2014

# Quarterly Report April - May - June

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## Message from the president and CEO

Dear valued Shareholders:

Earlier this year, it was stated that 2014 was to be the year of transformation for the Company. I believed it then, even more so now. Delivering our advanced technology into the hands of customers worldwide has proven to be a greater challenge than expected. Regulatory hurdles have cost the company time, resources and rapid market entry. That being said, the technology has yet to be challenged in either sterilization efficacy or load size which allows us to offer superior economics when compared to competitive devices. The technology and its potential to be used in additional applications with healthcare and the life science market, still has the ability to be a game changer!

As we navigate the path towards gaining clearance for our technologies in the US marketplace, those of you who have patiently followed our activities are likely to sense a difference in our degree of confidence in quickly securing the elusive clearance. Our latest submission, filed on May 2nd of this year, included data based on guidance from the US regulators. After a successful administrative review, the file started its substantive evaluation process and, late in the second quarter, the Agency opened a dialogue with $TSO_3$ on the file's contents. At the present time, in the Company's opinion, the bilateral communications pertaining to the file are productive and timely. The Company does not expect any further hurdles and continues to believe that this file will obtain the clearance that is required in order to promote our technology in the world's largest low temperature sterilizer market.

As reported in this MD&A, liquidities amounted to $7.5M as of the end of Q2-2014. The Company has been extremely conservative this year with its use of cash. A collective dismissal announced in January 2014, along with scaled back research and development's activities, has resulted in a substantially lower cash burn rate. By maintaining the same rate of spending as experienced in the second quarter, current liquidities would be sufficient to finance operations beyond Q3-2015. However, as I stated earlier, we expect 2014 to be a transition year and once the regulatory clearance is achieved and the channel partnership agreement signed, a more elaborate path forward will be developed.

The Company continues to make positive progress with respect to structuring the correct channel partner agreement. These discussions have accelerated, we believe due to progress on the regulatory front.

In summary, I am pleased with the progress being made and proud of the contribution of our dedicated employees and expert consultants. The valued contribution from the $TSO_3$ Board of Directors and ongoing Shareholders' support continue to be greatly appreciated.

It is getting interesting!

R.M. (Ric) Rumble
President and Chief Executive Officer

# Overview

**Who we are and what we do**

$TSO_3$ was founded in June 1998 in Québec City and currently employs 37 people. The Company's activities encompass research, development, limited commercialization and licensing of sterilization processes 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 compared to competitive systems 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® 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 of the Operating Room (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 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 ($H_2O_2$) sterilization systems. These methods offer "terminal sterilization" referring to the instruments being packaged and therefore, remaining sterile until opened at the surgical site. 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 $H_2O_2$ 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 that played an important role in a sub-segment of low temperature sterilization is that of 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. The Company believes that its technology offers a single solution to address customer needs.

## Second Quarter 2014 and recent Activities

**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 May 2, 2014, the Company announced that it had re-filed a new 510(k) with the US Regulatory Authorities ("the Agency"). This submission occurred after having met with the regulators throughout the 2013 calendar year and after having received additional guidance from the Agency early in 2014. As a result of this guidance early in 2014, the Company conducted a variety of tests to satisfy information requests contained in a guidance document provided by the US Regulatory Authorities. The submission is for the STERIZONE® VP4 Sterilizer, a product similar to the STERIZONE® 125L+ Sterilizer cleared in Canada and Europe yet with improved claims for the US market.

After clearing the administrative review, the file proceeded to the agencies substantive review process. Weeks into this process, the Company was notified that the reviewers had a set of additional questions or areas where additional clarity was sought. As a result, the Company received an Additional Information ("AI") request from the reviewers. Since the receipt of the AI letter, the Agency and the Company, including the Company's consultants, have had an open and ongoing dialogue to supply and secure assurances that the information being supplied by the Company adequately addresses the issues raised by the reviewers. $TSO_3$ has stated that the Company is comfortable with the current dialogue and pace with the Agency and believes that the path taken will lead to product clearance.

**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.

Projects in development were virtually halted in January 2014 simultaneously with the announcement of the collective dismissal of thirty (30) percent of the Company's workforce in order to protect the Company's cash resources against the risk that the US regulatory clearance would have additional delays. Since the end of March 2014, $TSO_3$ workforce has been reduced to 37 employees, down from 62 employees as at December 31, 2013.

**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. 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 installed base of STERIZONE® 125L+ sterilizers. 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.

**Intellectual Property**

Early in 2014, a patent describing a method for controlling condensation of hydrogen peroxide ($H_2O_2$) when sterilizing medical devices with hydrogen peroxide, either used alone or in combination with ozone or other chemistries, was granted by the European Patent Office. In addition, the Company has been recently notified by the European Patent Office of its decision to grant a second patent covering another aspect of $TSO_3$'s technology. In addition in 2014, the Australian Patent Office has granted six patents on various aspects of $TSO_3$'s technology while indicating a seventh application will be granted shortly. Lastly, in 2014, a Japanese patent has been granted on a core aspect of $TSO_3$'s technology while the Canadian Patent Office recently notified the Company of its intend to grant a corresponding patent in Canada.

Similar patent applications are pending in the United States as well as elsewhere in the world. $TSO_3$'s unique *Dynamic Sterilant Delivery System*™ is core to the differentiation of its products and its protection enhances the Company's value.

**Strategic Alternatives**

In the second quarter of 2013, the Company announced that, while it is pursuing the US regulatory approval for the STERIZONE® Sterilizer platform 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 States.

**2014 Focus**

- Obtain United States regulatory clearance for the STERIZONE® VP4 Sterilizer;
- Secure the right agreement and the right partner to achieve the global market potential for the STERIZONE® Sterilizers;
- Maintain compliance with applicable laws and regulations to be able to ramp up activities when US regulatory clearance will have been obtained;
- Maintain a level of cash resources appropriate for achieving the Company's priorities.

## Management Discussion and Analysis

The Management discussion and analysis (MD&A) is intended to help readers assess, through the eyes of management, the financial position and results of operations of $TSO_3$ Inc. ("$TSO_3$" or the "Company") for the three and six-month period ended June 30, 2014 and to compare them with the three and six-month periods ended June 30, 2013. This information is dated August 4, 2014 and should be read in conjunction with the Interim Condensed Unaudited 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 Interim Condensed Unaudited Financial Statements has been prepared in accordance with the International Financial Reporting Standards ("IFRS").

The Condensed Unaudited Interim 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. A statement about the forward-looking information as well as the associated risks and uncertainties can be found on pages 15 to 24 of the report.

## Summary of results

Periods ended June 30 (Unaudited, IFRS Basis)

| | SECOND QUARTER | | SIX MONTHS | |
|---|---|---|---|---|
| | **2014** | 2013 | **2014** | 2013 |
| | **$** | $ | **$** | $ |
| **Sales** | **132,179** | 37,255 | **213,936** | 113,314 |
| **Expenses** | | | | |
| Supply Chain | **209,994** | 276,760 | **460,963** | 531,451 |
| Customer Support and Communications | **71,807** | 133,821 | **172,439** | 258,492 |
| Research and Development | **524,779** | 833,117 | **1,122,537** | 1,844,060 |
| Administrative | **666,380** | 736,638 | **1,398,273** | 1,553,806 |
| Settlement Cost | **-** | 1,923,398 | **-** | 1,923,398 |
| Financial Income | **(28,779)** | (56,704) | **(67,907)** | (96,130) |
| Financial Costs | **12,515** | (3,901) | **13,152** | 3,983 |
| **Total Expenses** | **1,456,696** | 3,843,129 | **3,099,457** | 6,019,060 |
| **Net Loss before Income Taxes** | **(1,324,517)** | (3,805,874) | **(2,885,521)** | (5,905,746) |
| **IncomeTaxes** | **-** | - | **-** | - |
| **Net Loss and Total Comprehensive Loss attributable to Shareholders** | **(1,324,517)** | (3,805,874) | **(2,885,521)** | (5,905,746) |
| Basic and Diluted Net Loss per Share | **(0.02)** | (0.05) | **(0.04)** | (0.08) |
| Weighted Average Number of Outstanding Shares | **73,000,906** | 72,888,182 | **73,000,906** | 70,490,392 |

## Results Analysis

In the following paragraphs, the Company discusses the variations of certain accounts within the second quarter of 2014 and 2013 and within the six-month period ended June 30, 2014 and June 30, 2013.

