"Creating the Improved Standard in Healthcare Sterilization"

2010 Quarterly Report – Q1
January, February, March

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MESSAGE FROM THE CHIEF EXECUTIVE OFFICER

Dear shareholders,

As you are aware, toward the end of 2009, we concluded development work on enhanced cycles and finalized negotiations with 3M™'s Infection Prevention Division for the global distribution of our new generation sterilizer offering these enhanced cycles. In addition, we submitted our new product for market clearance in Canada, Europe and the United States. As we welcomed 2010, we did so with a new look and vastly expanded channel and a renewed sense of optimism for our Company and its contribution to positively impact the quality of global healthcare.

A new start

During first quarter 2010, we continued to show signs of success towards meeting stated goals. More specifically, this took the form of obtaining the CE Mark for our new product; allowing the placement of units in the European Union. This is a first for our Company and is consistent with our plans to see the product adopted not only in North America but around the globe.

In first quarter, the Company focused its efforts in support of our Channel Partner 3M™. In this area, the tremendous amount of activity and results that have been achieved may not be obvious outside the Company's walls. This is due to the fact that our efforts in first quarter have been focused on transfer of information, documentation development and exchange, as well as training support. In addition, we are supporting the entire enhanced product line, which includes a total of 19 products and accessories, with appropriate marketing collateral material that will be used by our channel partner as they begin the roll out of the product.

Some outward results of our activity have been apparent, this includes 3M's announcement of a new brand, the 3M™ Optreoz™ 125-Z Sterilizer and its use of the STERIZONE® technology. In addition, the product has been exhibited at a global nursing conference while educational events have been held for Canadian customers where regulatory clearance has already been obtained.

Late in first quarter 2010, we took our first orders for the enhanced system from 3M™. These initial orders are intended for internal 3M™ use such as training and customer support. With documentation completed for TSO_3 to produce 3M™ Optroez™ 125-Z sterilizers, we have now started the process of assembling the first units.

It is obvious that obtaining market clearance within the United States is a key milestone and one that will trigger a great deal of new activity. To this end, we are in the iterative process of questions and answers, and remain confident in our ability to work with the agency in order to obtain the expected clearances. While we can not predict the timing of such an outcome, we believe that our past success will help us respond to all questions in a timely and productive manner.

In the meantime, we are remaining very active developing a robust assembly process that meets not only expected demand, but also produces sterilizers of the highest possible quality.

In first quarter, the Company's revenues were $144,228. These revenues are attributable to the shipping of consumables and after sales services on the installed base of the first generation STERIZONE® Sterilizers (125L). As we prepare to support the formal introduction of the new 3M™ Optreoz™ 125-Z, we will also be rolling out a plan to support these original customers with the means to upgrade their existing equipment.

All of us at TSO_3 are excited about our prospects. Once again, I would like to take this opportunity to thank all of the Company's employees for their dedication towards meeting timelines and again, to you our shareholders for your continued support.

We look forward to communicating new developments and initiatives over the coming months.

R.M. (Ric) Rumble
President and CEO

INTRODUCTORY COMMENTS

The following Management's Discussion and analysis (MD&A) provides Management's point of view on the financial position and the results of operations of TSO_3 Inc. ("TSO_3" or the "Company"), for the three-month periods ended March 31, 2010 and March 31, 2009. This information is dated May 11, 2010, and should be read in conjunction with the quarterly financial statements, the annual audited financial statements and their accompanying notes. Unless specified otherwise, the amounts are in Canadian dollars.

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

THE PLAN

At the 2009 Annual General Meeting of the Shareholders, the management team presented a three year plan covering the period from 2009 to 2011, consistent with the company's new vision. This vision is: "To Create the Improved Standard in Healthcare Sterilization".

The plan described the following core objectives:

1. Improve product utility through increased compatibility (gentler cycles on device materials) and cycle speed;
2. Increase market opportunity via expansion outside North America;
3. Develop relationships leading to a strategic channel partner.

