Starting with the new “simplified” submission early in the first quarter of 2013;
- Then experiencing the relative “surprise” of hearing from the US Regulatory Authorities that the Company might wish to consider the *de novo* pathway to approval, as opposed to the 510(k) approach, which had been pursued over the past three years;
- Then to see, at the end of a summer meeting with the US Regulatory Authorities, the *de novo* pathway discarded and the 510(k) pathway being reaffirmed as the appropriate means to seek clearance;
- After a meeting in the fall, the Company provided to the US Regulatory Authorities enhanced technical information on the characterization of the loads and the cycles for our products’ wide performance claims; this information supplied with a view on resubmitting our application at the expiry of the file’s allowed schedule, and;
- Most recently, early in 2014, informing you of the US Regulatory Authorities’ response and guidance further to requests formulated by TSO_3 as part of our enhanced information package.

Yes… it was a year!

The above events during 2013 consumed more than the allotted time for a submission to gain clearance, even with the stop/start clock, which is sometimes difficult to follow and understand. During the year, we added significant “legal” resources with regulatory specialization to the effort to assure that the process was complying with the regulations without exceeding them, as well as augmented our technical resources with additional external expertise. In the end, with the guidance that we have received from the US Regulatory Authorities, with their reaffirmation in January of 2014 that the 510(k) process remains the pathway to follow, and information on what they would like to see in the new submission, the team is working aggressively to resubmit the file as requested, with all the information suggested and… we believe, for the last time.

On the operations side, early in 2013, we stated that as a result of our confidence in the simplified submission for the STERIZONE® 125L+ Sterilizer, the Company had increased resources allocated to our second generation product, the STERIZONE® 80L Sterilizer. This product, which targets the operating room sub-sterile area of large acute care facilities as well as smaller facilities and lower price point international markets, has been part of our development plans for the better part of two and a half years. Progress was made on its cycle development and pre-production prototypes were assembled. These devices will be used to conduct the final tests once, as we have stated many times in the past, the 510(k) is cleared on the original product. In addition, new innovations identified during the STERIZONE® 80L Sterilizer development were translated into patent applications and submitted for additional patent protection globally.

Aiming at selecting the best *go to market* strategy, a formal strategic review "process" took place during the year with the assistance of Desjardins Capital Markets. This process has led to discussions with more than one potential partner. However, the conclusion to these discussions is somewhat dependent on the timing of obtaining the US regulatory clearance.

Subsequent to year-end and based on the lack of US market clearance in 2013, the Company announced that it was proceeding with the collective dismissal of a portion of its workforce in order to preserve its resources. Such a move demonstrates our belief that a scaling-down to our operations was preferable to bolstering our balance sheet at the expense of severe dilution at a time when we believe we are close to the targeted regulatory milestone. This meant, however, that all non-essential activity (meaning that all resources not focused on the US clearance, both laboratory experiments and human) has been removed from the plan in 2014. We regret the impact of that decision on those loyal employees that departed.

So to be clear, the year 2014 will no doubt shape the future of TSO_3. We shall aim to obtain the US clearance in 2014. We have implemented steps to save the resources in order to achieve this goal while maintaining the systems required to support our existing customer base, and enable the Company to quickly access the markets globally post US clearance.

The team remains committed to the task. I would like to take this opportunity to thank the dedicated employees, both those that remain and those impacted by the collective dismissal, the Board of Directors for the oversight and counsel, and our shareholders for their continued support.

On a special note, I would like to thank Mr. Simon Robitaille, a TSO_3 co-founder, former Chief Science Scientific Officer and member of the Board of Directors, who recently gave notice of his resignation from the Board as a means of completing to finalize his retirement. Simon's dedication and council will be missed and I wish to acknowledge and thank him for his many contributions and support and I wish both, he and his entire family, only the best in their future endeavors!

R.M. (Ric) Rumble

Overview

TSO_3 was founded in June 1998 in Québec City and employed 62 people at the end of 2013. The Company's activities encompass research, development, limited commercialization and licensing of sterilization processes and accessories for heat-sensitive medical devices.

Initially, TSO_3 developed a unique sterilization process based solely on ozone as the sterilizing agent. It offered superior sterile efficacy and lower operating costs and was considered a "green" technology. However, this first generation product provided limited instrument compatibility and a relatively long sterilization cycle.

The first generation sterilizer received regulatory clearances from both Health Canada and the United States Food and Drug Administration. It also received additional clearances expanding the field of application to a wider range of complex surgical instruments, attesting to the high sterilization efficacy of the TSO_3 sterilization platform.

Despite its advantages, the first generation product did not succeed in addressing the overall market needs for compatibility, fast turn-around times and high-throughput and therefore, had limited commercial success achieving only 38 sales in North America by TSO_3's own sales force over a period of five years.

A renewed approach

In 2009, the Company developed a new sterilizer, the STERIZONE® 125L+ Sterilizer utilizing hydrogen peroxide as the sterilant and ozone, as well as a *Dynamic Sterilant Delivery System*™. This new product provides both improved cycle time and material compatibility enabling increased throughput of a wide range of medical devices - including some of the most complex and delicate instruments used in Minimally Invasive Surgeries (MIS).

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

Our business environment and the market drivers

Sterile reprocessing of medical devices is essential to ensure positive surgical outcomes. The use of non-sterile surgical instruments contributes to increased infection rates. This increases patient hospital stays, drives up the cost of care and can lead to increased mortality rates.

The growing and aging population worldwide (65 years +) demands more OR time, which in turn creates greater and growing demand for efficacious and high-throughput sterilization methods.

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

Why low temperature sterile reprocessing

While some medical instruments are designed for single use, the majority must be reprocessed between surgical cases and as such, need to be compatible with the sterilization process used. Traditionally, steam was used to sterilize surgical instruments.

Today's surgical suite is very different from those of the past. Currently, the trend continues towards the practice of minimally invasive surgery (MIS). Devices used in MIS are complex, expensive and delicate, and in most cases, do not tolerate the steam sterilization process – they require low temperature sterilization. These high-demand devices are a challenge for sterilization and are a major financial investment for hospitals.

Our competitive landscape

The Company competes in an industry characterized by both multinational and regional companies that market sterilization technologies. The main players in this space are STERIS Corporation, Johnson & Johnson, 3M Company, Getinge AB, and Belimed.

The low-temperature gas sterilization methods most commonly used today are Ethylene Oxide (EtO) and Hydrogen Peroxide (H2O2) sterilization systems. These methods offer "terminal sterilization" referring to the instruments being packaged and therefore, remaining sterile until opened at the surgical site. However, EtO is a toxic gas which requires aeration time for desorption of the chemistry; this keeps expensive inventory of medical devices captive for periods of 16 to 30 hours. Current H2O2 sterilization methods are fast, however they are very expensive to operate, and have limits as to efficacy and loading capacity based on their design.

Another method playing an important role in a sub-segment of low temperature sterilization is Liquid Chemical Sterilization. This type of process is used 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 require rinsing with extensively treated water that cannot be assured to be sterile. As such, instruments also cannot be assured to be sterile when used on a patient.

Each of these sterilization methods offers benefits to the customers, but none is a complete solution matching the customer need for high and cost effective throughput of complex and expensive medical devices. Therefore, customers have to purchase and support a combination of products to meet their daily requirements for sterile supplies.

2013 Annual Review

Regulatory Status

TSO_3 currently holds commercial clearance in Canada and Europe for the STERIZONE® 125L+ Sterilizer, as well as its accessories and consumables.

On January 28, 2013, the Company announced that it had re-filed a new 510(k) with the US Regulatory Authorities on the basis of a single cycle sterilizer with improved claims.

Early in second quarter, the Company had a follow-up communication with the US Regulatory Authorities. At that time, the US Regulatory Authorities expressed the opinion that there was no predicate to the STERIZONE® 125L+ Sterilizer available on the market suggesting the file was eligible to the *de novo* process and approval.

After continued review of the current 510(k) file and based on an additional discussion which took place early during the third quarter, the US Regulatory Authorities was able to conclude that the sterilizer could justify its Substantial Equivalence claim to a predicate device, allowing it to proceed through the 510(k) pathway for clearance. Additional communications with the US Regulatory Authorities continued throughout the year. On January 30, 2014, the Company announced that it had received confirmation from them that the 510(k) path was still appropriate and that, based on their latest communication, the Company believed it had received sufficient guidance to follow up with a new 510(k) submission that will meet the US Regulatory Authorities' requirements. Based on that, the Company is confident that it is on the right path towards market clearance of the STERIZONE® Sterilizer in the United States.

New Product Development

The terminal sterilization solution developed by TSO_3 can be favorably applied to multiple segments of the low-temperature sterilization market. In order to add to its revenue stream, TSO_3 had also initiated the development of additional products based on its patent-pending STERIZONE® technology.

The first of these new products, the STERIZONE® 80L Sterilizer, is targeting the need for a smaller device in the Operating Room sub-sterile area in the North American market, as well as a lower price-point product for some European markets.

As outlined in other communications, those projects in development were virtually halted in January 2014 simultaneously with the implementation of a contingency plan, including the planned dismissal of 30% of its work force, in order to protect the Company's resources against the risk that the US regulatory clearance would have additional delays.

Recent Commercial Activities

The Company had initiated marketing in Canada of the STERIZONE® 125L+ Sterilizer in 2011 under a distribution agreement with the 3M Company. The sterilizer was then distributed by the 3M Company under the brand name 3M™ Optreoz™ 125- Z sterilizer. On June 15, 2012, the Company issued a notice to the 3M Company terminating the distribution agreement. Further to that notice, the 3M Company disputed that TSO_3 had the right to terminate the distribution agreement. At the end of the second quarter 2013, TSO_3 announced that it had settled the ongoing dispute over the termination rights and that the 3M Company would no longer challenge its termination. The settlement of that dispute allowed TSO_3 to regain full control of its intellectual property and seek other strategic alternatives or go direct to the market.

Since the termination of the 3M agreement, sales have been essentially reduced to (1) services delivered to support the older 125L Ozone Sterilizer, whose installed base was seriously eroded as a result of the upgrade program successfully completed by TSO_3 in Q2-2012, and (2) consumables and service for the STERIZONE® 125L+ Sterilizer (formerly marketed under the brand name 3M™ Optreoz™ 125-Z Sterilizer). Since the settlement of its dispute with the 3M Company, the Company has not allocated significant resources to marketing and sales because these would be diverted from its core objective of gaining regulatory clearance to the US market.

Strategic Alternatives

In the second quarter, the Company announced that, while it is pursuing the US regulatory approval for the STERIZONE® Sterilizer as well as continuing commercial negotiations on a non-exclusive basis, the Company had initiated a formal process to assess the range of strategic alternatives available to the Company and engaged Desjardins Capital Markets to assist in this process. These steps are intended to maximize shareholder value post-regulatory clearance in the Unites Sates.

2014 Focus

- Obtain United States regulatory clearance for the STERIZONE® Sterilizer;

- Secure the right agreement and the right partner to achieve the global market potential for the STERIZONE® Sterilizer ;

- Maintain compliance with applicable laws and regulations to be able to ramp up activities when US regulatory clearance will have been obtained.

Forward Looking Statements

Certain statements contained in this annual report and the MD&A constitute forward-looking statements. These statements relate to future events or the Company's future performance, business prospects or opportunities and product development. All statements other than statements of historical facts may be forward-looking statements. Forward-looking statements are often, but not always, identified by the use of words such as "seek", "anticipate", "plan", "continue", "estimate", "expect, "may", "will", "project", "predict", "potential", "targeting", "intend", "could", "might", "should", "believe" and similar expressions. These statements involve known and unknown risks, uncertainties and other factors that may cause actual results or events to differ materially from those anticipated in such forward-looking statements.

The Company believes that the expectations reflected in those forward-looking statements are reasonable, but no assurance can be given that these expectations will prove to be correct. These statements speak only as of the date of this report. Such statements are based on a number of assumptions which may prove to be incorrect, including, but not limited to, assumptions about:

- Business and economic conditions;
- The ability to obtain sufficient quantities of materials when needed;
- The ability to obtain regulatory authorizations to market its product;
- The ability to attract and retain skilled staff;
- Market competition;
- Tax benefits and tax rates;
- The ability to complete research and development work; and
- The ability for the Company to market its products.
- The ability for the Company to attract capital.

These forward-looking statements involve risks and uncertainties relating to, among other things, commercial operations, compatibility, biocompatibility and research and development projects, dependency on key personnel, management of business growth, intellectual property and counterfeiting, competition, product liability issues, litigation, regulatory approvals and financial instruments. Actual results and developments are likely to differ, and may differ materially, from those expressed or implied by the forward-looking statements. Factors that could cause actual results to differ materially include, but are not limited to, the risk factors described under the section "Risk factors" of this report.

Investors should not place undue reliance on forward-looking statements as the plans, intentions or expectations upon which they are based might not occur. The Company cautions that the foregoing list of risk factors is not exhaustive. Investors and others who base themselves on the Company's forward-looking statements should carefully consider the above factors as well as the uncertainties they represent and the risk they entail. The reader must not unduly rely upon the Company's prospective statements.