**SALES**

As of June 2013, when $TSO_3$ terminated its distribution agreement with the 3M Company, $TSO_3$ has concentrated its efforts on securing the required regulatory clearance to market its products in the United States and has delayed developing sales until that clearance is obtained. Since June 2013, sales have primarily consisted of consumables and services and were made mostly in connection with the STERIZONE® 125L+ Sterilizers.

In Q2-2014, sales amounted to $132,179, as compared to $37,255 in the second quarter in 2013. For the six-month period ended June 30, 2014, sales were $213,936, as compared to $113,314 for the same period in 2013. The higher sales in 2014 reflect a higher utilization by the users of the installed base of sterilizers leading to increased sales of consumables, as well as an increase in maintenance and compatibility testing services.

The increase in the revenue from maintenance services is the result of the assumption by the Company, as of June 30, 2013, of multi-year service contracts that 3M Company had signed with hospitals prior to the settlement of the dispute over the termination rights of the 3M distribution agreement.

On a year-to-year basis, the increase in revenue mostly occurred in the second quarter due to a contract for compatibility testing services and because the Company was beginning to be entitled to the revenue from service contracts at their annual renewal dates.

| | **SECOND QUARTER** | | **SIX MONTHS** | |
|---|---|---|---|---|
| | **2014** | 2013 | **2014** | 2013 |
| | **$** | $ | **$** | $ |
| **As Reported** | | | | |
| Sales | **132,179** | 37,255 | **213,936** | 113,314 |
| Net Loss | **(1,324,517)** | (3,805,874) | **(2,885,521)** | (5,905,746) |
| Net loss per share | **(0.02)** | (0.05) | **(0.04)** | (0.08) |
| **Adjusted to Exclude Settlement Cost and Additional R&D Tax Credits** | | | | |
| Sales | **132,179** | 37,255 | **213,936** | 113,314 |
| Net Loss | **(1,465,718)** | (1,988,416) | **(3,282,127)** | (4,088,288) |
| Net loss per share | **(0.02)** | (0.03) | **(0.04)** | (0.06) |

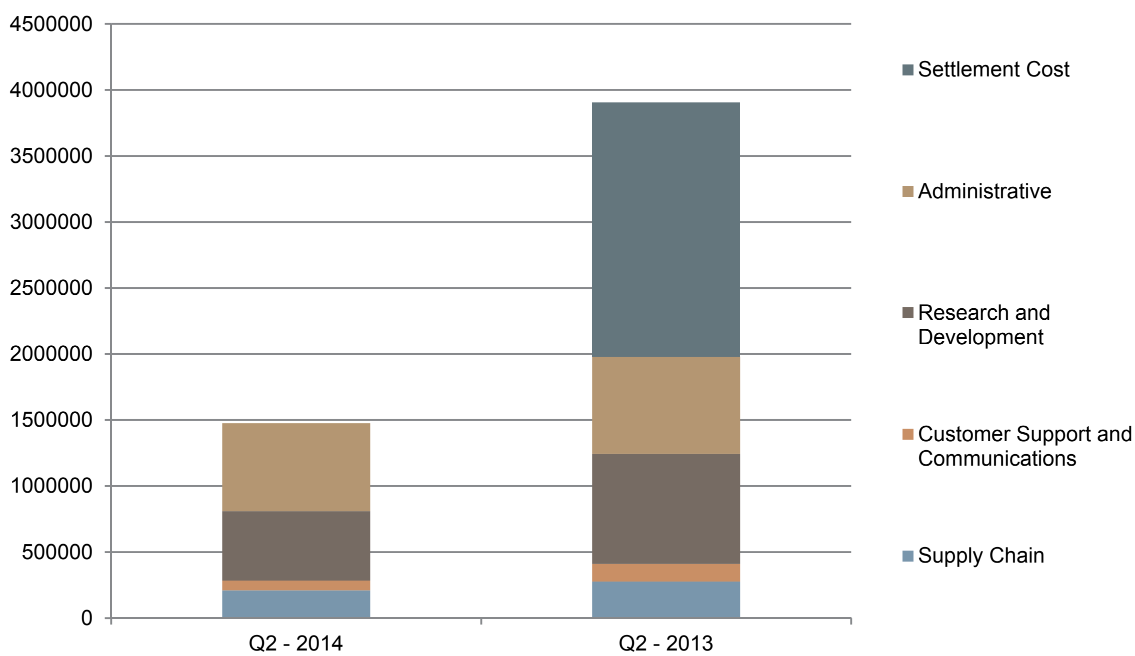
**NET LOSS**

In the second quarter of 2014, the Company experienced a loss of $1,324,517 ($0.02 per share), as compared to $3,805,874 ($0.05 per share) in Q2-2013. For the six-month period ended

June 30, 2014, the net loss was $2,885,521 ($0.04 per share), as compared to $5,905,746 ($0.08 per share) for the same period in 2013. The year-to-year variations are reflecting operating issues as well as onetime items related to R&D tax credits and the Settlement Cost incurred to eliminate litigation risks in connection with the termination of the distribution agreement with the 3M Company.

When adjusting the results to eliminate the impact of variations in R&D tax credits and the Settlement Cost with the 3M Company, the net loss in the second quarter of 2014 was $1,465,718 ($0.02 per share), as compared to $1,988,416 ($0.03 per share) for the same period in 2013. Similarly, the adjusted loss in the first half of 2014 was $3,282,127 ($0.04 per share), as compared to $4,088,288 ($0.06 per share) in the first half of 2013. Most of the reduction in the loss in 2014 occurred in Q2-2014 and was primarily due to the cost savings resulting from the collective dismissal announced on January 15, 2014. This cost reduction measure entailed severance payments and lay-offs spread until the end of the first quarter of 2014 and, hence, started to have a material impact on the expenses only during the second quarter of 2014.

**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 three-month period ended June 30, 2014, the Supply Chain expenses amounted to $209,994, as compared to $276,760 for the same period in 2013. For the six-month period ended June 30, 2014, these expenses amounted to $460,963, as compared to $531,451 for the same period in 2013.

The reduction in expenses for both periods was primarily due to a reduction in overhead which was partially offset by an increase in the cost of servicing the installed base of sterilizers. The reduction in overhead is mostly the result of a lower headcount due to the collective dismissal announced in January 2014. The higher cost incurred to service the installed base of sterilizers is due to the assumption by the Company, since July 2013, of service contracts that the 3M Company had signed prior to the June 2013 settlement.

**Customer Support and Communications**

For the quarter ended June 30, 2014, the Customer Support and Communications expenses amounted to $71,807, as compared to $133,821 for the same period in 2013. For the six-month period ended June 30, 2014, these expenses amounted to $172,439, as compared to $258,492 for the same period in 2013. For both periods, the smaller amount in 2014 is due to (1) a reduction in headcount further to the collective dismissal of January 2014, and (2) a decrease in the unallocated customer technical support costs as a result of a higher volume of maintenance services as they were reallocated to Supply Chain.

**Research and Development**

For the quarter ended June 30, 2014, Research and Development expenses were $524,779, as compared to $833,117 for the same period in 2013. For the six-month period ended June 30, 2014, these expenses were $1,122,537, as compared to $1,844,060 for the same period in 2013. However, the year-to-year basis comparisons are being distorted by the discontinuity of the recognition of R&D tax credits.

| | **SECOND QUARTER** | | **SIX MONTHS** | |
|---|---|---|---|---|
| | **2014** | 2013 | **2014** | 2013 |
| | **$** | $ | **$** | $ |
| R&D Expenses – Before Tax Credits | **665,980** | 939,057 | **1,519,143** | 1,950,000 |
| R&D Tax Credits | **(141,201)** | (105,940) | **(396,606)** | (105,940) |
| R&D Expenses – As Reported | **524,779** | 833,117 | **1,122,537** | 1,844,060 |

When R&D tax credits are being excluded, the R&D expenses have decreased from $1,950,000 in the first semester of 2013 to $1,519,143 in the first semester of 2014, or a year-to-year decrease of $430,857. Most of that decrease occurred in the second quarter of 2014. The bulk of the reduction occurred in salaries and benefits and is a direct result of the collective dismissal of January 2014 which started generating cost savings in Q2-2014.