A LOOK BACK ON 2009

1. Improve product utility:

a) Increased utilization

In first quarter 2009, the Company filed with the US Regulatory Agency and Health Canada for enhanced claims for its original product the STERIZONE® 125L Sterilizer to include sterilization of complex multi-channel flexible endoscopes. On March 31, 2009, the Company received the approval from Health Canada and on December 4, 2009, the clearance from the US Food and Drug Administration (FDA). These claims demonstrated the technologies superior sterilization efficacy albeit still in a cycle that lasted 4.5 hours and was aggressive on some materials used in medical device construction.

b) New cycles

Early in 2009 the R&D team was given the mandate of modifying the sterilization platform in order to adapt the technology to customers' needs instead of asking the customers to adapt to the TSO_3 technology. Using the STERIZONE® 125L Sterilizer and its demonstrated superior sterile efficacy as our platform, we created three new customer-driven cycles to address the widest range of medical devices. The new cycles continue to use ozone generated within the sterilizer as the sterilizing agent. In addition, a conditioning agent containing hydrogen peroxide has been added to prepare the load prior to the introduction of the ozone sterilant, which significantly reduces cycle times (46, 56 and 100 minutes) and increases compatibility. These new gentler and faster cycles allow the sterilization of some of the most challenging medical devices, including simple and complex rigid and flexible endoscopes.

2. New Cycle Regulatory Status

These new cycles were filed with the US Regulatory Authorities, Health Canada and with the European Notified Body in December 2009. On December 17, 2009, the Company received Health Canada's approval. On December 29, 2009, the Company filed for the CE Mark on its new generation STERIZONE® Sterilizers (125L+) which include the new cycles. This was the first step towards commercializing TSO3's products outside North America. Earlier this year, on March 5, 2010 the Company was notified that it had met all requirements of the European Medical Device Directive (MDD) and that the product could now bare the CE mark; a requirement to place product in Europe. The United States regulatory clearance is currently under review.

3. Channel Partner

TSO_3 believed that opportunities existed to establish channel partners as a means of accelerating the adoption of the technology on a regional and global level. After having completed extensive due diligence covering TSO_3's technology, regulatory and operating systems, 3M™ Infection Prevention Division and TSO_3, signed an agreement on December 16, 2009, giving 3M™ the exclusive global license to supply and distribute the new generation STERIZONE® Sterilizer under the 3M™ brand, to operating rooms and Central Sterile Departments in acute care facilities. The agreement includes marketing, sales and after-sales service on the product. 3M™ dominates the market in 100% Ethylene Oxide (EtO) sterilization systems and is the world leader in Sterility Assurance products commonly used by healthcare facilities to measure the effectiveness of the sterilization processes. 3M™ has operations in over 60 countries.

This agreement, combined with recent improvements to the sterilizer's performance in both cycle times and device compatibility, represents a significant step in the Company's move to accelerate the product's adoption in the global marketplace.

OVERVIEW AND UPDATE ON THE COMPETITIVE ENVIRONMENT

Low temperature sterilization is performed in three distinct areas within acute care hospitals, including: Central Sterilization (CS), Operating Rooms Sterile Processing area (OR), and Gastroenterology departments (GI). All three departments have potential uses for the TSO_3 sterilization technology. The primary target market for the TSO_3 new generation STERIZONE® Sterilization System is Central Sterilization departments within acute care hospitals. This targeted customer group, by nature, is conservative and the sales cycle is lengthy as result of administrative and budgeting procedures.

These customers are seeking increased throughput via a low temperature sterilization process which is efficacious, compatible, fast and cost-effective, while also being safe for patients, users and the environment. Historically there has not been a sterilization process on the market that offers a complete solution to sterilize the wide variety of instruments used in health care facilities. As a result, end-users use a combination of products and technologies to answer their sterilization needs.

The Company competes in an industry characterized by both multinational and regional companies that market low temperature sterilization technologies. The low temperature gas sterilization methods most commonly used today are Ethylene Oxide (EtO) and Hydrogen Peroxide (H_2O_2) sterilization systems.

Ethylene Oxide gas has been determined to be carcinogenic, mutagenic and a known pollutant requiring systems to prevent operator exposure to the gas as well as systems to treat the gas prior to its release into the atmosphere. In addition EtO sterilization cycles are long form 16 to 30 hours depending on the material being sterilized as there is a requirement to liberate the gas from the devices processed prior to their use.

Hydrogen Peroxide sterilization systems are also used as a low temperature sterilization method. These systems have significant load restrictions, which drive up the cost of the sterilizing process.

Another method playing an important role in a sub-segment of low temperature sterilization is liquid chemical sterilization. This type of procedure is located directly in the OR as a just-in-time method to complement the CS Department's sterile production. The GI department is also a heavy user of liquid chemical sterilization.