Further, the Company does not intend, and does not assume any obligation, to update these forward looking statements, except as may be required by applicable laws.

The Management, Discussion and Analysis has been prepared as at March 18, 2014. 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.

Benoît Deschamps
Vice President of Finance and
Chief Financial Officer

March 18, 2014

Management Discussion and Analysis

The Management discussion and analysis (MD&A) is intended to help the readers to assess, through the eyes of management, the financial position and results of operations of TSO_3 ("TSO_3" or the "Company") for the twelve-month period ended December 31, 2013 and to compare them with the twelve-month period ended December 31, 2012. This information is dated March 18, 2014 and should be read in conjunction with the audited Financial Statements and the 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 Audited Financial Statements has been prepared in accordance with the International Financial Reporting Standards ("IFRS").

The Annual audited Financial Statements, accompanying notes and MD&A have been reviewed by the Audit and Risk Management Committee of TSO_3 and approved by the Board of Directors.

This MD&A contains forward-looking information. Additional information about the forward-looking information can be found on page 8 as well as the associated risks and uncertainties can be found on pages 22 to 28 of the report.

Summary of results

Years ended December 31 (Audited, IFRS Basis)

	2013 **$**	2012 $
Revenues		
Sales	**254,370**	1,162,922
License Revenue	**-**	1,690,971
Total Revenues	**254,370**	2,853,893
Expenses		
Supply Chain	**1,064,957**	1,801,735
Customer Support and Communications	**524,817**	639,766
Research and Development	**3,502,505**	2,877,203
Administrative	**2,721,811**	3,476,843
Settlement Cost	**1,864,127**	-
Financial Income	**(183,687)**	(167,708)
Financial Costs	**30,009**	21,652
Total Expenses	**9,524,539**	8,649,491
Net Loss before Income Taxes	**(9,270,169)**	(5,795,598)
IncomeTaxes	**-**	-
Net Loss and Total Comprehensive Loss attributable to Shareholders	**(9,270,169)**	(5,795,598)
Basic and Diluted Net Loss per Share	**(0.13)**	(0.09)
Weighted Average Number of Shares Outstanding	**71,739,270**	63,675,137

Results Analysis

In the following paragraphs, the Company discusses the variations of certain accounts within the 12-month periods ended December 31, 2013 and 2012.

TOTAL REVENUES

Sales

For the 2013 fiscal year, sales amounted to $254,370, as compared to $1,162,922 in 2012. Since June 2012 when TSO_3 terminated its distribution agreement with the 3M Company, the Company has concentrated its efforts on securing the required regulatory clearance to market its products in the United States. Sales in 2013 are made of sales of consumable supplies and services in connection with the installed base of sterilizers.

License Revenue

Until June 2012, TSO_3 was recognizing revenue over the expected initial term of its agreement with the 3M Company by amortizing the payments it had received under that agreement. In June 2012, as a result of the termination of the 3M agreement, all unamortized license payments were recognized as revenue. Therefore, since the end of the second quarter of 2012, there was no license revenue.

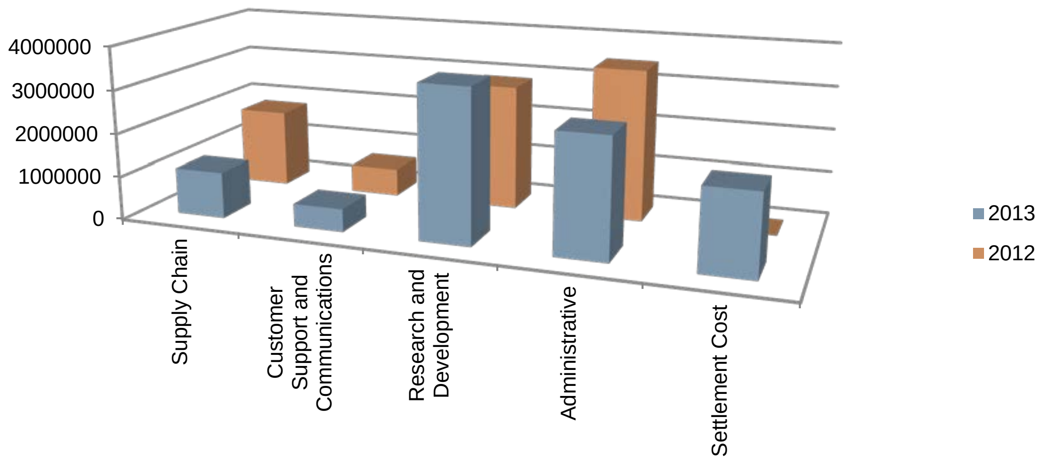
The $1,690,971 license revenues earned during the twelve-month period ended December 31, 2013 were primarily the result of the recognition, in June 2012, of the unamortized balance of $1,585,833 in deferred license revenues.

NET LOSS

In fiscal year 2013, the Company experienced a loss of $9,270,169 ($0.13 per share), as compared to $5,795,598 ($0.09 per share) in 2012. This increase of $3,474,571 is primarily due to three non-recurring items: (1) the recognition as revenue in June 2012 of $1,585,833 in unamortized license payments received in connection with the 3M distribution agreement, (2) the $1,864,127 settlement cost with the 3M Company incurred in June 2013, and (3) the recognition of $930,987 in investment tax credits in fiscal 2012, as compared to $289,128 in fiscal 2013.

When those three non recurrent items are removed from the reported loss, the adjusted loss is $7,695,170 ($0.11 per share) in 2013, down from $8,312,418 ($0.13 per share) in 2012.

EXPENSES



Supply Chain

Supply Chain expenses include all expenses incurred in connection with (1) the outsourcing services provided by the Supply Chain Department to all departments, (2) the production costs, (3) the related quality control and assurance expenses, and (4) the shipping expenses.

For the fiscal year ended December 31, 2013, the Supply Chain expenses amounted to $1,064,957, as compared to $1,801,735 in 2012. The variation is primarily due to a reduction in the sourcing activities as a result of lower sales since mid-Q2-2012 and a reduction of staffing due to attrition.

Customer Support and Communications

For the fiscal year ended December 31, 2013, the customer support and communication expenses amounted to $524,817, as compared to $639,766 expense incurred in 2012. The decrease is primarily due to reduced customer support activities during fiscal 2013.

Research and Development

Starting in Q2-2012, there has been a reallocation of research and development resources away from new product development and towards work related to the filings with the US Regulatory Authorities. Further to the refiling of its 510(k) submission in January 2013, the Company re-emphasized work related to new products development.

For the fiscal year ended December 31, 2013, research and development expenses were $3,502,505, as compared to $2,877,203 in 2012. This increase is due to the fact that the Company recognized $930,987 in R&D investment tax credits in fiscal 2012, as compared to $289,128 in fiscal 2013. Excluding these tax credits, the R&D expenditures were $3,791,633 in 2013, or virtually the same as the amount of $3,808,190 incurred in 2012. The small variation between 2013 and 2012 is the result of offsetting variations, the largest ones being an increase in costs incurred in connection to the protection of the Company's intellectual property, and a decrease in expenditures related to new product prototypes. The R&D tax credits recognized in 2012 included $603,521 related to the recording of un-booked R&D tax credits for the years 2008 to 2011 as a result of subsequent additional claims made by the Company.

Administrative

For the fiscal year 2013, the administrative expenses amounted to $2,721,811, as compared to $3,476,843 in 2012. Several items were smaller in 2013. The largest variations were the decrease in professional fees largely due to the settlement of the dispute with the 3M Company and the reduction of incentive-based compensation due to the elimination of bonuses in 2013.

Settlement Cost

The Company has recorded a $1,864,127 cost in connection with the settlement that it reached with the 3M Company. TSO_3 has always maintained, and still maintains, that both parties had the right to terminate the distribution agreement signed in December 2009. However, the 3M Company was disputing that right and a protracted litigation would have caused the Company to incur legal expenses and may have impacted its ability to obtain the right terms with a potential strategic partner. Therefore, the Company decided to incur the Settlement Cost in order to achieve a definitive conclusion of any dispute over the terminated agreement.

The Settlement Cost was a one-time payment of USD$2,000,000 (C$2,110,000) partly offset by the return of inventory held by the 3M Company and increased by the write-off of certain receivables in the amount of $16,195. The Company originally valued the returned inventory at $202,797 but re-assessed it to $262,068 at year-end on the basis of refurbishment expenditures incurred, and their prospective use.

Financial Income

For the year ended December 31, 2013, financial income amounted to $183,687, as compared to $167,708 in 2012.

Differences in investment amounts and interest rates explain the variation from 2012 to 2013.

Financial Position Analysis

(Audited, IFRS Basis)

	2013 **$**	2012 $
Cash and Cash Equivalents	**6,637,408**	7,758,103
Short-term Investments	**2,971,123**	5,049,087
Accounts Receivable	**1,165,666**	1,029,265
Inventories	**1,407,411**	1,216,721
Property, Plant and Equipment	**1,048,099**	1,208,394
Intangibles Assets	**3,027,739**	3,034,213
Accounts Payable and Accured Liabilities	**578,185**	842,867
Warranty Provision	**-**	62,032
Deferred Revenues (Current and Non-Current)	**91,905**	103,035
Equity	**15,641,270**	18,427,493

Liquid Assets

As at December 31, 2013, cash, cash equivalents and short-term investments amounted to $9,608,531, as compared to $12,807,190 as at December 31, 2012. The variation is primarily due to the cash absorbed by operations during fiscal 2013, which includes the US$2,000,000 cash payment to the 3M Company which was partly offset by the proceeds from the stock issue closed on March 4, 2013.

Accounts Receivable

On December 31, 2013, the accounts receivable were $1,165,666, comparatively with $1,029,265 on December 31, 2012. Substantially all of the receivables on those dates were made up of amounts recoverable from governments for research and development tax credits and input tax credits for sale taxes.

Inventories

As at December 31, 2013, inventories amounted to $1,407,411, as compared with $1,216,721 on December 31, 2012.

	2013 **$**	2012 $
Raw Materials	**1,001,932**	874 635
Work in Progress	**262,053**	111 470
Finished Goods	**143,426**	230 616
	1,407,411	1 216 721

On June 30, 2013, the Company entered into a Settlement Agreement with the 3M Company in order to reach a definitive conclusion on their dispute over the distribution agreement terminated by TSO_3 on June 15, 2012. As part of that agreement, the Company has paid an amount of US$ 2,000,000 to the 3M Company. That amount included payment for inventory held by the 3M Company and returned to TSO_3 as part of the Settlement Agreement. The inventory restocked by the Company included a net amount of $161,176 recorded as raw materials, $80,879 of sterilizers recorded as work in progress and $20,013 in supplies and accessories accounted for in finished goods inventory.

During 2013, the Company transferred sterilizers worth $128,015 ($247,980 in 2012) from its finished goods inventory to its property, plant and equipment to utilize them as part of its research and development activities. Finally, in 2013, primarily in connection with impaired or slow moving raw material inventories, the Company wrote-off inventories worth $140,941, as compared to $72,088 in 2012.

	2013	2012
	$	$
Inventories at the beginning of the exercice	**1,216,721**	1,120,482
Write-off of raw material inventories	**(140,941)**	(72,088)
Transfer to property, plant and equipment	**(128,015)**	(247,980)
Inventory returned by the 3M Company	**262,068**	-
Net addition to inventories	**197,578**	416,307
Inventories as at December 31	**1,407,411**	1,216,721

Other variations in inventory include (1) a marginal increase in raw materials inventory as a result of receiving raw materials ordered prior to the termination of the 3M Agreement, and (2) the use of raw materials in connection with service contracts and for work in progress in the assembly of sterilizers.

Property, Plant and Equipment

In 2013, the Company added $329,396 to its Property, Plant and Equipment, as compared to $480,188 during the same period in 2012. The bulk of these expenditures consisted in sterilizers and medical devices used as part of research and development activities.

Intangibles Assets

For fiscal year 2013, the Company capitalized $298,925 in intangible assets, as compared to $109,732 for the same period in 2012. These expenditures were for the most part made in connection with patents filed by the Company to improve the protection of its intellectual property.

Accounts Payable and Accrued Liabilities

As at December 31, 2013, accounts payable and accrued liabilities amounted to $578,185 as compared to $842,867 as at December 31, 2012. Most of the decrease experienced in 2013 was due to lower trade payables as a result of the lower sourcing activities. The remainder of the variation was due to the absence of bonuses payable for 2013.

Warranty Provision

There is no more warranty provision as at December 31, 2013 as compared to $62,032 on December 31, 2012. This elimination is due to the expiry of all of the warranties on sterilizers sold.

Deferred Revenues

As at December 31, 2013, current and non-current deferred revenues amounted to $91,905, as compared to $103,035 as at December 31, 2012.

Deferred revenues represent the prepaid portion of service contracts on the installed base of STERIZONE® 125L+ sterilizers and on the 125L Ozone Sterilizers commercialized by the Company up to 2009.