**Administrative**

For the quarter ended June 30, 2014, the administrative expenses amounted to $666,380, as compared to $736,638 for the second quarter of 2013. For the six-month period ended June 30, 2014, these expenses amounted to $1,398,273, as compared to $1,553,806 in the same period in 2013. Several items were smaller in 2014 as a result of general compressions of expenses, but the largest variations were the decrease in salaries and benefits and in professional fees, the latter largely due to the settlement of the dispute with the 3M Company in June 2013.

**Settlement Cost**

In the quarter ended June 30, 2013, the Company recorded a $1,923,398 cost in connection with the settlement that it reached with the 3M Company over the termination rights of the distribution agreement signed in December 2009. $TSO_3$ has always maintained, and still maintains, that both parties had the right to terminate that distribution agreement. However, the 3M Company was disputing that right and a protracted litigation may 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) partially offset by the return of inventory held by the 3M Company valued $202,797 and increased by the write-off of certain receivables in the amount of $16,195.

## Financial Position Analysis

(Unaudited, IFRS Basis)

| | **June 30 2014 $** | December 31 2013 $ |
|---|---|---|
| Cash and Cash Equivalents | **4,573,960** | 6,637,408 |
| Short-term Investments | **2,992,311** | 2,971,123 |
| Accounts Receivable | **580,123** | 1,165,666 |
| Inventories | **1,410,130** | 1,407,411 |
| Property, Plant and Equipment | **857,618** | 1,048,099 |
| Intangibles Assets | **2,924,451** | 3,027,739 |
| Accounts Payable and Accured Liabilities | **546,948** | 578,185 |
| Deferred Revenues (Current and Non-Current) | **85,959** | 91,905 |
| Equity | **12,816,835** | 15,641,270 |

**Liquid Assets**

As at June 30, 2014, cash, cash equivalents and short-term investments amounted to $7,566,271, as compared to $9,608,531 as at December 31, 2013. The variation is due to the cash absorbed by operations during the first two quarters of fiscal 2014.

**Accounts Receivable**

On June 30, 2014, the accounts receivable were $580,123, comparatively with $1,165,666 on December 31, 2013. A substantial portion of the receivables on those dates was made up of amounts recoverable from governments for Research and Development tax credits and input tax credits for sale taxes.

The variation since the beginning of 2014 is mainly due to the collection in the first quarter of 2014 of $1,020,688 in R&D tax credits claims related to years 2011 and 2012. This amount exceeded by $237,222 the amount of $783,466 included in the accounts receivable recorded in accordance with the Company's accounting policy as at December 31, 2013.

**Inventories**

As at June 30, 2014, inventories amounted to $1,410,130, as compared to $1,407,411 on December 31, 2013.

| | **June 30 2014 $** | December 31 2013 $ |
|---|---|---|
| Raw Materials | **1,019,848** | 1,001,932 |
| Work in Progress | **267,141** | 262,053 |
| Finished Goods | **123,141** | 143,426 |
| | **1,410,130** | 1,407,411 |

During the first two quarters of 2014, there was no material variation in the levels of inventories nor in their composition.

**Property, Plant and Equipment**

During the first two quarters of 2014, the Company added $20,204 to its Property, Plant and Equipment, as compared to $251,373 during the same period in 2013. Most of the expenditures in 2014 were for mandatory improvements to its premises, while those in 2013 consisted primarily in sterilizers and medical devices used as part of its research and development activities.

**Intangibles Assets**

During the first two quarters of 2014, the Company capitalized $46,307 in intangible assets, as compared to $193,650 for the same period in 2013. These expenditures were made in connection with patents filed by the Company in order to improve the protection of its intellectual property.

**Accounts Payable and Accrued Liabilities**

As at June 30, 2014, accounts payable and accrued liabilities amounted to $546,948, as compared to $578,185 as at December 31, 2013. The variation reflects a decrease in trade payables offset by a seasonal increase in accrued expenses.

**Deferred Revenues**

As at June 30, 2014, current deferred revenues amounted to $85,959, as compared to $91,905 as at December 31, 2013.

Deferred revenues represent the unamortized portion of prepaid service contracts covering about two thirds of the installed base of STERIZONE® 125L+ Sterilizers.

**Shareholders' Equity**

As at June 30, 2014, Shareholders' Equity amounted to $12,816,835, as compared to $15,641,270 as at December 31, 2013. The variation is the result of the absorption of the operating deficits incurred in the first two quarters of fiscal 2014.

## Cash Flows Analysis

(Unaudited, IFRS Base)

| | | **SIX MONTHS** |
|---|---|---|
| | **2014** | 2013 |
| | **$** | $ |
| Operating Activities | **(1,977,741)** | (3,701,931) |
| Investing Activities | **(85,707)** | 790,705 |
| Financing Activities | **-** | 6,234,281 |

**Operating Activities**

Cash absorbed by Operating Activities amounted to $1,977,741 for the six-month period ended June 30, 2014, as compared to $3,701,931 for the corresponding period in 2013.

The lower amount of cash absorbed by operations during the six-month period ended June 30, 2014 is due to a reduction in operating expenses and to the collection of $1,020,688 in R&D tax credits claims related to years 2011 and 2012.

**Investing Activities**

For the six-month period ended June 30, 2014, Investing Activities generated $85,707, while in the same period in 2013, Investing Activities absorbed $790,705. Most of the variation observed between 2014 and 2013 is immaterial because it was the result of re-investing funds from investments that had expired, or transferring funds from an investment account to a bank account. When adjusting for those immaterial movements, Investing Activities absorbed $66,511 in the first two quarters of 2014, as compared with $317,008 during the same period in 2013. The reduction in 2014 was the result of fewer capital expenditures on medical devices used for R&D activities, and timing differences on expenditures on patents.

**Financing Activities**

For the six-month period ended June 30, 2014, cash was neither generated nor absorbed by Financing Activities while during the same period in 2013, these activities generated $6,234,281 as a result of a share issue closed on March 4, 2013.

## Summary of Quarterly Results

(Unaudited, IFRS Basis)

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

| ($OOO EXCEPT LOSS/SHARE) | **2014** | | | | 2013 | | 2012 | |
|---|---|---|---|---|---|---|---|---|
| | **Q2** | Q1 | Q4 | Q3 | Q2 | Q1 | Q4 | Q3 |
| Sales | **132** | 82 | 98 | 43 | 37 | 76 | 59 | 66 |
| Settlement Cost | **-** | - | 10 | (69) | 1,923 | - | - | - |
| Net Loss | **(1,325)** | (1,561) | (1,415) | (1,949) | (3,806) | (2,100) | (1,100) | (2,160) |
| Net Loss per Share (basic and diluted) | **(0.02)** | (0.02) | (0.02) | (0.03) | (0.05) | (0.03) | (0.02) | (0.03) |

The lower loss in Q4-2012 was due to the recording of additional of R&D tax credit claims related to previous years and the higher loss in Q2-2013 was due to the cost to settle the dispute with the 3M Company over the termination of the distribution agreement.

## 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 June 30:

| | **SECOND QUARTER** | | | | **SIX MONTHS** | | | |
|---|---|---|---|---|---|---|---|---|
| | **2014** | | 2013 | | **2014** | | 2013 | |
| | **$** | **%** | $ | % | **$** | **%** | $ | % |
| Canada | **76,916** | **58** | 23,703 | 64 | **148,218** | **69** | 89,015 | 79 |
| Rest of the world | **55,263** | **42** | 13,552 | 36 | **65,718** | **31** | 24,299 | 21 |
| | **132,179** | **100** | 37,255 | 100 | **213,936** | **100** | 113,314 | 100 |

## Contractual Commitments

As at June 30, 2014, the contractual commitments for future fiscal years are as follows:

| | 2015 | 2016 | 2017 | 2018 |
|---|---|---|---|---|
| | $ | $ | $ | $ |
| Operating leases and service contracts | 142,000 | 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 second quarter of 2014.