Key Competitors:

1. 3M™

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

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

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

3. STERIS®

   STERIS® offers the following products:

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

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

More recently, on April 6, 2010 STERIS® announced that it was granted by the FDA a 510k for a new product, the STERIS's System 1E® ("SS1E"). Devices processed in the SS1E are sterilized by a liquid chemical sterilant and then rinsed with extensively treated water to remove chemical residues and exposed to the room environment, since not packaged. As a result, we believe that the new SS1E is not a viable alternative for all applications of the original SS1 in the OR settings, where devices must be sterile.

OVERVIEW OF THE ACTIVITIES OF THE FIRST QUARTER 2010

A major event for the Company in the first quarter of 2010 was the completion of a public round of financing resulting in the sale and issuance of 10,000,000 shares for cash proceeds of $16,000,000. This financing provides the Company with a sound cash position of $24.3 million at the end of the first quarter 2010.

During the quarter, the Company booked an additional payment of $526,250 resulting from the agreement with 3M™, for the completion of an additional milestones meeting the requirements for the CE Mark. The final milestone remaining is clearance from the US regulatory body.

Since the signing of the agreement with 3M™ on December 16, 2009, the TSO_3 team has been dedicated to supporting 3M™ in the transition of the new STERIZONE® product line to the 3M™ systems, in order to initiate the international commercial launch of the newly 3M™ branded sterilizer : 3M™ Optreoz™ 125-Z.

The transition to 3M™ distribution covers documentation of all functional areas of the Company including regulatory, quality, production, marketing and field service. Each function is being documented and audited to assure a robust process is in place to meet anticipated demand. TSO_3 and 3M™ are working closely and with a sense of urgency to complete documentation required and its transfer, by end of second quarter 2010.

On the financial side, despite lower sales, the first quarter of 2010 experienced a loss similar to that of the first quarter of last year, corresponding to $2.03M compared to a loss of $1.99M for the first quarter of 2009.

SUMMARY OF OPERATING RESULTS

Three-month periods ended March 31 (Unaudited)

	FIRST QUARTER	
	2010	2009
SALES	**$144,228**	$533,488
EXPENSES		
Operating	**341,336**	594,273
Sales & Marketing	**313,358**	611,553
Research & Development	**758,344**	739,056
Administrative	**909,793**	695,828
Financial	**2,153**	4,308
	2,324,984	2,645,018
OPERATING LOSS	**2,180,756**	2,111,530
Other Income	**146,824**	124,186
NET LOSS AND COMPREHENSIVE LOSS	**$2,033,932**	$1,987,344
BASIC AND DILUTED NET LOSS PER SHARE	**$0.04**	$0.04
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING	**51,227,865**	47,863,402

OPERATING RESULTS ANALYSIS

Three-month period ended March 31, 2010, compared to the three-month period ended March 31, 2009.

Sales

Sales for the three-month period ended March 31, 2010 amounted to $144,228 representing the sale of accessories and service contracts, compared to $533,488 representing the sale of three of its first generation ozone sterilizers, the STERIZONE® 125L Sterilizer, and related accessories for the same period in 2009.

Operating

For the three-month period ended March 31, 2010 operating expenses amounted to $341,336 compared to $594,273 for the same period in 2009. Operating expenses are related to production, manufacturing and after-sales service departments. Having sold fewer devices, the variance between the two periods is the result of a decrease in the cost of goods sold. This variance is also explained by a decrease in salaries related to customer service and after-sales service.

Sales and Marketing

Sales and Marketing expenses amounted to $313,358 for the three-month period ended March 31, 2010 compared to $611,553 for the same period in 2009. The variance between the two periods is mainly the result of a decrease in salaries and expenses due to a reduction in workforce in the sales department. This variance can also be explained by a decrease in expenses related to exhibitions and professional fees. We anticipate our Sales and Marketing expenses to decrease going forward since these expenses are now the responsibility of our channel partner.

Research and Development

For the first quarter of 2010, Research and Development expenses amounted to $758,344, compared to $739,056 for the same period in 2009. The difference between the two periods is due to an increase in sub-contracting fees as well as an increase in salaries resulting from the addition of employees in the R&D department to pursue the work on patents and the filings of the new cycles with agencies. Conversely, material and instrument purchases decreased between the two periods.