Shareholders' Equity

As at December 31, 2013, Shareholders' Equity amounted to $15,641,270, as compared with $18,427,493 as at December 31, 2012. Most of the variation is the net result of (1) an increase due to the net cash proceeds of $6,234,281 from the equity issue closed on March 4, 2013, (2) the absorption of the operating deficit for year of 2013, and (3) the Settlement Cost with the 3M Company.

Cash Flows Analysis

(Audited, IFRS Base)

	2013	2012
	$	$
Operating Activities	**(8,988,442)**	(6,469,004)
Investing Activities	**1,568,676**	(2,762,720)
Financing Activities	**6,299,071**	8,207,620

Operating Activities

Cash absorbed by Operating Activities amounted to $8,988,442 for the fiscal year ended December 31, 2013, as compared to $6,469,004 for the corresponding period in 2012.

The higher amount of cash absorbed by operations during 2013 is caused by the 3M settlement payment of US$ 2,000,000 (C$ 2,110,000) in June 2013, which was larger than the 2013 reduction in the cash used by operating activities.

Investing Activities

For the fiscal year ended December 31, 2013, cash flows generated by the Investing Activities amounted to $1,568,676 while these activities absorbed an amount of $2,762,720 during the same period in 2012.

The variation is almost equally caused by the monetization of short-term financial investments during 2013 and an increase in expenditures on patents.

Financing Activities

For the fiscal year ended December 31, 2013, cash flows from Financing Activities amounted to $6,299,071, as compared to $8,207,620 for the same period in 2012.

Both of these amounts primarily represent the net cash proceeds from the equity issues closed in 2012 and 2013.

Summary of Quarterly Results

(Unaudited, IFRS Basis)

This table shows the quarterly evolution of sales, net loss and net los per share.

($OOO EXCEPT LOSS/SHARE)				**2013**				2012
	Q4	**Q3**	**Q2**	**Q1**	Q4	Q3	Q2	Q1
Sales	**98**	**43**	**37**	**76**	59	66	310	728
License Revenue	**-**	**-**	**-**	**-**	-	-	1,639	52.5
Settlement Cost	**10**	**(69)**	**1,923**	**-**	-	-	-	-
Net Loss	**(1,415)**	**(1,949)**	**(3,806)**	**(2,100)**	(1,100)	(2,160)	(526)	(2,009)
Net Loss per Share (basic and diluted)	**(0.02)**	**(0.03)**	**(0.05)**	**(0.03)**	(0.02)	(0.03)	(0.01)	(0.03)

Fourth Quarter Analysis

(Unaudited, IFRS Basis)

Three month period ended December 31, 2013, compared to the three-month period ended December 31, 2012:

	FOURTH QUARTER 2013 $	FOURTH QUARTER 2012 $
Revenues		
Sales	**98,202**	59,140
License Revenue	**-**	-
Total Revenues	**98,202**	59,140
Expenses		
Supply Chain	**325,902**	270,543
Customer Support and Communications	**94,851**	168,170
Research and Development	**709,370**	(184,923)
Administrative	**404,262**	948,152
Settlement Cost	**10,098**	-
Financial Income	**(40,414)**	(37,815)
Financial Costs	**9,323**	(5,013)
Total Expenses	**1,513,392**	1,159,114
Net Loss before income Taxes	**(1,415,190)**	(1,099,974)
Income Taxes	**-**	-
Net Loss and Total Comprehensive Loss attributable to Shareholders	**(1,415,190)**	(1,099,974)
Basic and Diluted Loss per Share	**(0.02)**	(0.02)
Weighted Average Number of Shares Outstanding	**73,000,906**	65,888,182

TOTAL REVENUES

For the three-month period ended December 31, 2013, total revenues amounted to $98,202 primarily representing the sale of consumable supplies, service contracts, training and after-sale service as compared to $59,140 for the same period in 2012. No sterilizer was sold by the Company during either of these two periods.

NET LOSS

For the three-month period ended December 31, 2013, the Company recorded a net loss of $1,415,190, or $0.02 per share, compared to a net loss of $1,099,974, or $0.02 per share in 2012. The lower loss in 2012 was primarily the result of the recognition, in Q4-2012 of $930,987 in R&D investment tax credits, as compared to $170,673 in Q4-2013.

EXPENSES

Supply Chain

For the three-month period ended December 31, 2013, supply chain expenses amounted to $325,902, as compared to $270,543 for the same period in 2012. The increase experienced in 2013 is the result of the write-down of impaired and slow moving raw material inventories.

Customer Support and Communications

For the three-month period ended December 31, 2013, customer support and communications expenses amounted to $94,851, as compared to $168,170 for the same period in 2012. The decrease is primarily due to reduced customer support activities during Q4-2013.

Research and Development

For the three-month period ended December 31, 2013, research and development expenses amounted to $709,370, as compared to revenue of $184,923 for the same period in 2012. The variation is explained by the recognition, in Q4-2012 of $930,987 in R&D investment tax credits, as compared to $170,673 in Q4-2013. The amount recognized in Q4-2012 included $603,521 related to the recording of un-booked R&D tax credits for the years 2008 to 2011 as a result of subsequent additional claims made by the Company.

Administrative

For the three-month period ended December 31, 2013, administrative expenses amounted to $404,262, as compared to $948,152 for the same period in 2012. The difference between the two periods is primarily explained by a reduction in incentive-based compensation and a decrease in professional fees largely due to the settlement of the dispute with the 3M Company.

Cash Flows Analysis

(Unaudited, IFRS Basis)

	2013 **$**	2012 $
Operating Activities	**(1,630,044)**	(1,888,599)
Investing Activities	**(565,240)**	(106,828)
Financing Activities	**-**	(828)

Operating Activities

Cash absorbed by Operating Activities amounted to $1,630,044 for the three-month period ended December 31, 2013, as compared to $1,888,599 for the same period in 2012. The higher amount in 2012 was due to an increase in working capital in Q4-2012.

Investing Activities

For the three-month period ended December 31, 2013, cash flows absorbed by the Investing Activities amounted to $565,240 while these activities absorbed an amount of $106,828 for the same period in 2012. The increase experienced in 2013 was primarily the result of the monetization of short-term investments.

Financing Activities

For the three-month period ended December 31, 2013, there is no cash flows from Financing Activities as compared to an amounted of $828 in 2012.

Segmented Information

The Company is structured as a single operating segment.

Substantially all property, plant and equipment of the Company are located in Canada.

Sales are allocated between geographic areas based on the location of the invoiced client and are as follows for periods ended December 31:

	FOURTH QUARTER				TWELVE MONTHS			
	2013		2012		**2013**		2012	
	$	**%**	$	%	**$**	**%**	$	%
Canada	**88,533**	**90**	47,021	80	**212,047**	**83**	961,520	83
Rest of the world	**9,669**	**10**	12,119	20	**42,323**	**17**	201,402	17
	98,202	**100**	59,140	100	**254,370**	**100**	1,162,922	100

Up until June 15, 2012, the Company earned a material part of its revenues under the now-terminated distribution agreement with the 3M Company. Shipments to that client were made in Canada and elsewhere in the world.

Contractual Commitments

As at December 31, 2013, the contractual commitments for future fiscal years are as follows:

	2014	2015	2016	2017	2018
	$	$	$	$	$
Operating leases and service contracts	122,000	13,000	9,000	8,000	1,000

Off-Balance Sheet Arrangement

Other than disclosed under the heading "Contractual Commitments" and purchase orders issued in the normal course of business, the Company made no off-balance sheet arrangement during the fiscal year 2013.

Additional Disclosure – Unrecorded Tax Assets

The Company has accumulated a substantial amount of losses, unclaimed expenses and tax credits that could be claimed in the future to reduce income taxes on profits. The related deferred income tax assets would be recorded in the financial statements only when the Company concludes that these losses will probably be materialized by shielding profits from taxes, or otherwise. If the Company had reached this conclusion on December 31, 2013, an amount of $25,443,000 in tax assets would have been recorded based on an effective rate of 15% for federal taxes and 11.9% for provincial taxes.

Capital Resources

The Company needs capital primarily to finance its research and development activity, its supply chain, administrative and customer support and communications expenses, its working capital and its capital expenditures. The Company capital is comprised of share capital, reserve for share-based compensation and reserve for warrants.

In the past, the Company has financed its activities primarily through equity issues and, to a lesser extent, through investment tax credits. Given its history of negative earnings, it is unlikely at the present time that the Company could access senior debt financing in any meaningful amount from traditional sources such as commercial banks.

For the twelve-month period ended December 31, 2013, the average monthly cash burn rate was $791,478, as compared with $565,400 in 2012. A significant part of the increase in the burn rate in 2013 is due to the US$ 2,000,000 settlement cost paid to the 3M Company. When adjusted for that item, the average monthly burn rate in 2013 is reduced to $615,644 or $50,244 more than in 2012. The lower burn rate in 2012 was primarily caused by a net reduction of $1,327,072 in operating working capital (receivables, inventories and payables) experienced as a result of the reduction in sales. The cash burn rate for 2013 was not materially affected by variations in operating working capital and is more in line with the monthly average of about $650,000 experienced over the 24-month period covered by fiscal 2011 and 2012 which included the original build-up in working capital in 2011 and its recovery in 2012.

As at December 31, 2013, the Company had $9,608,531 in liquidities (cash, cash equivalents and short-term investments). At a burn rate of $615,644 per month, these liquidities would be sufficient to finance the Company's activities until April 2015.

The Company invests its liquidities in highly liquid short-term investments as required by its Investment Policy (see section on Risk Factors). These securities are chosen on the basis of foreseen cash requirements and safety.

As at December 31, 2013, the number of outstanding shares was 73,000,906.

Accounting Policies

See note 2 and 3 of our annual audited financial statements for the year ended December 31, 2013 for a detailed presentation of accounting policies, critical accounting judgments, key source of estimation uncertainty and futures accounting changes.

Risk Factors

The Company has identified certain risks and uncertainties that may have a material adverse effect on its business, results of operations, or financial condition. In any such case, the market price of its common shares could decline, and investors may lose all or part of their investment. Only potential investors who are experienced in high risk investments and who can afford to lose their entire investment should consider an investment in the Company.

The following list of risk factors is not expected to be exhaustive but investors should carefully consider them before purchasing securities of the Company. Accordingly, the Company does not, and nor should shareholders of the Company or purchasers of common shares, rely on forward-looking statements as a prediction of actual results. In addition, investors should understand that the Company operates in a rapidly changing business, economic and regulated environment, and new risk factors emerge from time to time. The risks described below are not the only ones the Company faces as additional risks not currently known to the Company or believed to be immaterial may also significantly impair its business operations.

Limited Revenue History and a History of Previous Losses

Since its inception in June 1998, TSO_3 has not yet generated significant revenues from the sale of its products except in the second half of 2011 and the first half of 2012. Until now, the Company has spent its resources in order to develop new products, submit and, in certain jurisdictions, obtain marketing clearances and conduct limited commercial activities. Additional investments in research and development are required to support the application for clearance in the United States, and to continue the development of new products based on the Company's technology. It is unknown whether any of TSO_3's current and future products will obtain the necessary clearances to be marketed in all major jurisdictions, including the United States.

Some of the products currently being developed may not be commercially available for some years to come or may be discontinued altogether, for reasons not within the control of the Company, and this may create difficulties or delays in operations or marketing efforts undertaken by TSO_3 as well as potential difficulties in achieving manufacturing and purchasing efficiencies.

Lack of revenue and the need for continued spending to support research and development and submissions to regulatory agencies has resulted in the accumulation of sizable losses since the Company was founded.

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, a manufacturer must identify an existing "predicate" device from which to compare the new technology. The Company has effectively demonstrated such "predicate" devices in the past with its first generation sterilizer.

The Company has obtained clearance in Canada and in the European Community for its new generation STERIZONE® 125L+ Sterilizer. While these are important markets and these clearances can be used in other countries, clearance in the United States of America is the most important clearance to obtain due to the size of that market and its importance in terms of practice. The Company first filed for clearance in the USA in December 2009. The predicate device then utilized was found by the US Regulatory Authorities not substantially equivalent to the STERIZONE® 125L+ Sterilizer. The Company refiled using another predicate device in June 2011. Since then, the Company has answered numerous questions from the US Regulatory Authorities. In response to these questions, in December 2012, the Company announced that it was adopting a simplified strategy in its application for clearance. In January 2013, the Company announced that it had refiled with the US Regulatory Authorities on the basis of a single cycle sterilizer with improved claims. Several communications with the US Regulatory Authorities occurred during 2013. In January 2014, the Company announced that it had received enough guidance from the US Regulatory Authorities to be able to file a new submission.

Although the Company is confident to obtain that clearance, there is no guarantee that such clearance will be obtained. Failure to obtain clearance in the United States would significantly reduce the eventual value of the Company's technology and its attractiveness for potential distributors.