## 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. The related deferred income tax assets will be recorded on the financial statements only when the Company concludes that these tax assets will probably be materialized by shielding profits from taxes, or otherwise. If the Company had reached this conclusion on June 30, 2014, an amount of $26,200,000 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 activities, its supply chain, administrative and customer support and communications expenses, its working capital and its capital expenditures. The Company’s 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 for any meaningful amount from traditional sources such as commercial banks.

For the six-month period ended June 30, 2014, the average monthly burn rate was $340,377, as compared to $674,049 for the same period in 2013. The burn rate in 2014 has benefited from the collection of additional claims for R&D tax credits for years 2011 and 2012. When adjusted for that non recurrent item, the average burn rate for the six-month period ended June 30, 2014 is $510,491, or a decrease of $163,558 as compared to 2013. Most of that decrease occurred in the second quarter of 2014 when the monthly burn rate was reduced to $471,402 as a result of the contraction of activities further to the collective dismissal of January 2014.

| | SECOND QUARTER | | SIX MONTHS | | TWELVE MONTHS | 36-MONTHS TO |
|---|---|---|---|---|---|---|
| | **2014** **$** | 2013 $ | **2014** **$** | 2013 $ | 2013 $ | December 2013 $ |
| Unadjusted Monthly Burn Rate | **471,402** | 686,286 | **340,377** | 674,049 | 791,478 | 701,019 |
| Impact of Unusual Collection of R&D Tax Credits and 3M Settlement Cost | **-** | - | **170,115** | - | (174,833) | (58,611) |
| Adjusted Monthly Burn Rate | **471,402** | 686,286 | **510,491** | 674,049 | 615,644 | 642,408 |

The monthly burn rate in the first and second quarters of fiscal 2014 was significantly lower than the adjusted average burn rate of $642,408 experienced over the three-year periods ended December 31, 2013.

As at June 30, 2014, the Company had $7,566,271 in liquidities (cash, cash equivalents and short-term investments). Based on the Q2-2014 monthly burn rate of $471,402, these liquidities would be sufficient to finance the Company's activities beyond October 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 June 30, 2014, the number of outstanding shares was 73,000,906.

## Accounting Policies

See note 2 and 3 of our Interim Condensed Unaudited Financial Statements for the quarter ended June 30, 2014 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 or identified by the Company, or because the Company believed those risks being 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. Such new submission was filed on May 2, 2014 for a rebranded sterilizer, the STERIZONE® VP4 Sterilizer with a single cycle and improved claims vis-à-vis the STERIZONE® 125L+ Sterilizer. The Company and the US Regulatory Authorities are in active communications with respect to that filing.

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. Since then, negotiations towards a worldwide distribution agreement have taken place with potential distributors, including with Getinge Infection Control, a division of the Getinge AB, but no final agreement has been reached.

There is no guarantee that an agreement with the right conditions will be reached with a potential partner. 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 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 and extend 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 material adverse 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 Economic 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 securities and capital markets, exchange rates, debt crisis periodically 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 conversion 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.

For the six-month period ended June 30, 2014, 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 $4,664 higher ($3,332 for the year ended December 31, 2013), 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 period would have been $4,633 lower ($3,312 for the year ended December 31, 2013), 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 substantially the same sensitivity to interest rate increases and interest rate decreases.

*Credit Risk*

The use of financial instruments can create a credit risk entailing 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 receivables from clients, cash and cash equivalents and short-term investments.

Receivables from clients are from government-funded hospitals and large public corporations. By their nature, the credit risk related to those receivables is reduced.

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 agencies. This policy sets limits to the size of exposures.

As at June 30, 2014, the Company's investments were rated by at least two recognized agencies and were within the credit ratings 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 June 30, 2014, 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 may not be able to monetize its financial instruments so as to meet its 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 sufficient liquidity available on demand to meet current and future financial obligations, under both normal and exceptional circumstances.

*Currency Risk*

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

For the six-month period ended June 30, 2014, 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 $19,798 lower ($17,731 for the year ended December 31, 2013). 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 $19,798 higher ($17,731 for the year ended December 31, 2013).

*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 accordance with National Instrument 52-109 of the Canadian Securities Authorities, the Company has filed certificates signed by the Chief Executive Officer ("CEO") and the Chief Financial Officer ("CFO") that, among other things, report on the design of disclosure controls and procedures (DC&P) and the design of internal control over financial reporting (ICFR).

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

Also, the CEO and the CFO have designed ICFR, or have caused it to be designed under their supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of interim financial statements for financial reporting purposes in accordance with IFRS.

**Evaluation of Disclosure controls and procedures and internal controls over financial reporting**

An evaluation of the design of DC&P and ICFR is carried out annually under the supervision of the CEO and the CFO and the results of the last such evaluation were communicated to the Board of Directors at the end of fiscal year 2013. This evaluation consisted of a review of documentation, audits and other procedures that management considered appropriate in the circumstances.

Based on this evaluation and using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) on Internal Control – Integrated Framework and in connection with the preparation of its interim financial report and management's discussion and analysis, the two certifying officers consider the design of DC&P and ICFR to be adequate for the Company's interim reporting for the interim period ended June 30, 2014.

**Changes in internal controls over financial reporting**

No changes were made to the Company's internal controls over financial reporting that occurred during the quarter ended June 30, 2014 that have materially affected, or are reasonably likely to materially affect, the internal controls over financial reporting.

## Forward Looking Statements

Certain statements contained in this quarterly 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 August 4, 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

August 4, 2014

# INTERIM CONDENSED UNAUDITED FINANCIAL STATEMENTS

## For the three and six-month periods ended June 30, 2014 and 2013

## INTERIM CONDENSED STATEMENTS OF LOSS AND TOTAL COMPREHENSIVE LOSS (Unaudited)

**Periods ended June 30, 2014 and 2013**
**(In Canadian $)**

| | | SECOND QUARTER | | SIX MONTHS | |
|---|---|---|---|---|---|
| | | **2014** | 2013 | **2014** | 2013 |
| | **Notes** | **$** | $ | **$** | $ |
| **Sales** | 20 | **132,179** | 37,255 | **213,936** | 113,314 |
| **Expenses** | 6 | | | | |
| Supply Chain | | **209,994** | 276,760 | **460,963** | 531,451 |
| Customer Service and Communications | | **71,807** | 133,821 | **172,439** | 258,492 |
| Research and Development | | **524,779** | 833,117 | **1,122,537** | 1,844,060 |
| Administrative | | **666,380** | 736,638 | **1,398,273** | 1,553,806 |
| Settlement Cost | 4 | **-** | 1,923,398 | **-** | 1,923,398 |
| Financial Income | 5 | **(28,779)** | (56,704) | **(67,907)** | (96,130) |
| Financial Costs | 5 | **12,515** | (3,901) | **13,152** | 3,983 |
| **Total Expenses** | | **1,456,696** | 3,843,129 | **3,099,457** | 6,019,060 |
| **Net Loss before Income Taxes** | | **(1,324,517)** | (3,805,874) | **(2,885,521)** | (5,905,746) |
| **Income Taxes** | 18 | **-** | - | **-** | - |
| **Net Loss and Comprehensive Loss** | | **(1,324,517)** | (3,805,874) | **(2,885,521)** | (5,905,746) |
| **Basic and Diluted Net Loss per Share** | 21 | **(0.02)** | (0.05) | **(0.04)** | (0.08) |

The accompanying notes are an integral part of these Interim Condensed Financial Statements.