Marketing and Distribution Challenges

Worldwide distribution of the Company's products critically depends on its channel partners, and the conditions of distribution agreements with such channel partners. Until June 15, 2012, TSO_3 had an agreement with the Infection Prevention Division of the 3M Company for the marketing, sale, distribution and service of its STERIZONE® 125L+ Sterilizer. On June 15, 2012, the Company terminated its distribution agreement with the 3M Company. On August 7, 2012, the Company announced that it had signed a letter of intent with Getinge Infection Control, a division of the Getinge AB, for the purpose of negotiating a worldwide distribution agreement. Since then, negotiations have been taking place but no final agreement has been reached.

There is no guarantee that an agreement with the right conditions will be reached with Getinge, or other potential partners. Although a worldwide distribution agreement is desirable from a marketing perspective, failure to obtain the US Regulatory Authorities clearance in a timely fashion may force the Company to enter into distribution agreements specific to certain territories.

To the extent that the Company relies on third parties, such as the 3M Company until June 15, 2012, to market and distribute its products, the commercial success of such products may become somewhat beyond the Company's control. Moreover, there can be no assurance that any agreement with these third parties will be beneficial to the Company.

Compatibility with Medical Instruments

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 hydrogen peroxide and ozone, TSO_3 seeks to expose instruments to a gentle cycle to reduce to a minimum the frequency and duration that the devices are exposed to hydrogen peroxide and ozone. Nevertheless, oxidation can produce several effects, depending on the material. In order to fully establish the true commercial value of its sterilization process, the Company must continue to demonstrate the compatibility of its technology with a wide range of medical instruments. Even though the tests and studies undertaken to date by TSO_3 have shown that its STERIZONE® Sterilization Process is compatible with the majority of medical instruments currently used in the hospital environment, the Company must maintain ongoing studies in this respect.

Intellectual Property and Technologies

The Company's success depends, in part, on the Company's ability to obtain patents or rights thereto, protect trade secrets and operate without violating the exclusive rights of third parties.

Although the Company already owns certain pending applications or issued patents, there is no guarantee that such patents are valid, that the pending applications will be allowed or that the Company will develop other patentable technologies in the future. Moreover, there can be no assurance that a patent granted to the Company or in respect of which the Company holds a license will make the related product more competitive, that third parties will not challenge the protection provided by the patent, or that the patents of third parties will not be detrimental to the Company's commercial activities.

There is no guarantee that other companies will not independently develop products similar to those of the Company, that they will not imitate the Company's products or that the Company's competitors will not develop products designed to circumvent the Company's exclusive proprietary rights.

In order to protect or enforce the intellectual property rights owned, used or commercialized by the Company, the Company may have to initiate legal proceedings against third parties. The Company may also have to defend claims brought against it or any purchaser or user of its products asserting that such product or process infringes intellectual property rights of third parties. Legal proceedings relating to intellectual property typically are expensive, take significant time and divert management's attention from other business matters. The cost of this litigation could adversely affect the business of the Company. Further, should the Company not prevail in an infringement lawsuit brought against it, the Company may have to pay substantial damages, and could be required to stop the infringing activity or obtain a license to use the patented technology. Such royalty or licensing agreements, if required, may not be available on acceptable terms, if at all. In the event a claim is successful against the Company and the Company cannot obtain a license to the relevant technology on acceptable terms, license a substitute technology or redesign potential products to avoid infringement, the business, financial condition and operating results of the Company could be materially adversely affected. Loss of patent protection could lead to new competition for the Company's current and future products, which could materially and adversely affect the financial prospects for the Company's products.

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 Board of Directors and Management have reviewed in 2013 the Company's succession plan for 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, production capacity, and financing requirements.

Competition Risks

The Company's products face intense competition. Most of the Company's competitors have greater financial resources and marketing capabilities than TSO_3 and, assuming that the Company succeeds in getting a new channel partner, several of the competitors may also have greater resources and capabilities that a new channel partner may make available to the commercial venture. TSO_3's competitors and potential competitors may succeed in developing products and processes that are more effective and less expensive to use than any products or processes the Company may develop or license, or that may render TSO_3's products or processes obsolete. The high level of competition in the sterilization industry could force the Company to reduce the price at which it sells its products.

Product Liability Issues

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

Need for Additional Capital and Liquidity

The Company faces a number of challenges in its business, including the fact that it currently has limited commercial activities while it awaits market clearance in the United States, the largest potential market for its products, and it still has one major product under development. This creates liquidity needs that must be funded through various rounds of investment capital. In order to reduce those cash requirements, the Company reduced its workforce during Q1-2014 and discontinued most product development efforts other than those related to its product under review with the US Regulatory Authorities. The ability by the Company to raise cash so as to maintain sufficient cash reserves to ensure continuation of activities may be adversely impacted by global political and economic conditions and by other risk factors identified in this MD&A. There can be no assurance that the Company will continue to be able to obtain on a timely basis sufficient funds to provide adequate liquidity and to finance the operating and capital expenditures necessary to overcome challenges and support its business strategy while its cash flows from operations are insufficient to support its operations.

Failure to generate additional funds, whether from operations or additional debt or equity financings, could require the Company to delay or abandon some or all of its anticipated expenditures or to modify its business strategy and could have a material adverse effect on the Company, its business prospects, results from operations and financial condition, including on its ability to complete certain internal development and commercialization projects or complete its submissions with regulatory agencies.

Challenging Global Political and Economical Conditions

The general economic and business conditions around the world affect the Company's business prospects and the demand for its products in Canada, the United States, Europe and elsewhere in the world. Such conditions include short- and long-term interest rates, inflation, fluctuations in debt securities markets and financial markets, exchange rates, the debt crisis affecting certain countries, volatility in the financial markets throughout the world, the tightening of liquidity in selected financial markets, and the strength of the regional and international economies.

All of these factors affect the business and economic conditions in a given geographic region and, consequently, affect the demand for the products developed or being developed by the Company. Currency rate movements in the United States and other countries where the Company seeks to market or distribute its products may significantly impact the Company's business prospects and future earnings as a result of foreign currency translation adjustments. The monetary policies of the Bank of Canada, the U.S. Federal Reserve and the European monetary authorities as well as other interventionist measures in capital markets by public organizations are impacting economic conditions and therefore have consequences on the Company's business prospects.

The Company has no control over changes in inflation and interest rates, foreign currency exchange rates and controls or other economic factors affecting its business or the possibility of political unrest, legal and regulatory changes in jurisdictions in which the Company operates or intends to market its products.

Financial Instruments

The Company's risk exposure includes the risk incurred in connection with its investments in financial instruments, namely cash, cash equivalents and short-term investments. In order to manage the risk entailed by these financial instruments, controls have been implemented and, in particular, an investment policy was adopted and implemented. The Company considers that the return on short-term investments is secondary to risk minimization and primarily aims to optimize cash flows from a maturity perspective. With respect to investments, the main risk exposures are as follows:

Market risk

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

Interest rate risk

Interest rate risk exists when interest rate fluctuations modify the cash flows of the Company's investments, including the price at which an investment could be sold.

As at December 31, 2013, if interest rates on that date had been 0.5% lower, and all other variables held constant, the net loss and total comprehensive loss for the period would have been $3,332 higher, arising mainly as a result of an increase in the fair value of fixed rate financial assets classified as fair value through profit or loss. If the interest rates on that date had been 0.5% higher, all other variables being held constant, the net loss and total comprehensive loss for the period would have been $3,312 lower, arising mainly as a result of a decrease in the fair value of fixed rate financial assets classified as fair value through profit or loss. The net loss therefore has a similar sensitivity to interest rate increases and interest rate decreases.

Credit Risk

The use of financial instruments can create a credit risk in which there is a risk of financial loss resulting from counterparty's inability or refusal to fully meet its contractual obligations. The Company's maximum exposure to credit risk is equal to the amounts recognized as accounts receivable, cash and cash equivalents and short-term investments.

The Investment Policy established by the Company addresses management of credit risk exposures and permits investments in securities or instruments issued by, or guaranteed by, the Canadian federal or provincial governments, crown corporations as well as certain municipalities and financial institutions, provided that the issuer or guarantor benefits from a credit rating not less than A- on the rating scale of Standard and Poor's or the equivalent for other credit rating agency. This policy sets limits to the size of exposures based on the credit risk of the counterparties.

As at December 31, 2013, the Company's investments were rated by two recognized agencies, and were within the credit metrics required by 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 at December 31, 2013, there was no single investment that exceeded the limit required under the Company's Investment Policy except a bank deposit that exceeded such limit by a non material amount.

Liquidity risk

Liquidity risk represents the possibility that the Company would be unable to monetize its financial instruments so as to meet financial commitments at the appropriate time and under reasonable conditions.

The Company's maximum exposure to liquidity risk is equal to the amounts recognized as accounts payable and accrued liabilities and these amounts will be paid in the following year. 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 securities.

Currency Risk

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

As at December 31, 2013, if the Canadian dollar had weakened 10 percent against the US dollar with all other variables held constant, the net loss and total comprehensive loss for the period would have been $17,731 lower. Conversely, if the Canadian dollar had strengthened 10 percent against the US dollar with all other variables held constant, the net loss and total comprehensive loss for the period would have been $17,731 higher.

Fair Value

The fair value of a financial instrument is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

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

Disclosure and Internal Controls

In compliance with the Canadian Securities Administrators' National Instrument 52-109, we have filed certificates signed by the Chief Executive Officer ("CEO") and the Chief Financial Officer ("CFO") that, among other things, report on the design and effectiveness of disclosure controls and procedures and the design and effectiveness of internal controls over financial reporting.

Disclosure controls and procedures

The CEO and the CFO have designed disclosure controls and procedures, or have caused them to be designed under their supervision, in order to provide reasonable assurance that (1) material information relating to the Corporation has been made known to them; and (2) information required to be disclosed in the Corporation's filings is recorded, processed, summarized and reported within the time periods specified in securities legislation.

At the end of the year ended December 31, 2013, an evaluation was carried out, under the supervision of the CEO and the CFO, of the design and effectiveness of our disclosure controls and procedures. Based on this evaluation, the CEO and the CFO concluded that the disclosure controls and procedures are effective.

Internal controls over financial reporting

The CEO and the CFO have also designed internal controls over financial reporting, or have caused them to be designed under their supervision, in order to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS.

At the end of the year ended December 31, 2013, an evaluation was carried out, under the supervision of the CEO and the CFO, of the design and effectiveness of our internal controls over financial reporting. Based on this evaluation, the CEO and the CFO concluded that the internal controls over financial reporting are effective, using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) on Internal Control – Integrated Framework.

Changes in internal controls over financial reporting

No changes were made to our internal controls over financial reporting that occurred during the quarter and fiscal year ended December 31, 2013 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

Management Report

Responsibility of the Financial Statements

The financial statements of TSO_3 Inc., which have been approved by the Board of Directors, were prepared by Management in accordance with International Financial Reporting Standards. It contains certain amounts based on best judgment and estimates as their final determination is dependent upon subsequent events. It is the opinion of Management that the accounting policies utilized are appropriate in the circumstances and are adequate to reflect the financial position and the results of operations within reasonable limits of materiality. The financial information presented elsewhere in this annual report is consistent with the information contained in the financial statements.

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

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

The functions of the Audit and Risk Management Committee are to:

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

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

The independent auditor is appointed to report to the shareholders regarding the fairness of presentation of the Company's financial statements. The independent auditor fulfills its responsibility by carrying out an independent audit of these statements in accordance with Canadian Generally Accepted Auditing Standards.

On behalf of Management,

Richard M. Rumble
President and CEO

Benoît Deschamps
Vice President Finance and CFO

Le 18 mars 2014

Financial Statements – December 31, 2013 and 2012

Independent Auditor's Report

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To the shareholders of
TSO_3 inc.

We have audited the accompanying financial statements of TSO_3 inc., which comprise the statements of financial position as at December 31, 2013, and 2012, and the statements of loss and total comprehensive loss, the statements of changes in equity and the statements of cash flows for the years then ended and a summary of significant accounting policies and other explanatory information.

Management's responsibility for the financial statements

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

Auditor's responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of TSO_3 inc. as at December 31, 2013 and 2012, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

Deloitte LLP[1]

March 18, 2014

[1)] CPA auditor, CA, public accountancy permit No. A107622

STATEMENTS OF LOSS AND TOTAL COMPREHENSIVE LOSS

Years ended December 31, 2013 and 2012 (in Canadian $)

	NOTES	**2013** **$**	2012 $
Revenues			
Sales	22	**254,370**	1,162,922
License Revenue	13	**-**	1,690,971
Total Revenues		**254,370**	2,853,893
Expenses	6		
Supply Chain		**1,064,957**	1,801,735
Customer Service and Communications		**524,817**	639,766
Research and Development		**3,502,505**	2,877,203
Administrative		**2,721,811**	3,476,843
Settlement Cost	4	**1,864,127**	-
Financial Income	5	**(183,687)**	(167,708)
Financial Costs	5	**30,009**	21,652
Total Expenses		**9,524,539**	8,649,491
Net Loss before Income Taxes		**(9,270,169)**	(5,795,598)
Income Taxes	20	**-**	-
Net Loss and Total Comprehensive Loss attributable to Shareholders		**(9,270,169)**	(5,795,598)
Basic and Diluted Net Loss per Share	23	**(0.13)**	(0.09)

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

STATEMENTS OF CHANGES IN EQUITY

Years ended December 31, 2013 and 2012 (in Canadian $)

	NOTES	SHARE CAPITAL	RESERVE-SHARE-BASED COMPEN-SATION	RESERVE – WARRANTS	DEFICIT	TOTAL
		$	$	$	$	$
Balance at January 1, 2012		89,920,532	3,533,130	-	(77,759,899)	15,693,763
Issuance of Share Capital and Warrants	14	8,694,000	-	276,000	-	8,970,000
Options exercised	14	96,121	(39,866)	-	-	56,255
Share-based Compensation	15	-	321,708	-	-	321,708
Compensation to Underwriters	14,16	(117,300)	-	117,300	-	-
Share Issue Expenses	14	(818,635)	-	-	-	(818,635)
Net Loss for the year		-	-	-	(5,795,598)	(5,795,598)
Balance at December 31, 2012		97,774,718	3,814,972	393,300	(83,555,497)	18,427,493
Balance at January 1, 2013		97,774,718	3,814,972	393,300	(83,555,497)	18,427,493
Issuance of Share Capital	14	7,000,000	-	-	-	7,000,000
Options exercised	14	100,922	(32,160)	-	-	68,762
Transfer to Deficit – Warrants expired	16	-	-	(393,300)	393,300	-
Share-based Compensation	15	-	184,875	-	-	184,875
Compensation to Underwriters	14,16	(77,000)	-	77,000	-	-
Share Issue Expenses	14	(769,691)	-	-	-	(769,691)
Net Loss for the year		-	-	-	(9,270,169)	(9,270,169)
Balance at December 31, 2013		104,028,949	3,967,687	77,000	(92,432,366)	15,641,270

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

STATEMENTS OF FINANCIAL POSITION

As at December 31, 2013 and 2012 (In Canadian $)

	NOTES	2013 $	2012 $
Current Assets			
Cash and Cash Equivalents	7	**6,637,408**	7,758,103
Short-term Investments	7	**2,971,123**	5,049,087
Accounts Receivable	8	**1,165,666**	1,029,265
Inventories	9	**1,407,411**	1,216,721
Prepaid Expenses		**53,914**	139,644
		12,235,522	15,192,820
Non-current Assets			
Property, Plant and Equipment	10	**1,048,099**	1,208,394
Intangible Assets	11	**3,027,739**	3,034,213
		4,075,838	4,242,607
		16,311,360	19,435,427
Current Liabilities			
Accounts Payable and Accrued Liabilities		**578,185**	842,867
Warranty Provision	12	**-**	62,032
Deferred Revenues		**91,905**	55,093
		670,090	959,992
Non-current Liabilities			
Deferred Revenues		**-**	47,942
		670,090	1,007,934
Equity			
Share Capital	14	**104,028,949**	97,774,718
Reserve – Share-based Compensation	15	**3,967,687**	3,814,972
Reserve – Warrants	16	**77,000**	393,300
Deficit		**(92,432,366)**	(83,555,497)
		15,641,270	18,427,493
		16,311,360	19,435,427

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

Approved by the Board

Director **Director**

STATEMENTS OF CASH FLOWS

Years ended December 31, 2013 and 2012 (in Canadian $)

	NOTES	2013 $	2012 $
Cash Flows from Operating Activities			
Net Loss before Income Taxes		**(9,270,169)**	(5,795,598)
Adjustments for:			
Depreciation of Property, Plant and Equipment	10	**486,255**	444,664
Amortization of Intangible Assets	11	**305,399**	302,254
Write-off Property, Plant and Equipment		**3,436**	45,511
Share-based Compensation		**184,875**	321,708
Investment Income	5	**(183,687)**	(193,895)
		(8,473,891)	(4,875,356)
Changes in non-cash operating working capital items	18	**(707,220)**	(1,761,402)
Interest received		**192,669**	167,754
Cash Flows used in Operating Activities		**(8,988,442)**	(6,469,004)
Cash Flows from Investing Activities			
Acquisition of Short-term Investments		**(9,026,369)**	(8,614,190)
Disposal of Short-term Investments		**11,095,351**	6,193,410
Acquisition of Property, Plant and Equipment		**(201,381)**	(232,208)
Acquisition of Intangible Assets		**(298,925)**	(109,732)
Cash Flows generated by (used in) Investing Activities		**1,568,676**	(2,762,720)
Cash Flows from Financing Activities			
Issuance of Share Capital and Warrants	14	**7,000,000**	8,970,000
Payment for Share Issue Expenses	14	**(769,691)**	(818,635)
Options exercised	14	**68,762**	56,255
Cash Flows generated by Financing Activities		**6,299,071**	8,207,620
Decrease in Cash and Cash Equivalents		**(1,120,695)**	(1,024,104)
Cash and Cash Equivalents at the beginning		**7,758,103**	8,782,207
Cash and Cash Equivalents at the End		**6,637,408**	7,758,103

Additionnal information is presented in Note 18.

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

Notes to the Financial Statements

YEARS ENDED DECEMBER 31, 2013 AND 2012

1. Description of Business

TSO_3 ("the Company") exists under the Business Corporations Act (Québec). Its activities encompass research, development, limited commercialization and licensing of sterilization processes, related consumable supplies and accessories for heat-sensitive medical devices. The head office of the Company is located at 2505, avenue Dalton, Québec (Québec), Canada.

2. Accounting Policies

Statement of Compliance

The Financial Statements have been prepared in accordance with International Financial Reporting Standards (IFRS), included in the CPA Canada Handbook.

Standards adopted

In June 2011, the International Accounting Standards Board (IASB) issued an amendment to IAS 1 – Presentation of Items of Other Comprehensive Income. This amendment requires items of other comprehensive income to be grouped into those that will and will not be reclassified to profit and loss in the future. The Company adopted this new amendment on January 1, 2013. As the Company does not have any element of reconciliation between Net Loss and Total Comprehensive Loss, this amendment had no impact on its financial reporting.

IFRS 13 – Fair value measurement establishes a single framework for measuring fair value where such required measure was under other IFRS. IFRS 13 applies to financial and non-financial items measured at fair value. Under IFRS 13, fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The Company adopted this new standard on January 1, 2013 and discloses the information in the section "Financial Instruments" (Note 7). IFRS 13 had no impact on the Net Loss and Total Comprehensive Loss.

Basis of Presentation

The financial statements have been prepared on a going concern basis, at historical cost, except for certain financial instruments that are measured at fair value, as explained in the accounting policies below. Historical cost is generally based on the fair value of the consideration given in exchange for assets.

The principal accounting policies are set out hereafter.

Notes to the Financial Statements

YEARS ENDED DECEMBER 31, 2013 AND 2012

2. Accounting Policies (cont'd)

Presentation Currency and Foreign Currency Translation

The financial statements are presented in Canadian dollars, which is also the functional currency of the Company.

Foreign currency transactions are translated into Canadian dollars as follows: monetary assets and liabilities are translated at the exchange rates in effect at the financial position 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 recorded in net income.

Revenue Recognition

Sales

The Company generates revenue from the sale of sterilizers as well as parts, consumable supplies and accessories related to these units. For such sales, the Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred, the price to the buyer is fixed or determinable and collection is reasonably assured. In addition, the Company earns revenue from service contracts that is recognized using the straight-line method over the term of each contract.

Financial Income

Financial Income from a financial asset is recognized when it is probable that the economic benefits will flow to the Company and the amount of income can be measured reliably. Financial income is accounted for on an accrual basis, by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that discounts estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount on initial recognition.

License Revenues

Up until June 30, 2012, the license revenues and the deferred license revenues resulted from a distribution agreement with the 3M Company. This agreement included license revenues that had been paid but were recognized on a straight line basis over the expected initial term of the agreement. The Company terminated that agreement on June 15, 2012. Any license revenue unrecognized on the termination date was recognized in June 2012.

Notes to the Financial Statements

YEARS ENDED DECEMBER 31, 2013 AND 2012

2. Accounting Policies (cont'd)

Share-based Compensation

The Company uses the fair value method to measure compensation expense at the date of award of stock options to employees. Fair value is determined using the Black-Scholes option pricing model and is amortized to net income over the vesting period with an offset to the Reserve - Share-based Compensation. The amortization of the fair value is based on a graded vesting approach over the vesting period, and takes into consideration the number of options which are expected to vest. The forfeiture rate is revised at each reporting period and changes are recorded to net income. When options are exercised, the corresponding Reserve - Share-based Compensation and the proceeds received by the Company are credited to share capital. The Stock option plan is an equity-settled plan.

Income Taxes

The Company follows the liability method of accounting for income taxes. Under this method, deferred income taxes are recognized based on the expected future tax consequences of differences between the carrying amount of financial position items and their corresponding tax basis, using the enacted and substantively enacted income tax rates for the years in which the differences are expected to reverse. Deferred income tax assets are recognized in net income only if their realization is considered probable.

Government Assistance and Research and Development Tax Credits

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 tax authorities. Government assistance, including the tax credits for scientific research and experimental development costs, is presented as a reduction of the related expense.

Inventories

The cost of inventories is essentially determined using the first-in, first-out method. The specific identification of the individual cost is also used for inventories segregated for specific projects. In both cases, 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 rates. Inventories are valued at the lower of cost and net realizable value.

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 and the new carrying amount is the lower of the cost or the revised net realizable value.

Notes to the Financial Statements

YEARS ENDED DECEMBER 31, 2013 AND 2012

2. Accounting Policies (cont'd)

Property, Plant and Equipment

Property, plant and equipment are recorded initially and subsequently at cost less depreciation and impairment. Depreciation is calculated using the straight-line method over their estimated useful life taking into account any residual value, as follows:

Office Furniture and Lift Truck	10 years
Equipment and Tools	7 years
Sterilizers used Internally	5 years
Stand	5 years
Medical Devices	3 years
Computer Equipment	3 years
Leasehold Improvements	2 years

The residual value, depreciation method and the useful life of an asset are reviewed at each financial year-end.

Intangible Assets

Intangible assets are recorded initially and subsequently at cost less amortization and impairment. Amortization is calculated using the straight-line method over their estimated useful lives taking into account any residual value, as follows:

Acquired in a Business Combination	
Technology	20 years
Acquired Externally	
Patents	20 years
License	16 years
Software	3 years
Trademarks	10 and 15 years
Web Site	3 years

The residual value, amortization method and the useful life of an asset are reviewed at each financial year-end.

Notes to the Financial Statements

YEARS ENDED DECEMBER 31, 2013 AND 2012

2. Accounting Policies (cont'd)

Impairment of Property, Plant and Equipment and Intangible Assets

At the end of each reporting period, assets are reviewed for indication of any impairment. When such indicators are identified, the Company is required to perform an impairment test in order to measure the asset's recoverable value and to establish the amount of the impairment loss, if any. If it is not possible to determine the recoverable value for an individual asset, then the recoverable value of the asset is determined on the basis of its cash generating unit.

The recoverable value is the higher of (1) an asset's fair value less the cost to sell it and (2) its value in use. Value in use is the present value of estimated future cash flows discounted using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which estimated future cash flows were not adjusted.

If the asset's (or a cash generating unit's) estimated recoverable value is lower than its carrying value, the asset's (or the cash generating unit's) carrying value is reduced to its recoverable value. An impairment loss is immediately recognized in the Statement of Loss and Total Comprehensive Loss.

Where an impairment loss subsequently reverses, the carrying value of the asset is increased to the revised estimate of its recoverable value, but such reversal may not increase the carrying value in excess of the carrying value that would have been determined had no impairment loss been recognized for the asset in prior years. A reversal of an impairment loss is recognized immediately in the Statement of Loss and Total Comprehensive Loss.

In 2013, considering its loss history, the Company performed an impairment test. The results allowed the Company to conclude that no impairment loss needs to be recorded.

Warranty Provision

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

Warrants

The Company uses the fair value method to measure the value of warrants at the award date. Fair value is determined using the Black-Scholes option pricing model and is recorded as part of the Reserve - Warrants. When warrants are exercised, the corresponding Reserve - Warrants and the proceeds received by the Company are credited to Share Capital.

Notes to the Financial Statements

YEARS ENDED DECEMBER 31, 2013 AND 2012

2. Accounting Policies (cont'd)

Financial Instruments

Financial assets and financial liabilities are recognized when the Company becomes a party to the contractual provisions of the instrument.

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 of Financial Instruments

Category	Classification
Cash	Loans and Receivables
Cash Equivalents	Fair value through profit or loss
Short-term Investments	Fair value through profit or loss
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 from the date of acquisition and money market funds. These investments are highly liquid and are held for the purpose of meeting short-term cash commitments. Cash equivalents are recorded at fair value. Increases and decreases in fair value are recognized through net income and presented under "Change in the Value of Investments held as Cash Equivalents" in the "Financial Income" of the Statement of Loss and Total Comprehensive Loss (Note 5).