## INTERIM CONDENSED STATEMENTS OF CHANGES IN EQUITY (Unaudited)

**(In Canadian $)**

| | Notes | SHARE CAPITAL $ | RESERVE-SHARE-BASED COMPEN-SATION $ | RESERVE – WARRANTS $ | DEFICIT $ | TOTAL $ |
|---|---|---|---|---|---|---|
| **Balance at January 1, 2013** | | 97,774,718 | 3,814,972 | 393,300 | (83,555,497) | 18,427,493 |
| Issuance of Share Capital | 13 | 7,000,000 | - | - | - | 7,000,000 |
| Transfer to Deficit – Warrants Expired | 15 | - | - | (276,000) | 276,000 | - |
| Share-Based Compensation | 14 | - | 91,724 | - | - | 91,724 |
| Compensation to Underwriters | 13,15 | (77,000) | - | 77,000 | - | - |
| Share Issue Expenses | 13 | (765,719) | - | - | - | (765,719) |
| Net Loss for the Period | | - | - | - | (5,905,746) | (5,905,746) |
| **Balance at June 30, 2013** | | 103,931,999 | 3,906,696 | 194,300 | (89,185,243) | 18,847,752 |
| **Balance at July 1, 2013** | | 103,931,999 | 3,906,696 | 194,300 | (89,185,243) | 18,847,752 |
| Options Exercised | 14 | 100,922 | (32,160) | - | - | 68,762 |
| Transfer to Deficit – Warrants Expired | 15 | - | - | (117,300) | 117,300 | - |
| Share-Based Compensation | 14 | - | 93,151 | - | - | 93,151 |
| Share Issue Expenses | 13 | (3,972) | - | - | - | (3,972) |
| Net Loss for the Period | | - | - | - | (3,364,423) | (3,364,423) |
| **Balance at December 31, 2013** | | 104,028,949 | 3,967,687 | 77,000 | (92,432,366) | 15,641,270 |
| **Balance at January 1, 2014** | | 104,028,949 | 3,967,687 | 77,000 | (92,432,366) | 15,641,270 |
| Share-Based Compensation | 14 | - | 61,086 | - | - | 61,086 |
| Net Loss for the Period | | - | - | - | (2,885,521) | (2,885,521) |
| **Balance at June 30, 2014** | | 104,028,949 | 4,028,773 | 77,000 | (95,317,887) | 12,816,835 |

The accompanying notes are an integral part of these Interim Condensed Financial Statements.

## INTERIM CONDENSED STATEMENTS OF FINANCIAL POSITION (Unaudited)

**(In Canadian $)**

| | Notes | As at June 30, 2014 $ | As at December 31, 2013 $ |
|---|---|---|---|
| **Current Assets** | | | |
| Cash and Cash Equivalents | 7 | **4,573,960** | 6,637,408 |
| Short-term Investments | 7 | **2,992,311** | 2,971,123 |
| Accounts Receivable | 8 | **580,123** | 1,165,666 |
| Inventories | 9 | **1,410,130** | 1,407,411 |
| Prepaid Expenses | | **111,149** | 53,914 |
| | | **9,667,673** | 12,235,522 |
| **Non-current Assets** | | | |
| Property, Plant and Equipment | 10 | **857,618** | 1,048,099 |
| Intangible Assets | 11 | **2,924,451** | 3,027,739 |
| | | **3,782,069** | 4,075,838 |
| | | **13,449,742** | 16,311,360 |
| **Current Liabilities** | | | |
| Accounts Payable and Accrued Liabilities | | **546,948** | 578,185 |
| Deferred Revenues | | **85,959** | 91,905 |
| | | **632,907** | 670,090 |
| **Equity** | | | |
| Share Capital | 13 | **104,028,949** | 104,028,949 |
| Reserve – Share-based Compensation | 14 | **4,028,773** | 3,967,687 |
| Reserve – Warrants | 15 | **77,000** | 77,000 |
| Deficit | | **(95,317,887)** | (92,432,366) |
| | | **12,816,835** | 15,641,270 |
| | | **13,449,742** | 16,311,360 |

The accompanying notes are an integral part of these Interim Condensed Financial Statements.

## INTERIM CONDENSED STATEMENTS OF CASH FLOWS (Unaudited)

**Periods ended June 30, 2014 and 2013**
**(In Canadian $)**

| | | SIX MONTHS | |
|---|---|---|---|
| | | **2014** | 2013 |
| | **Notes** | **$** | $ |
| **Cash Flows from Operating Activities** | | | |
| Net Loss before Income Taxes | | **(2,885,521)** | (5,905,746) |
| Adjustments for: | | | |
| Depreciation of Property, Plant and Equipment | 10 | **210,685** | 237,265 |
| Amortization of Intangible Assets | 11 | **149,595** | 151,301 |
| Write-off of Property, Plant and Equipment | | **-** | 2,615 |
| Share-Based Compensation | | **61,086** | 91,724 |
| Investment Income | 5 | **(59,911)** | (96,130) |
| | | **(2,524,066)** | (5,518,971) |
| Changes in Non-Cash Operating Working Capital Items | 17 | **488,406** | 1,695,555 |
| Interest Received | | **57,919** | 121,485 |
| **Cash Flows Used in Operating Activities** | | **(1,977,741)** | (3,701,931) |
| **Cash Flows from Investing Activities** | | | |
| Acquisition of Short-term Investments | | **(2,980,994)** | (6,081,673) |
| Disposal of Short-term Investments | | **2,961,798** | 7,189,386 |
| Acquisition of Property, Plant and Equipment | | **(20,204)** | (123,358) |
| Acquisition of Intangible Assets | | **(46,307)** | (193,650) |
| **Cash Flows Generated by (Used in) Investing Activities** | | **(85,707)** | 790,705 |
| **Cash Flows from Financing Activities** | | | |
| Issuance of Share Capital | 13 | **-** | 7,000,000 |
| Payment for Share Issue Expenses | 13 | **-** | (765,719) |
| **Cash Flows Generated by Financing Activities** | | **-** | 6,234,281 |
| Increase (Decrease) in Cash and Cash Equivalents | | **(2,063,448)** | 3,323,055 |
| Cash and Cash Equivalents at the Beginning | | **6,637,408** | 7,758,103 |
| **Cash and Cash Equivalents at the End** | | **4,573,960** | 11,081,158 |

Additionnal information is presented in Note 17.

The accompanying notes are an integral part of these Interim Condensed Financial Statements.

## NOTES TO THE INTERIM CONDENSED FINANCIAL STATEMENTS (Unaudited)

**Periods ended June 30, 2014 and 2013**
**(In Canadian $)**

### 1. Description of Business

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

### 2. Accounting Policies

#### Statement of Compliance

These interim condensed unaudited financial statements ("Financial Statements") are prepared in compliance with International Accounting Standard 34 – Interim Financial Reporting ("IAS 34"). Accordingly, certain information and footnote disclosure normally included in annual financial statements prepared in accordance with International Financial Reporting Standards (IFRS) and applicable as at June 30, 2014 have been omitted or condensed. As such, these financial statements should be read in conjunction with the Company's 2013 annual financial statements.

#### Standards adopted

In May 2013, the International Accounting Standards Board ("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 Company adopted those amendments on January 1, 2014. Since the Company has no impairment of assets, those amendments have no impact on its financial reporting.

#### 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 generally reflects the fair value of the consideration given in exchange for assets.

The principal accounting policies are set out hereafter.

## NOTES TO THE INTERIM CONDENSED FINANCIAL STATEMENTS (Unaudited)

**Periods ended June 30, 2014 and 2013**
**(In Canadian $)**

### 2. Accounting Policies (cont'd)

**Presentation Currency and Foreign Currency Translation**

The financial statements are presented in Canadian dollars, which is 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, related spare parts, consumable supplies, accessories and compatibility testing services. The Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred, the price to the buyer is fixed or determinable and collection is reasonably assured. 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.

**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.

## NOTES TO THE INTERIM CONDENSED FINANCIAL STATEMENTS (Unaudited)

**Periods ended June 30, 2014 and 2013**
**(In Canadian $)**

### 2. Accounting Policies (cont'd)

#### 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 materialization 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 primarily 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 includes the cost of raw materials and an applicable share of the cost of labor 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.

#### 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 the following estimated useful lives taking into account any residual value:

## NOTES TO THE INTERIM CONDENSED FINANCIAL STATEMENTS (Unaudited)

**Periods ended June 30, 2014 and 2013**
**(In Canadian $)**

**2. Accounting Policies (cont'd)**

**Property, Plant and Equipment (cont'd)**

| | |
|---|---|
| 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 the end of each fiscal year.

**Intangible Assets**

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

| | |
|---|---|
| *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 the end of each fiscal year.