Short-term Investments

Short-term investments are instruments presented at fair value through profit or loss because they will be used for short-term cash commitments. These investments are recorded at fair value. Increases and decreases in fair value are recognized as investment income.

Notes to the Financial Statements

YEARS ENDED DECEMBER 31, 2013 AND 2012

2. Accounting Policies (cont'd)

Financial Instruments (cont'd)

Loans and Receivables

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

Other Liabilities

Other liabilities are recorded at amortized cost using the effective interest method.

Transaction Costs

Transaction costs related to financial assets presented at fair value through profit or loss are expensed as incurred. Transaction costs related to other liabilities and to loans and receivables are added to the carrying value of the asset or are netted against the carrying value of the liability and are then recognized over the expected life of the instrument using the effective interest method.

Fair Value

The fair value of a financial instrument is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

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

Critical Accounting Judgments and Key Sources of Estimates Uncertainty

In the application of the Company's accounting policies, which are described in this note, management is required to make judgments, estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates. The following are the critical judgments and key sources of estimates:

Notes to the Financial Statements

YEARS ENDED DECEMBER 31, 2013 AND 2012

2. Accounting Policies (cont'd)

Critical Accounting Judgments and Key Sources of Estimates Uncertainty (cont'd)

1. *Recoverability of Long-lived Assets:*

   On an annual basis the Company evaluates if there are indicators of impairment. When such indicators are identified, the Company is required to perform an impairment test in order to measure the recoverable amount of its long-lived assets. The main judgments made by management for the impairment test performed as at December 31, 2013 were the following:

   - Most probable discounted cash flow projections based on management's best estimate of the range of economic conditions that will exist over the remaining useful life of the intangible assets and property, plant and equipment;

   - A pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the intangible assets and property, plant and equipment.

2. *Inventory Valuation:*

   On a regular basis, the Company evaluates the value of its inventories. The obsolescence and the net realizable value are reviewed on an ongoing basis by management of the supply chain function, based on its experience and knowledge of the current market conditions.

3. *Government Assistance and Research and Development Tax Credits*

   Government assistance and research and development tax credits are 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. In general, the Company recognizes 80 % of the amount that it expects to receive.

4. *Share-based Compensation:*

   The Share-based Compensation expense pertaining to the options awarded has been amortized using the graded vesting method. The options awarded pursuant to this plan generally vest over a three-year period and may be exercised within a maximum of 10 years of the award date. The Company uses judgment in evaluating the expected volatility, the risk free-rate as well as the estimated number of options that will vest.

Notes to the Financial Statements

YEARS ENDED DECEMBER 31, 2013 AND 2012

2. Accounting Policies (cont'd)

Critical Accounting Judgments and Key Sources of Estimates Uncertainty (cont'd)

5. *Deferred Taxes Income:*

The deferred income tax assets will be recorded in the financial statements only when the Company concludes that these losses will probably be materialized by shielding profits from taxes or otherwise. The tax assets amount will be recorded based on an effective rate of 15% for federal taxes and 11.9% for provincial taxes.

6. *Settlement Cost:*

The Company initially assessed the value of the inventories returned as part of its settlement with the 3M Company based on a list of items received and on the estimated refurbishment cost of few items received. Once items received, and upon completion of refurbishment expenditures, the Company reassessed the value of those inventories. The obsolescence and the net realizable value are assessed based on management's experience and knowledge of the current market conditions.

For all these items, relevant accounting policies are discussed in the other parts of Note 2.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both the current and future periods.

3. Future Accounting Changes

In May 2013, the IASB published amendments to IAS 36: Recoverable Amount Disclosures for Non-Financial Assets. These amendments to IAS 36 Impairment of Assets propose adding additional disclosure about the recoverable amount of impaired assets if that amount is based on the fair value net of costs of disposal, and also clarify the IASB's intention concerning disclosure on this recoverable value following the application of IFRS-13 "Fair Value Measurement". The amendments are to be applied retrospectively for annual periods beginning on or after January 1, 2014. Early adoption is permitted when the entity has already applied IFRS 13. The Company is currently evaluating the impact of this new standard on its financial statements.

Notes to the Financial Statements

YEARS ENDED DECEMBER 31, 2013 AND 2012

3. Future Accounting Changes (cont'd)

The IASB published IFRS 9 "Financial Instruments", which replaces the provisions of IAS 39 "Financial Instruments: Recognition and Measurement," for the classification and measurement of financial assets and liabilities. The provisions of IFRS 9 were initially scheduled to apply to financial statements for periods beginning on or after January 1, 2013. On December 16, 2011, the IASB published an amendment to IFRS 9, in order to defer the mandatory effective date to annual periods beginning on or after January 1, 2015. On November 19, 2013, the IASB removed the January 1, 2015 mandatory effective date; the new date will be determine when the entire IFRS 9 will be close to completion. Early adoption is permitted. The Company is currently evaluating the impact of this new standard on its financial statements.

4. Settlement Cost

Until June 15, 2012, the Company had a distribution agreement with the 3M Company. On June 15, 2012, on the basis of a right granted to each party to the agreement, TSO_3 issued to the 3M Company a termination notice. The 3M Company disputed that termination notice. On June 30, 2013, TSO_3 and the 3M Company reached an agreement to settle definitively their dispute about the terminated agreement.

As part of this agreement, the Company incurred a net Settlement Cost of $1,864,127. This cost is made of a single payment of US$2,000,000 (C$2,110,000) which was partly offset by the return of inventory held by the 3M Company (Note 9) and increased by the write-off of certain receivables for an amount of $16,195. The Company originally valued the returned inventory at $202,797 but re-assessed it to $262,068 at the year-end once the items received and refurbishment expenditures incurred.

5. Financial Income and Costs

	2013 $	2012 $
Financial Income		
Investment Income	**(183,687)**	(193,895)
Change in the Value of Investments held as Cash Equivalents	**-**	26,187
	(183,687)	(167,708)
Financial Costs		
Bank Charges	**31,510**	12,161
Foreign Exchange Loss (gain)	**(1,501)**	9,837
Miscellaneous	**-**	(346)
	30,009	21,652

Notes to the Financial Statements

YEARS ENDED DECEMBER 31, 2013 AND 2012

6. Additional Information on the Statements of Loss and Total Comprehensive Loss

EXPENSES INCLUDED IN FUNCTIONS	**2013** **$**	2012 $
Salary and other Benefits	**4,754,795**	5,079,592
Supply Chain		
Customer Service and Communications		
Research and Development		
Administrative		
Depreciation of Property, Plant and Equipment	**486,255**	444,664
Supply Chain		
Customer Service and Communications		
Research and Development		
Administrative		
Amortization of Intangible Assets	**305,399**	302,254
Supply Chain		
Customer Service and Communications		
Research and Development		
Administrative		

7. Financial Instruments

Cash and Cash Equivalents

	2013 **$**	2012 $
Cash	**4,638,533**	6,305,645
Short-term Investments less than three months		
Interest-bearing Saving Account	**1,998,875**	-
Money Market Funds	**-**	1,452,458
	6,637,408	7,758,103

No Money Market Funds were held as at December 31, 2013 (Money Market Funds were rated AA- as of December 31, 2012).

Notes to the Financial Statements

YEARS ENDED DECEMBER 31, 2013 AND 2012

7. Financial Instruments (cont'd)

Cash and Cash Equivalents (cont'd)

Money market funds held by the Company are classified as level 1 under IFRS 7 because their valuations are based on quote, prices, and active markets (unadjusted) for identical assets or liabilities. There fair value is the closing price on an active market on the measurement date.

Short-term Investments

	2013	2012
	$	$
Bank Guaranteed Investment Certificates	**2,971,123**	5,049,087

As at December 31, 2013, Bank Guaranteed Investment Certificates were rated AA- or better by two recognized rating agencies and had a yield of 1.47 % versus rated AA- or better with a yield of 1.60% as of December 31, 2012.

The Bank Guaranteed Investment Certificates and the Interest Bearing Saving Account held by the Company are classified as level 2 under IFRS 7 because their valuation model is based on inputs other than quoted prices included in Level 1 that are observable for the assets for liability, either directly or indirectly. Their fair value is calculated using the expected cash flow method discounted at the market rate on the measurement date.

No transfer between Level 1 and Level 2 of the fair value hierarchy has been made during the period.

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 and cash equivalents and short-term investments, controls have been implemented and, in particular, an investment policy was adopted and implemented. The Company considers that the return on short-term investments is secondary to risk minimization and primarily aims to optimize cash flows from a maturity perspective. With respect to investments, the main risk exposures are as follows:

Market Risk

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

Notes to the Financial Statements

YEARS ENDED DECEMBER 31, 2013 AND 2012

7. Financial Instruments (cont'd)

Interest Rate Risk

Interest rate risk exists when interest rate fluctuations modify the cash flows of the Company's investments, including the price at which an investment could be sold.

At December 31, 2013, if interest rates on that date had been 0.5% lower, and all other variables held constant, the net loss and total comprehensive loss for the year would have been $3,332 higher ($3,247 for the year ended December 31, 2012), arising mainly as a result of an increase in the fair value of fixed rate financial assets classified at fair value through profit or loss. If the interest rates on that date had been 0.5% higher, all other variables being held constant, the net loss and total comprehensive loss for the year would have been $3,312 lower ($3,229 for the year ended December 31, 2012), arising mainly as a result of a decrease in the fair value of fixed rate financial assets classified at fair value through profit or loss. The net loss therefore has a similar sensitivity to interest rate increases and interest rate decreases.

Credit Risk

The use of financial instruments can create a credit risk in which there is a risk of financial loss resulting from counterparty's inability or refusal to fully meet its contractual obligations. The Company's maximum exposure to credit risk is equal to the amounts recognized as accounts receivable, cash and cash equivalents and short-term investments.

The Investment Policy established by the Company addresses management of credit risk exposures and permits investments in securities or instruments issued by, or guaranteed by, the Canadian federal or provincial governments, crown corporations as well as certain municipalities and financial institutions, provided that the issuer or guarantor benefits from a credit rating not less than A- on the rating scale of Standard and Poor's or the equivalent for other credit rating agency. This policy sets limits to the size of exposures based on the credit risk of the counterparties.

As at December 31, 2013 and December 31, 2012, the Company's investments were rated by two recognized agencies, and were within the credit metrics required by the Company's investment policy.

Notes to the Financial Statements

YEARS ENDED DECEMBER 31, 2013 AND 2012

7. Financial Instruments (cont'd)

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 at December 31, 2013 and December 31, 2012, there was no single investment that exceeded the limit required under the Company's Investment Policy.

Liquidity Risk

Liquidity risk represents the possibility that the Company would be unable to monetize its financial instruments so as to meet financial commitments at the appropriate time and under reasonable conditions.

The Company's maximum exposure to liquidity risk is equal to the amounts recognized as accounts payable and accrued liabilities and these amounts will be paid in the following year. 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 securities.

Currency Risk

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

As at December 31, 2013, if the Canadian dollar had weakened 10 percent against the US dollar with all other variables held constant, the net loss and total comprehensive loss for the year would have been $17,731 lower ($26,979 for the year ended December 31, 2012). Conversely, if the Canadian dollar had strengthened 10 percent against the US dollar with all other variables held constant, the net loss and total comprehensive loss for the year would have been $17,731 higher ($26,979 for the year ended December 31, 2012).

Notes to the Financial Statements

YEARS ENDED DECEMBER 31, 2013 AND 2012

8. Accounts Receivable

	2013	2012
	$	$
Accounts Receivables	**92,923**	55,034
Government Credits Receivable	**1,072,743**	968,820
Other	**-**	5,411
	1,165,666	1,029,265

There were no bad debt allowances as at December 31, 2013 (none as of December 31, 2012).

9. Inventories

	2013	2012
	$	$
Raw Materials	**1,001,932**	874,635
Work in Progress	**262,053**	111,470
Finished Goods	**143,426**	230,616
	1,407,411	1,216,721

In accordance with the settlement agreement concluded on June 30, 2013, the 3M Company has returned to TSO_3, inventories that it held. These inventories include a net amount of $161,176 recorded as raw materials, $80,879 of sterilizers recorded as work in progress and $20,013 in supplies and accessories accounted for in finished goods inventory (Note 4).

Supply Chain expenses include a write-down of raw materials of $140,941 for year ended December 31, 2013 ($72,088 in 2012).

For fiscal year 2013, the Company transferred $128,015 to its property, plant and equipment to account for sterilizers used internally ($247,980 in 2012).

Notes to the Financial Statements

YEARS ENDED DECEMBER 31, 2013 AND 2012

10. Property, Plant and Equipment

	OFFICE FURNITURE $	LIFT TRUCK $	EQUIPMENT AND TOOLS $	STERILIZERS USED INTERNALLY $	STAND $	MEDICAL DEVICES $	COMPUTER EQUIPMENT $	LEASEHOLD IMPROVE-MENTS $	TOTAL $
Cost									
Balance as January 1, 2013	187,121	14,115	1,173,220	986,762	22,735	391,758	594,958	197,788	3,568,457
Additions	10,854	-	27,293	128,015	3,481	144,663	15,090	-	329,396
Write-off	-	-	(2,967)[1)]	-	(22,735)[1)]	-	(479,058)[1)]	(4,725)[1)]	(509,485)
Balance at December 2013	197,975	14,115	1,197,546	1,114,777	3,481	536,421	130,990	193,063	3,388,368
Accumulated Depreciation									
Balance as January 1, 2013	135,306	14,115	888,930	361,215	21,392	222,469	519,396	197,240	2,360,063
Depreciation	12,273	-	104,848	207,915	869	120,445	39,357	548	486,255
Eliminated on Write-off	-	-	(353)[1)]	-	(21,913)[1)]	-	(479,058)[1)]	(4,725)[1)]	(506,049)
Balance at December 31, 2013	147,579	14,115	993,425	569,130	348	342,914	79,695	193,063	2,340,269
Carrying Amount at December 31, 2013	50,396	-	204,121	545,647	3,133	193,507	51,295	-	1,048,099

[1)] In 2013, the Company wrote off a cost amount of $4,725 in leasehold improvements, $2,967 for production tools, $479,058 for computer equipment which were no longer used and $22,735 for a stand replaced, and the depreciation related to those cost amounts.

Notes to the Financial Statements

YEARS ENDED DECEMBER 31, 2013 AND 2012

10. Property, Plant and Equipment (cont'd)

	OFFICE FURNITURE $	LIFT TRUCK $	EQUIPMENT AND TOOLS $	STERILIZERS USED INTERNALLY $	STAND $	MEDICAL DEVICES $	COMPUTER EQUIPMENT $	LEASEHOLD IMPROVE-MENTS $	TOTAL $
Cost									
Balance at January 1, 2012	186,189	14,115	1,121,985	794,509	22,735	278,370	528,305	197,788	3,143,996
Additions	932	-	51,235	247,980	-	113,388	66,653	-	480,188
Write-off	-	-	-	(55,727)[1)]	-	-	-	-	(55,727)
Balance at December 31, 2012	187,121	14,115	1,173,220	986,762	22,735	391,758	594,958	197,788	3,568,457
Accumulated Depreciation									
Balance at January 1, 2012	121,493	13,140	787,549	189,184	20,497	114,896	488,785	189,801	1,925,615
Depreciation	13,813	705	101,381	182,247	895	107,573	30,611	7,439	444,664
Eliminated on Write-off	-	-	-	(10,216)[1)]	-	-	-	-	(10,216)
Balance at December 31, 2012	135,306	14,115	888,930	361,215	21,392	222,469	519,396	197,240	2,360,063
Carrying amount at December 31, 2012	51,815	-	284,290	625,547	1,343	169,289	75,562	548	1,208,394

[1)] In 2012, the Company wrote off a cost amount of $55,727 for sterilizers of the former generation which were no longer used in its R&D activities, and the depreciation related to this cost amount.

Notes to the Financial Statements

YEARS ENDED DECEMBER 31, 2013 AND 2012

11. Intangible Assets

	TECHNOLOGY $	PATENTS $	LICENSE $	SOFTWARE $	TRADEMARKS $	WEB SITE $	TOTAL $
Cost							
Balance at January 1, 2013	2,984,124	873,713	991,063	610,876	104,727	54,691	5,619,194
Additions	-	294,193	-	1,053	3,679	-	298,925
Write-off	-	-	-	(491,559)[1)]	-	-	(491,559)
Balance at December 31, 2013	2,984,124	1,167,906	991,063	120,370	108,406	54,691	5,426,560
Accumulated Amortization							
Balance at January 1, 2013	1,191,683	193,757	557,472	556,154	31,224	54,691	2,584,981
Amortization	149,206	51,039	61,943	33,208	10,003	-	305,399
Eliminated on Write-off	-	-	-	(491,559)[1)]	-	-	(491,559)
Balance at December 31, 2013	1,340,889	244,796	619,415	97,803	41,227	54,691	2,398,821
Carrying Amount at December 31, 2013	1,643,235	923,110	371,648	22,567	67,179	-	3,027,739

1) In 2013, The Company wrote off a cost amount of $491,559 for software no longer used, and the depreciation related to this cost amount.

	TECHNOLOGY $	PATENTS $	LICENSE $	SOFTWARE $	TRADEMARKS $	WEBSITE $	TOTAL $
Cost							
Balance at January 1, 2012	2,978,874	789,174	991,063	594,125	101,535	54,691	5,509,462
Additions	5,250	84,539	-	16,751	3,192	-	109,732
Balance at December 31, 2012	2,984,124	873,713	991,063	610,876	104,727	54,691	5,619,194
Accumulated Amortization							
Balance at January 1, 2012	1,042,607	152,185	495,531	517,918	21,564	52,922	2,282,727
Amortization	149,076	41,572	61,941	38,236	9,660	1,769	302,254
Balance at December 31, 2012	1,191,683	193,757	557,472	556,154	31,224	54,691	2,584,981
Carrying Amount at December 31, 2012	1,792,441	679,956	433,591	54,722	73,503	-	3,034,213

Notes to the Financial Statements

YEARS ENDED DECEMBER 31, 2013 AND 2012

12. Warranty Provision

	2013	2012
	$	$
Balance at Beginning	**62,032**	88,972
Additional Provisions Recognized	**-**	30,314
Amounts used during the year	**-**	(51,974)
Unused Amounts Reversed during the year	**(62,032)**	(5,280)
Balance at the end	**-**	62,032

13. License Revenues related to License

Up until June 2012, the Company was amortizing over the expected life of its distribution agreement the license payments it had received from the 3M Company under that agreement. On June 15, 2012, the Company terminated that distribution agreement.

As a result of such termination, the unamortized amount of $1,585,833 of the license payments was recognized in June 2012 as revenue in accordance with the Company's accounting policies, and the Company ceased to recognize license revenue since that date.

14. Share Capital

Authorized

An unlimited number of shares

Common, voting, participating, without par value.

Preferred, non-voting, having priority over the common shares, issuable in series, each series bearing the number of shares, designation, rights, privileges, restrictions and conditions as determined by the Board of Directors.

		2013		2012
Issued and Paid	**Number of Common Shares**	**$**	Number of Common Shares	$
Balance at Beginning	**65,888,182**	**97,774,718**	58,785,682	89,920,532
New Issue	**7,000,000**	**6,153,309**	6,900,000	7,758,065
Options Exercised	**112,724**	**100,922**	202,500	96,121
Balance at the End	**73,000,906**	**104,028,949**	65,888,182	97,774,718

Notes to the Financial Statements

YEARS ENDED DECEMBER 31, 2013 AND 2012

14. Share Capital (cont'd)

On March 4, 2013, the Company issued, by way of prospectus, 7,000,000 common shares with gross proceeds of $7,000,000 and expenses of $846,691 for a net proceed of $6,153,309. The warrants included in those expenses had a fair value of $77,000 (Note 16).

On April 24, 2012, the Company closed an equity private placement with gross proceeds of $8,970,000 from the sale of units that were comprised of 6,900,000 shares and 3,450,000 warrants. The share component of the gross proceeds was evaluated at $8,694,000 and expenses related to the issue amounted to $935,935. Therefore, the net proceeds allocated to the share issue were $7,758,065. The fair value of the warrants issued to investors was evaluated at $276,000 and the fair value of the warrants issued to underwriters in connection with that private placement was evaluated at $117,300.

During the year ended December 31, 2013, pursuant to the Company's Stock Option Plan, holders exercised certain options and subscribed for 112,724 shares for a cash consideration of $68,762. For the year ended December 31, 2012, holders subscribed for 202,500 shares for a cash consideration of $56,255.

Shareholder Rights Plan Agreement

The Board of Directors of TSO_3 has adopted a shareholder rights plan agreement (the "Plan") designed to foster fair treatment of all shareholders in connection with any take-over bid for TSO_3. TSO_3's shareholders ratified the Plan at the annual and special shareholder meeting held on April 25, 2012. The Plan has been designed to give the Board and shareholders more time to fully consider any take-over bid and to provide the Board with more time to pursue, if appropriate, other alternatives to maximize shareholder value. The plan expires unless its renewal is ratified at every third annual meeting of shareholders of the Company. Consequently, the next ratification will take place at the 2015 Annual Meeting.

Under the terms of the Plan one right (a "Right") has been issued and attached to each voting share (each a "Share") of TSO_3 issued and outstanding as of the opening of business on October 25, 2011. One Right has and will, as the case may be, also be issued and attached to each Share subsequently issued. These Rights would become exercisable only when a person, including any party related to it, acquires or announces its intention to acquire 20% or more of the outstanding Shares of TSO_3, without complying with the "Permitted Bid" provisions of the Plan or, in certain cases, without the approval of the Board. Until such time, the Rights are not separable from the Shares, are not exercisable and no separate rights certificates are issued.

Notes to the Financial Statements

14. Share Capital (cont'd)

Shareholder Rights Plan Agreement (cont'd)

To qualify as a "Permitted Bid" under the Plan, a bid must, among other things: (1) be made to all holders of Shares of TSO_3; (2) provide that the Shares tendered will be taken up or paid for on a closing date which is not less than 60 days from the date of the bid and more than 50% of the Shares, other than those owned by the bidder and any related persons, were tendered and not withdrawn on that date; (3) provide that Shares tendered may be withdrawn by their holder at any time prior to closing; (4) provide that on the date where the Shares could be taken up and paid for, if more than 50% of the Shares held by holders independent from the bidder and any related persons were tendered, the bidder must disclose such fact in an announcement and the bid must remain open for another 10 days.

Following the occurrence of an event which triggers the right to exercise the Rights and subject to the terms and conditions of the Plan, each Right would entitle the holders thereof, other than the acquiring person or any related persons, to exercise their Rights and purchase Shares of TSO_3 at a substantial discount to the market price at that time.

The agreement has no impact on the financial statements.

Employee stock Purchase Plan

On May 2, 2007, the Company set up an employee stock purchase plan for employees and executives. Eligible participants may contribute, in the form of payroll deductions, up to 5% of their basic salary. The Company contributes an amount equal to 50% of the participant's total monthly contribution. Every month, the participants' and Company's contributions are transferred to an investment dealer that purchases, on the open market and promptly upon reception of the contributions, shares for a total purchase price equal to the amount of such contributions.

Notes to the Financial Statements

YEARS ENDED DECEMBER 31, 2013 AND 2012

15. Reserve – Share-Based compensation

The Company's Board of Directors adopted a Share-Based Compensation plan in the form of an option plan designed solely for directors, executives, key employees and service providers of the Company. The plan was approved by the shareholders. The total number of common shares that can be issued under this plan from the Company's share capital was, as at December 31, 2013, 5,262,349 (5,375,073 as of December 31, 2012). The options awarded pursuant to this plan generally vest over a three-year period and may be exercised within a maximum of 10 years of the date of award.

During the year ended December 31, 2013, the Company awarded 110,000 stock options (238,000 for the year ended December 31, 2012) at a weighted average exercise price of $0.86 per option ($1.33 for the year ended December 31, 2012). The weighted average fair value of these stock options was $0.51 per option ($0.61 for the year ended December 31, 2012).

The Share-Based Compensation expense pertaining to the options awarded has been amortized using the graded vesting method and represents a share-based compensation expense of $184,875 for the year ended December 31, 2013 ($321,708 for the year ended December 31, 2012) presented as part of the " Administrative Expenses ".

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

	2013	2012
Weighted Average Share Price	**$0.89**	$1.32
Exercise Price	**$0.86**	$1.33
Risk Free Interest Rate	**2.17%**	2.23%
Estimated Share Price Volatility	**51%**	39%
Expected Life	**8 years**	8 years
Expected Dividend Yield	**0%**	0%

Notes to the Financial Statements

YEARS ENDED DECEMBER 31, 2013 AND 2012

15. Reserve – Share-Based Compensation (cont'd)

The Share-Based Compensation expenses takes into account an estimate of the number of options which will vest and be exercised. In addition, option pricing models such as the Black-Scholes model require highly subjective valuations, including the assumed stock price volatility of the underlying shares. Volatility was estimated for the 2013 and 2012 awards on the basis of the historical volatility of the Company's share price prior to the date of award. Any change in the assumptions can materially affect the fair value estimates.