**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 is determined for the cash generating unit holding the asset.

## 2. Accounting Policies (cont'd)

### Impairment of Property, Plant and Equipment and Intangible Assets (cont'd)

The recoverable value is the higher of (1) an asset 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 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 (or a cash generating unit's) estimated recoverable value is lower than its carrying value, the asset (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.

As at December 31, 2013, considering its loss history, the Company performed an impairment test. The results allowed the Company to conclude that no impairment loss needed to be recorded as at June 30, 2014.

### 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 devices and their related spare parts and accessories, the probability that these defects will materialize and their repair costs.

### 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.

### Financial Instruments

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

## 2. Accounting Policies (cont'd)

### Financial Instruments (cont'd)

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, Recognition and Measurement of Financial Instruments

Financial instruments are classified in categories and their measurement in subsequent periods depends on their classification. The Corporation has classified its financial instruments as follows:

| 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 is recorded at amortized cost and 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.

*Loans and Receivables*

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

## NOTES TO THE INTERIM CONDENSED FINANCIAL STATEMENTS (Unaudited)

**Periods ended June 30, 2014 and 2013**
**(In Canadian $)**

**2. Accounting Policies (cont'd)**

**Financial Instruments (cont'd)**

*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:

1. *Recoverability of Long-Lived Assets:*

   On an annual basis, the Company evaluates if there are indicators of value 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;

## NOTES TO THE INTERIM CONDENSED FINANCIAL STATEMENTS (Unaudited)

**Periods ended June 30, 2014 and 2013**
**(In Canadian $)**

### 2. Accounting Policies (cont'd)

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

1. *Recoverability of Long-Lived Assets (cont'd):*

    - 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 under item "Research and Development" 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 at the time a claim is recorded.

4. *Share-based Compensation:*

    The Share-Based Compensation expense entailed by the award of stock options has been amortized using the graded vesting method. The options awarded pursuant to the Company's option 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.

5. *Deferred Income Taxes:*

    A deferred income tax asset will be recognized in the financial statements only when the Company concludes that these tax assets will probably be materialized by shielding profits from taxes or otherwise. The tax assets amount will be recorded based on the enacted and substantively enacted income tax rates for the year in which the differences are expected to reverse.

## NOTES TO THE INTERIM CONDENSED FINANCIAL STATEMENTS (Unaudited)

**Periods ended June 30, 2014 and 2013**
**(In Canadian $)**

### 2. Accounting Policies (cont'd)

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

*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

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; on February 20, 2014, the new date was tentatively determined to be January 1, 2018. 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 that dispute about the terminated agreement.

As part of this agreement, the Company incurred a net Settlement Cost of $1,923,398 for the three-month and six-month periods ended June 30, 2013. 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 as at June 30, 2013 but re-assessed it to $262,068 at year-end once the items received and refurbishment expenditures incurred.

## NOTES TO THE INTERIM CONDENSED FINANCIAL STATEMENTS (Unaudited)

**Periods ended June 30, 2014 and 2013**
**(In Canadian $)**

### 5. Financial Income and Costs

| | SECOND QUARTER | | SIX MONTHS | |
|---|---|---|---|---|
| | **2014** | 2013 | **2014** | 2013 |
| | **$** | $ | **$** | $ |
| **Financial Income** | | | | |
| Investment Income | **(28,784)** | (56,704) | **(59,911)** | (94,589) |
| Change in the Value of Investments Held as Cash Equivalents | **-** | - | **-** | (1,541) |
| Other income | **5** | - | **(7,996)** | - |
| | **(28,779)** | (56,704) | **(67,907)** | (96,130) |
| **Financial Costs** | | | | |
| Bank Charges | **5,782** | 9,294 | **11,641** | 15,343 |
| Foreign Exchange Loss (Gain) | **6,733** | (13,195) | **1,511** | (11,360) |
| | **12,515** | (3,901) | **13,152** | 3,983 |

## NOTES TO THE INTERIM CONDENSED FINANCIAL STATEMENTS (Unaudited)

**Periods ended June 30, 2014 and 2013**
**(In Canadian $)**

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

| Expenses Included in Functions | SECOND QUARTER 2014 $ | SECOND QUARTER 2013 $ | SIX MONTHS 2014 $ | SIX MONTHS 2013 $ |
|---|---|---|---|---|
| **Salary and Other Benefits** | **937,473** | 1,359,609 | **2,165,335** | 2,664,408 |
| Supply Chain | | | | |
| Customer Service and Communications | | | | |
| Research and Development | | | | |
| Administrative | | | | |
| **Depreciation of Property, Plant and Equipment** | **106,438** | 125,323 | **210,685** | 237,265 |
| Supply Chain | | | | |
| Customer Service and Communications | | | | |
| Research and Development | | | | |
| Administrative | | | | |
| **Amortization of Intangible Assets** | **74,973** | 76,256 | **149,595** | 151,301 |
| Supply Chain | | | | |
| Customer Service and Communications | | | | |
| Research and Development | | | | |
| Administrative | | | | |

### 7. Financial Instruments

Cash and Cash Equivalents

| | June 30 2014 $ | December 31 2013 $ |
|---|---|---|
| Cash | **2,562,205** | 4,638,533 |
| Investments With Maturities Shorter Than Three Months | | |
| Interest-Bearing Bank Saving Account | **2,011,755** | 1,998,875 |
| | **4,573,960** | 6,637,408 |

## NOTES TO THE INTERIM CONDENSED FINANCIAL STATEMENTS (Unaudited)

**Periods ended June 30, 2014 and 2013**
**(In Canadian $)**

### 7. Financial Instruments (cont'd)

Short-term Investments with Maturities Longer than Three Months

| | **June 30 2014 $** | December 31 2013 $ |
|---|---|---|
| Bank Guaranteed Investment Certificates | **2,992,311** | 2,971,123 |

As at June 30, 2014, Bank Guaranteed Investment Certificates were rated AA- or better by two recognized rating agencies and had a yield of 1.37 % as compared to similar investments as at December 31, 2013 with ratings AA- or better and a yield of 1.47%.

The Bank Guaranteed Investment Certificates and the Interest Bearing Bank 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, 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 INTERIM CONDENSED FINANCIAL STATEMENTS (Unaudited)

**Periods ended June 30, 2014 and 2013**
**(In Canadian $)**

**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.

For the six-month period ended June 30, 2014, 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 $4,664 higher ($3,332 for the year ended December 31, 2013), 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 period would have been $4,633 lower ($3,312 for the year ended December 31, 2013), 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 substantially the same sensitivity to interest rate increases and interest rate decreases.

Credit Risk

The use of financial instruments can create a credit risk entailing 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 receivables from clients, cash and cash equivalents and short-term investments.

Receivables from clients are from government-funded hospitals and large public corporations. By their nature, the credit risk related to those receivables is reduced.

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 agencies. This policy sets limits to the size of exposures.

As at June 30, 2014, the Company's investments were rated by at least two recognized agencies and were within the credit ratings 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 June 30, 2014, there was no single investment that exceeded the limit required under the Company's Investment Policy.

## NOTES TO THE INTERIM CONDENSED FINANCIAL STATEMENTS (Unaudited)
**Periods ended June 30, 2014 and 2013**
**(In Canadian $)**

### 7. Financial Instruments (cont'd)

Liquidity Risk

Liquidity risk represents the possibility that the Company may not be able to monetize its financial instruments so as to meet its 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 sufficient liquidity available on demand to meet current and future financial obligations, under both normal and exceptional circumstances.

Currency Risk

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

For the six-month period ended June 30, 2014, 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 $19,798 lower ($17,731 for the year ended December 31, 2013). 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 $19,798 higher ($17,731 for the year ended December 31, 2013).

### 8. Accounts Receivable

| | **June 30 2014 $** | December 31 2013 $ |
|---|---|---|
| Receivables from Clients | **129,893** | 92,923 |
| Government Credits Receivable | **450,230** | 1,072,743 |
| | **580,123** | 1,165,666 |

There were no bad debt allowances as at June 30, 2014 (none as of December 31, 2013).

## NOTES TO THE INTERIM CONDENSED FINANCIAL STATEMENTS (Unaudited)

**Periods ended June 30, 2014 and 2013**
**(In Canadian $)**

### 9. Inventories

| | **June 30 2014 $** | December 31 2013 $ |
|---|---|---|
| Raw Materials | **1,019,848** | 1,001,932 |
| Work in Progress | **267,141** | 262,053 |
| Finished Goods | **123,141** | 143,426 |
| | **1,410,130** | 1,407,411 |

Inventories as at December 31, 2013 include items returned to $TSO_3$ by the 3M Company in accordance with the settlement agreement concluded on June 30, 2013. The restocked inventories amounted to $161,176 in raw materials, $80,879 in 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-off of raw materials of $8,373 for the second quarter of 2014 and $12,092 for the six-month period ended June 30, 2014 ($3,525 for the second quarter of 2013 and $52,889 for the six-month period ended June 30, 2013).

No inventory was transferred to the Company's Property, Plant and Equipment during the six-month period ended June 30, 2014 ($128,015 for sterilizers used internally during the same period in 2013).

## NOTES TO THE INTERIM CONDENSED FINANCIAL STATEMENTS (Unaudited)

**Periods ended June 30, 2014 and 2013**
**(In Canadian $)**

### 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 at January 1, 2014 | 197,975 | 14,115 | 1,197,546 | 1,114,777 | 3,481 | 536,421 | 130,990 | 193,063 | 3,388,368 |
| Additions | - | - | 1,230 | - | - | - | - | 18,974 | 20,204 |
| Balance at June 30, 2014 | 197,975 | 14,115 | 1,198,776 | 1,114,777 | 3,481 | 536,421 | 130,990 | 212,037 | 3,408,572 |
| **Accumulated Depreciation** | | | | | | | | | |
| Balance at January 1, 2014 | 147,579 | 14,115 | 993,425 | 569,130 | 348 | 342,914 | 79,695 | 193,063 | 2,340,269 |
| Depreciation | 5,584 | - | 37,925 | 97,101 | 348 | 51,138 | 16,213 | 2,376 | 210,685 |
| Balance at June 30, 2014 | 153,163 | 14,115 | 1,031,350 | 666,231 | 696 | 394,052 | 95,908 | 195,439 | 2,550,954 |
| **Net Carrying Amount at June 30, 2014** | 44,812 | - | 167,426 | 448,546 | 2,785 | 142,369 | 35,082 | 16,598 | 857,618 |

## NOTES TO THE INTERIM CONDENSED FINANCIAL STATEMENTS (Unaudited)

**Periods ended June 30, 2014 and 2013**
**(In Canadian $)**

### 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, 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 31, 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 at 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 |
| Elimination 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 |
| **Net 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 assets with original cost amounting to $4,725 in leasehold improvements, $2,967 in equipment and tools, $479,058 in computer equipment which were no longer used and $22,735 for a stand which was replaced, and the accumulated depreciation related to those write-offs was eliminated.

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## NOTES TO THE INTERIM CONDENSED FINANCIAL STATEMENTS (Unaudited)

**Periods ended June 30, 2014 and 2013**
**(In Canadian $)**

### 11. Intangible Assets

| | TECHNOLOGY $ | PATENTS $ | LICENSE $ | SOFTWARE $ | TRADEMARKS $ | WEB SITE $ | TOTAL $ |
|---|---|---|---|---|---|---|---|
| **Cost** | | | | | | | |
| Balance at January 1, 2014 | 2,984,124 | 1,167,906 | 991,063 | 120,370 | 108,406 | 54,691 | 5,426,560 |
| Additions | - | 43,365 | - | - | 2,942 | - | 46,307 |
| Balance at June 30, 2014 | 2,984,124 | 1,211,271 | 991,063 | 120,370 | 111,348 | 54,691 | 5,472,867 |
| **Accumulated Amortization** | | | | | | | |
| Balance at January 1, 2014 | 1,340,889 | 244,796 | 619,415 | 97,803 | 41,227 | 54,691 | 2,398,821 |
| Amortization | 74,603 | 29,745 | 30,969 | 9,111 | 5,167 | - | 149,595 |
| Balance at June 30, 2014 | 1,415,492 | 274,541 | 650,384 | 106,914 | 46,394 | 54,691 | 2,548,416 |
| **Net Carrying Amount at June 30, 2014** | 1,568,632 | 936,730 | 340,679 | 13,456 | 64,954 | - | 2,924,451 |

| | TECHNOLOGY $ | PATENTS $ | LICENSE $ | SOFTWARE $ | TRADEMARKS $ | WEBSITE $ | 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 |
| Elimination 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 |
| **Net 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 software no longer used with an original cost amounting to $491,559, and eliminated the corresponding accumulated depreciation of that software.

## NOTES TO THE INTERIM CONDENSED FINANCIAL STATEMENTS (Unaudited)

**Periods ended June 30, 2014 and 2013**
**(In Canadian $)**

### 12. Warranty Provision

| | **June 30 2014 $** | December 31 2013 $ |
|---|---|---|
| Balance at Beginning | **-** | 62,032 |
| Unused Amounts Reversed during the year | **-** | (62,032) |
| Balance at the end | **-** | - |

### 13. Share Capital

*Authorized :*

The authorized capital of the Company consists of an unlimited number of common shares and an unlimited number of preferred shares.

The common shares are voting, participating and without par value.

The preferred shares are non-voting, without par value, have priority over the common shares for dividends and a distribution of their capital upon liquidation of the Company, and are issuable in series, each series bearing the number of shares, designation, rights, privileges, restrictions and conditions determined by the Board of Directors upon their issue.

*Issued:*

| | **June 30, 2014** | | December 31, 2013 | |
|---|---|---|---|---|
| **Issued and Paid** | **Number of Common Shares** | **$** | Number of Common Shares | $ |
| Balance at Beginning | **73,000,906** | **104,028,949** | 65,888,182 | 97,774,718 |
| New Issue | **-** | **-** | 7,000,000 | 6,153,309 |
| Options Exercised | **-** | **-** | 112,724 | 100,922 |
| Balance at the End | **73,000,906** | **104,028,949** | 73,000,906 | 104,028,949 |

On March 4, 2013, the Company issued, by way of prospectus, 7,000,000 common shares with gross proceeds of $7,000,000 and share issue expenses of $846,691 for a net proceed of $6,153,309.

During the second quarter of 2014 and the six-month period ended June 30, 2014, pursuant to the Company's Stock Option Plan, no option was exercised by option holders. For the entire year ended December 31, 2013, holders exercised 112,724 options for a cash consideration of $68,762.

## NOTES TO THE INTERIM CONDENSED FINANCIAL STATEMENTS (Unaudited)

**Periods ended June 30, 2014 and 2013**
**(In Canadian $)**

### 13. Share Capital (cont'd)

#### 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 plan will either expire or be ratified 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.

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.

## NOTES TO THE INTERIM CONDENSED FINANCIAL STATEMENTS (Unaudited)

**Periods ended June 30, 2014 and 2013**
**(In Canadian $)**

### 13. Share Capital (cont'd)

#### 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 base salary. The Company contributes an amount equal to 50% of the participant's total monthly contribution. Each month, the participants' and Company's contributions are transferred to an investment dealer who 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.

### 14. 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 June 30, 2014, and as at December 31, 2013, 5,262,349. The options awarded pursuant to this plan generally vest over a three-year period and may be exercised within a maximum of 10 years from the date of award.

During the second quarter of 2014, the Company awarded 60,000 stock options, (70,000 for the second quarter of 2013) at a weighted average exercise price of $0.49 ($0.91 for the second quarter of 2013). The weighted average fair value of these stock options was $0.24 ($0.51 for the second quarter of 2013).

For the six-month period ended June 30, 2014, the Company has awarded 237,500 stock options, (90,000 for the six-month period ended June 30, 2013 and 110,000 for the year ended December 31, 2013) at a weighted average exercise price of $0.61 ($0.91 for the six-month period ended June 30, 2013 and $0.86 for the year ended December 31, 2013). The weighted average fair value of these stock options was $0.27 ($0.54 for the six-month period ended June 30, 2013 and $0.51 for the year ended December 31, 2013).