	Number	**2013 Weighted Average Exercise Price $**	Number	2012 Weighted Average Exercise Price $
Outstanding at beginning	**3,714,145**	**1.13**	3,748,645	1.08
Granted	**110,000**	**0.86**	238,000	1.33
Exercised	**(112,724)**	**0.61**	(202,500)	0.27
Expired	**(449,845)**	**1.55**	(19,000)	2.30
Forfeited	**(96,892)**	**2.00**	(51,000)	0.78
Outstanding at end	**3,164,684**	**1.05**	3,714,145	1.13
Exercisable at end	**2,657,917**	**0.95**	2,975,212	1.00

The following table summarizes certain information regarding the stock options of the Company as at December 31, 2013:

	OUTSTANDING OPTIONS		**EXERCISABLE OPTIONS**	
Exercise Price	Number	Average Remaining Contractual Life (year)	Number	Average Remaining Contractual Life (year)
$0.37 to $0.94	1,730,500	5.14	1,620,500	4.88
$1.08 to $1.97	1,191,460	5.55	794,693	3.60
$2.20 to $3.45	242,724	2.94	242,724	2.94
	3,164,684	5.13	2,657,917	4.32

Notes to the Financial Statements

YEARS ENDED DECEMBER 31, 2013 AND 2012

15. Reserve – Share-Based Compensation (cont'd)

The following table summarizes certain information regarding the stock options of the Company as of December 31, 2012:

	OUTSTANDING OPTIONS		**EXERCISABLE OPTIONS**	
Exercise Price	Number	Average Remaining Contractual Life (year)	Number	Average Remaining Contractual Life (year)
$0.37 to $0.94	1,816,769	5.29	1,816,769	5.29
$1.08 to $1.97	1,629,860	5.50	890,927	2.80
$2.20 to $3.45	267,516	3.66	267,516	3.66
	3,714,145	5.28	2,975,212	4.41

16. Reserve – Warrants

	Number	**2013 Exercise Price $**	Number	2012 Exercise Price $
Outstanding at Beginning	**3,795,000**	**1.94**	-	-
Granted	**350,000**	**1.00**	3,795,000	1.94
Expired	**(3,795,000)**	**1.94**	-	-
Outstanding at End	**350,000**	**1.00**	3,795,000	1.94
Exercisable at End	**350,000**	**1.00**	3,795,000	1.94

During the first quarter of 2013, 350,000 warrants were issued as part of the compensation to Underwriters in connection with the share issue closed on March 4, 2013. Each of the 350,000 compensation warrants will be exercisable to acquire one common share at the exercise price of $1.00 until September 4, 2014. On March 4, 2013, the fair value of each of these compensation warrants was $0.22.

During the year ended December 31, 2012, 3,450,000 warrants were issued to purchasers of the bought deal private placement closed on April 24, 2012, and 345,000 warrants issued as part of the compensation to Underwriters. The 3,450,000 warrants issued to investors allowed its holders to purchase one common share at the price of $2.00 and expired on April 24, 2013.

Notes to the Financial Statements

YEARS ENDED DECEMBER 31, 2013 AND 2012

16. Reserve – Warrants (cont'd)

Each of the 345,000 compensation warrants was exercisable to acquire one common share at the exercise price of $1.30 and expired on October 24, 2013. On April 24, 2012, the fair value of each of these compensation warrants was $0.10.

The fair value of the warrants was estimated using the Black-Scholes option pricing model under the following assumptions:

	2013	2012
Weighted Average Share Price	**$0.99**	$1.40
Exercise Price	**$1.00**	$1.94
Risk Free Interest Rate	**1.23%**	1.32%
Estimated Share Price Volatility	**45%**	42%
Expected Life	**18 months**	12.5 months
Expected Dividend Yield	**0%**	0%

At any time when warrants expire without being exercised or are being cancelled, the Company is authorized to transfer to the Deficit the amount corresponding to such warrants that would be included in the Reserve for Warrants. Such transfer was made on April 24, 2013 on the expiry date for 3,450,000 warrants and on October 24, 2013 on the expiry date for 345,000 compensation warrants (no transfer was made during the year ended December 31, 2012).

17. Capital Management

The Company needs capital primarily to finance its research and development activity, its supply chain, administrative and marketing expenses, its working capital and its capital expenditures. The Company's capital is comprised of share capital, share-based compensation and warrants. Depending on the quality of the credit structure of a prospective debt transaction and prevailing market conditions, the Company could finance a portion of its cash needs through debt issues. However, given its history of negative earnings, it is unlikely at the present time that the Company could access senior debt financing in any sizable amount from traditional sources such as commercial banks. In the past, the Company has financed its activities through various rounds of public and private financing and, to a small extent, through government grants and tax credits.

Notes to the Financial Statements

YEARS ENDED DECEMBER 31, 2013 AND 2012

18. Additional Information Relating to Cash Flows

	2013 $	2012 $
Change in Non-Cash Operating Working Capital Items		
Decrease (Increase) in Currents Assets		
Accounts Receivable	**(136,401)**	864,205
Inventories	**(190,690)**	(96,239)
Prepaid Expenses	**85,730**	(62,629)
Increase (Decrease) in Liabilities		
Accounts Payable and Accrued Liabilities	**(264,682)**	(388,334)
Warranty Provision	**(62,032)**	(26,940)
Deferred Revenues	**(11,130)**	(1,803,485)
	(579,205)	(1,513,422)
Non-cash Items transferred to Property, Plant and Equipment	**(128,015)**	(247,980)
	(707,220)	(1,761,402)
Research and Development Tax Credits		
Received	**122,115**	627,042

Notes to the Financial Statements

YEARS ENDED DECEMBER 31, 2013 AND 2012

19. Related Party Transactions

The Company has made severance payments to some of its employees for a total of $15,770 ($76,608 in 2012).

Compensation of Key Management Personnel

People in key management positions have authority and responsibility for planning, directing and controlling the activities of the Company. Key management comprises the Chief Executive Officer, the Chief Financial Officer, other vice presidents and directors. The remuneration of key management personnel during the year was as follows:

	2013 **$**	2012 $
Short-term salaries and other benefits	**740,760**	1,133,308
Post-employment Benefits	**12,359**	12,278
Share-based Payments	**7,321**	4,971
Option-based Awards[1]	**154,573**	259,897
	915,013	1,410,455

[1] Share-based value including the amount of the expenses for stock-options, accounted for during the year.

The compensation of key executives is determined by the Human Resources Committee taking into consideration the individual performance and market trends.

Notes to the Financial Statements

YEARS ENDED DECEMBER 31, 2013 AND 2012

20. Income Taxes

For tax purposes, each year the losses from operations can be applied against future taxable income.

As at December 31, 2013, the accumulated tax losses that can be carried forward are as follows:

	LOSS CARRY-FORWARDS	
Expiry Date	**Federal**	**Provincial**
2033	8,210,000	8,027,000
2032	4,933,000	4,612,000
2031	6,185,000	5,795,000
2030	6,594,000	6,327,000
2029	7,569,000	7,122,000
2028	8,052,000	8,040,000
2027	6,224,000	6,822,000
2026	5,481,000	5,820,000
2015	5,009,000	4,961,000
2014	4,601,000	4,591,000
	62,858,000	62,117,000

As at December 31, 2013, based on an effective rate of 15% for federal taxes and 11.9% for provincial taxes, the undiscounted value of tax losses carried forward is $16,821,000.

As at December 31, 2013, in addition to these tax losses carried forward, the Company has unclaimed research and development expenses ($12,443,000 at the federal level and $19,129,000 at the provincial level) and $1,565,000 in financing costs that can be carried forward to reduce future taxable income. The unrealized tax benefit related to these items is estimated at $4,565,000.

With respect to property, plant and equipment, the Company has a deferred income tax related to the tax cost that is higher than the carrying amount of these capital assets. The unrecorded eventual tax benefit related to that difference is evaluated at $804,000.

In addition, as of December 31, 203, the Company has $3,419,000 in additional tax credits representing the outstanding and unrecorded portion of the federal research and development tax credit receivable.

The Company also has a capital loss balance creating deferred income tax assets of $19,000.

Notes to the Financial Statements

YEARS ENDED DECEMBER 31, 2013 AND 2012

20. Income Taxes (cont'd)

Furthermore, the cost of intangible assets for tax purposes was $564,000 (carrying amount of $1,643,000) resulting from the Company taking advantage of provisions in the federal and provincial income tax laws with respect to rollovers. Deferred income taxes liability of $184,000 resulting from the difference between the carrying value and the tax value of intangible assets has been recorded. As well, a deferred income taxes asset of the same amount has been recorded relating to the items previously presented.

The deferred income tax assets related to such losses and non-refundable investment tax credits will not be recognized in the financial statements, then resulting in an increase in earnings and shareholders' equity, until the Company is enabled to conclude that these unrecorded tax assets are probable to be materialized by shielding profits from taxes or otherwise. If the Company had concluded on December 31, 2013 that these items would likely be materialized, based on an effective rate of 15% for federal taxes and 11.9% for provincial taxes, it would have recorded an aggregate net amount of $25,443,000 in tax assets ($22,443,000 as at December 31, 2012).

21. Research and Development Tax Credits

The Company claims two different types of tax credits, one type is refundable regardless of the level of taxable income, and the other can only be obtained to offset a tax liability. At the present time, in accordance with the Company's accounting policies, the non-refundable credits are not recorded as a deferred tax asset.

For tax credit purposes, eligible research and development expenditures incurred during the year 2013 totaled $750,000 ($884,000 en 2012); of these eligible research and development expenditures, none as at December 31, 2013 (none in 2012) is related to property, plant and equipment.

Some of these eligible expenses qualify for refundable scientific research tax credits amounting to $346,000 as at December 31, 2013 ($409,000 in 2012).

The tax credits claimed for the fiscal years ended on December 31, 2013, 2012 and 2011 have not been completely reviewed by the tax authorities. Consequently, those amounts of tax credits that will be awarded could differ from the ones already recorded.

Notes to the Financial Statements

YEARS ENDED DECEMBER 31, 2013 AND 2012

22. Segmented Information

The Company is structured as a single operating segment. Almost all property, plant and equipment of the Company are located in Canada.

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

	2013		2012	
	$	**%**	$	%
Canada	**212,047**	**83**	961,520	83
Rest of the world	**42,323**	**17**	201,402	17
	254,370	**100**	1,162,922	100

Up until June 15, 2012, the Company earned a material part of its revenues under the now-terminated distribution agreement with the 3M Company. Shipments to that client were made in Canada and elsewhere in the world.

License revenue recorded up until June 2012 in connection with the terminated distribution agreement with the 3M Company is allocated to the geographic area « Rest of the world ».

23. Loss per Share

The following table reconciles the basic and diluted loss per share for years ended December 31:

	2013 **$**	2012 $
Net Loss		
Basic and Diluted	**(9,270,169)**	(5,795,598)
Number of Shares		
Weighted Average Number of Outstanding Shares (1)	**71,739,270**	63,675,137
Loss per Share		
Basic	**(0.13)**	(0.09)
Diluted (2)	**(0.13)**	(0.09)

1) The calculation of the weighted average number of outstanding shares is determined by 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 the inclusion of common shares resulting from the potential exercise of options and warrants is antidilutive, in the calculation of the diluted loss per share.

Notes to the Financial Statements

YEARS ENDED DECEMBER 31, 2013 AND 2012

24. Contractual Commitments

As at December 31, 2013, the contractual commitments in the fiscal years to come are as follows:

	2014	2015	2017	2017	2018
	$	$	$	$	$
Operating Leases and Services Contracts	122,000	13,000	9,000	8,000	1,000

25. Approval of Financial Statements

The financial statements were approved by the Board of Directors on March 18, 2014.

Directors

Germain Carrière [1) 2) 3) 4)]

Chairman of the Board of Directors
Corporate Director

Pierre Désy [1) 2)]

Corporate Director

James Husman [2) 3)]

Corporate Director

Jean Lamarre [2) 3)]

President, Lamarre Consultants
Corporate Director

W. Barry McDonald [1) 4)]

Consultant and Corporate Director

Claude Michaud [1) 3)]

Corporate Director

Richard M. Rumble [4)]

President and Chief Executive Officer, TSO_3

Simon Robitaille [3)]

Corporate Director and TSO_3's Co-Founder

1) Member of the Audit Committee
2) Member of the Human Resources
3) Member of the Corporate Governance Committee
4) Member of the Advisory Committee

Investor's Information

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Ticker Symbol: TOS Listing: TXS www.tso3.com

Annual Shareholder Meeting

Wednesday, May 7, 2014 at 10:30 am
Palais Montcalm, salle d’Youville
995, Place d’Youville
Québec (Québec) G1R 3P1

R.M. (RIC) RUMBLE PRÉSIDENT AND CEO	BENOIT DESCHAMPS VICE PRESIDENT OF FINANCE ANC CFO	GERMAIN CARRIÈRE PRESIDENT OF THE BOARD OF DIRECTORS
		
Tel : 418 651-0003 **Fax :** 418 651-2288 rrumble@tso3.com	**Tel :** 418 651-0003 **Fax:** 418 653-5726 bdeschamps@tso3.com	germain.carriere@gmail.com

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U.S. Pat. No. 7,128,872 / 7,582,257 / 7,588,720 / 7,608,217
TSO_3 STERIZONE® Chemical Indicator U.S. Pat. No. 6,589,479
Other patents pending