The Share-Based Compensation expense pertaining to the options awarded is amortized using the graded vesting method and represents a share-based compensation expense of $33,674 for the second quarter of 2014 and $61,086 for the six-month period ended June 30, 2014 ($49,498 for the second quarter of 2013 and $91,724 for the six-month period ended June 30, 2013) presented as part of the "Administrative Expenses".

## NOTES TO THE INTERIM CONDENSED FINANCIAL STATEMENTS (Unaudited)
**Periods ended June 30, 2014 and 2013**
**(In Canadian $)**

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

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

| | **June 30 2014** | December 31 2013 |
|---|---|---|
| Weighted Average Share Price | **$0.60** | $0.89 |
| Exercise Price | **$0.61** | $0.86 |
| Risk Free Interest Rate | **2.53%** | 2.17% |
| Estimated Share Price Volatility | **39%** | 51% |
| Expected Life | **7 years** | 8 years |
| Expected Dividend Yield | **0%** | 0% |

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 2014 and 2013 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.

| | **June 30, 2014** | | December 31, 2013 | |
|---|---|---|---|---|
| | **Number** | **Weighted Average Exercise Price $** | Number | Weighted Average Exercise Price $ |
| **Outstanding at beginning** | **3,164,684** | **1.05** | 3,714,145 | 1.13 |
| Granted | **237,500** | **0.61** | 110,000 | 0.86 |
| Exercised | **-** | **-** | (112,724) | 0.61 |
| Expired | **(219,935)** | **1.73** | (449,845) | 1.55 |
| Forfeited | **(132,714)** | **1.69** | (96,892) | 2.00 |
| **Outstanding at end** | **3,049,535** | **0.94** | 3,164,684 | 1.05 |
| **Exercisable at end** | **2,583,068** | **0.92** | 2,657,917 | 0.95 |

## NOTES TO THE INTERIM CONDENSED FINANCIAL STATEMENTS (Unaudited)

**Periods ended June 30, 2014 and 2013**
**(In Canadian $)**

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

The following table summarizes certain information regarding the stock options of the Company as at June 30, 2014:

| | OUTSTANDING OPTIONS | | EXERCISABLE OPTIONS | |
|---|---|---|---|---|
| **Exercise Price** | Number | Average Remaining Contractual Life (year) | Number | Average Remaining Contractual Life (year) |
| $0.37 to $0.94 | 1,926,000 | 5.16 | 1,650,166 | 4.39 |
| $1.08 to $1.97 | 926,567 | 5.11 | 735,934 | 5.06 |
| $2.20 to $3.45 | 196,968 | 1.96 | 196,968 | 2.39 |
| | 3,049,535 | 4.94 | 2,583,068 | 4.43 |

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 INTERIM CONDENSED FINANCIAL STATEMENTS (Unaudited)

**Periods ended June 30, 2014 and 2013**
**(In Canadian $)**

### 15. Reserve – Warrants

| | June 30, 2014 | | December 31, 2013 | |
|---|---|---|---|---|
| | **Number** | **Exercise Price $** | Number | Exercise Price $ |
| **Outstanding at Beginning** | **350,000** | **1.00** | 3,795,000 | 1.94 |
| Granted | **-** | **-** | 350,000 | 1.00 |
| Expired | **-** | **-** | (3,795,000) | 1.94 |
| **Outstanding at End** | **350,000** | **1.00** | 350,000 | 1.00 |
| **Exercisable at End** | **350,000** | **1.00** | 350,000 | 1.00 |

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, for an aggregate value of $77,000.

3,795,000 warrants issued in 2012 in connection with an equity issue expired in 2013 without being exercised.

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

| | **June 30 2014** | December 31 2013 |
|---|---|---|
| Weighted Average Share Price | - | $0.99 |
| Exercise Price | - | $1.00 |
| Risk Free Interest Rate | - | 1.23% |
| Estimated Share Price Volatility | - | 45% |
| Expected Life | - | 18 months |
| Expected Dividend Yield | - | 0% |

## NOTES TO THE INTERIM CONDENSED FINANCIAL STATEMENTS (Unaudited)
**Periods ended June 30, 2014 and 2013**
**(In Canadian $)**

### 15. Reserve – Warrants (cont'd)

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 was included in the Reserve for Warrants. No transfer has been made in the six-month period ended June 30, 2014 (such transfers were made in 2013 upon the expiry of 3,795,000 warrants).

### 16. 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 public and private financings and, to a small extent, through government grants and tax credits.

### 17. Additional Information Relating to Cash Flows

| | | SIX MONTHS |
|---|---|---|
| | **2014** | 2013 |
| | **$** | $ |
| *Change in Non-Cash Operating Working Capital Items* | | |
| Decrease (Increase) in Current Assets | | |
| Accounts Receivable | **585,543** | (61,761) |
| Inventories | **(2,719)** | (164,315) |
| Prepaid Expenses | **(57,235)** | 32,176 |
| Increase (Decrease) in Current Liabilities | | |
| Accounts Payable and Accrued Liabilities | **(31,237)** | (7,967) |
| Settlement Cost Payable | **-** | 2,110,000 |
| Warranty Provision | **-** | (52,921) |
| Deferred Revenues | **(5,946)** | (31,642) |
| | **488,406** | 1,823,570 |
| Non-Cash Assets transferred to R&D (Note 9) | - | (128,015) |
| | **488,406** | 1,695,555 |
| *Research and Development Tax Credits* | | |
| Received | **1,020,688** | - |

## NOTES TO THE INTERIM CONDENSED FINANCIAL STATEMENTS (Unaudited)
**Periods ended June 30, 2014 and 2013**
**(In Canadian $)**

### 18. Income Taxes

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

The deferred income tax assets related to such losses and non-refundable investment tax credits will not be recognized in the financial statements until the Company is able 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 June 30, 2014 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 $26,200,000 in tax assets and a corresponding increase in earnings and shareholders' equity.

### 19. 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 used 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.

The tax credits claimed for the fiscal year ended on December 31, 2013 and those recorded for the period ended June 30, 2014 have not been reviewed by the tax authorities. Consequently, the amount of tax credits that will be awarded could differ from the ones already recorded.

### 20. 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 periods ended June 30:

| | **SECOND QUARTER** | | | | **SIX MONTHS** | | | |
|---|---|---|---|---|---|---|---|---|
| | **2014** | | 2013 | | **2014** | | 2013 | |
| | **$** | **%** | $ | % | **$** | **%** | $ | % |
| Canada | **76,916** | **58** | 23,703 | 64 | **148,218** | **69** | 89,015 | 79 |
| Rest of the world | **55,263** | **42** | 13,552 | 36 | **65,718** | **31** | 24,299 | 21 |
| | **132,179** | **100** | 37,255 | 100 | **213,936** | **100** | 113,314 | 100 |

## NOTES TO THE INTERIM CONDENSED FINANCIAL STATEMENTS (Unaudited)
**Periods ended June 30, 2014 and 2013**
**(In Canadian $)**

### 21. Loss per Share

The following table reconciles the basic and diluted loss per share for periods ended June 30:

| | SECOND QUARTER | | SIX MONTHS | |
|---|---|---|---|---|
| | **2014** | 2013 | **2014** | 2013 |
| | **$** | $ | **$** | $ |
| Net Loss | | | | |
| Basic and Diluted | **(1,324,517)** | (3,805,874) | **(2,885,521)** | (5,905,746) |
| Number of Shares | | | | |
| Weighted Average Number of Outstanding Shares (1) | **73,000,906** | 72, 888,182 | **73,000,906** | 70,490,392 |
| Loss per Share | | | | |
| Basic | **(0.02)** | (0.05) | **(0.04)** | (0.08) |
| Diluted (2) | **(0.02)** | (0.05) | **(0.04)** | (0.08) |

1) The calculation of the weighted average number of outstanding shares is determined by the number of outstanding common shares based on 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.

### 22. Contractual Commitments

As at June 30, 2014, the contractual commitments in the fiscal years to come are as follows:

| | 2015 | 2016 | 2017 | 2018 |
|---|---|---|---|---|
| | $ | $ | $ | $ |
| Operating Leases and Services Contracts | 142,000 | 9,000 | 8,000 | 1,000 |

### 23. Approval of Financial Statements

The Interim Condensed Unaudited Financial Statements were approved by the Board of Directors on August 4, 2014.

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