Administrative

Administrative expenses amounted to $909,793 for the three-month period ended March 31, 2010, compared to $695,828 for the same period in 2009. The variance between the two periods is explained by an increase in salaries due to the Company's contractual obligation to compensate employee(s) for double taxation (US and Canadian). The variance is also explained by a provision for bonuses, by an increase

in director's fees and professional fees mainly related to the review as well as tests performed on internal controls. Conversely, expenses related to Stock-based Compensation decreased between the two periods.

Other Income

For the three-month period ended March 31, 2010, the Company realized other revenues of $146,824 compared to $124,186 for the same period in 2009. The variance is due to the amortization of the Deferred revenues from the 3M™ agreement. In the first quarter of 2010, an amount of $44,046 was amortized. The variance is also due to a foreign exchange gain. Conversely, there was a decrease in investment revenues between the two periods due to the Company's use of its liquidity to finance its operations and to lower interest rates on its investment.

Net Loss

The Company recorded a net loss of $2,033,932 for the first quarter of 2010, or $0.04 per share compared to a net loss of $1,987,344 or $0.04 for the same period in 2009.

FINANCIAL SITUATION ANALYSIS

	MARCH 31 (Unaudited)		DECEMBER 31 (Audited)	
	2010	2009	2009	2008
Cash, Cash equiv. and Temporary Investments	**$24,298,537**	$15,914,834	$10,671,845	$17,718,470
Accounts Receivable	**$1,034,289**	$984,503	$1,333,178	$820,318
Inventories	**$1,652,752**	$2,223,811	$1,483,810	$2,548,075
Property, Plant and Equipment	**$1,205,991**	$905,604	$1,256,339	$675,810
Intangible Assets	**$3,502,254**	$3,589,647	$3,549,189	$3,642,126
Deferred Revenues (Short and long term)	**$2,382,296**	$439,379	$2,052,333	$388,958
Share Capital and Contributed Surplus	**$98,027,761**	$81,167,190	$81,322,484	$81,111,234
Shareholders' Equity	**$27,683,595**	$21,940,521	$14,865,527	$23,871,909

Liquid Assets and Financial Situation

As of March 31, 2010, cash, cash equivalents and temporary investments amounted to $24,298,537 compared to an amount of $15,914,834 as of March 31, 2009.

Accounts Receivable

Accounts receivable, as of March 31, 2010, amounted to $1,034,289 compared to a total amount of $984,503 for the same period in 2009. The difference between the two periods is due to an increase in the tax credit receivable and by the booking of an amount of $526,250 from a milestone payment as per our Agreement with 3M™. Conversely, the accounts receivable from customers decreased between the two periods.

Inventories

Inventories, as of March 31, 2010, amounted to $1,652,752 compared to a total amount of $2,223,811 for the corresponding period in 2009. The variance is explained by a decrease in the inventory of sterilizers resulting from the sale of devices between the two periods. It is also resulting from the transfer of materials and sterilizers to the R&D department in order to accelerate the work we have been conducting on compatibility of medical devices and to pursue the development and regulatory work of the new sterilization cycles.

Deferred Revenues

Short and Long Term Deferred Revenues, as of March 31, 2010, amounted to $2,382,296 compared to $439,379 as of March 31, 2009. The item *Deferred Revenues* reflects financial transactions related to parts, warranties, license revenue and service contracts not yet recognized as revenue. The variance between the two periods is mainly explained by the amount of $2,102,750 received from the 3M™ Agreement. The amount of $2,383,296 includes a foreign exchange gain of $51,232. Since the beginning of the year, deferred revenues have been amortized and recognized as revenue over the duration of the Agreement on a straight-line basis. As of March 31, 2010, the remaining Deferred Revenue to amortize was $2,007,472.

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

Statements of Cash Flow

	FIRST QUARTER	
	2010	2009
Operating Activities	**($1,114,218)**	($1,623,718)
Investing Activities	**$1,449,591**	$2,441,455
Financing Activities	**$14,813,626**	$ -

Operating activities

Cash flow used for operating activities amounted to $1,114,218 for the first quarter of 2010, compared to $1,623,718 for the same period in 2009. This variance is mainly explained by an increase in non-cash working capital, mostly due to an increase in deferred revenues related to the 3M™ Agreement.

Investing activities

For the first quarter 2010, cash flows from investing activities amounted to $1,449,591 compared to an amount of $2,441,455 for the same period in 2009. This variance is mainly explained by a decrease of the net difference between the acquisition and disposal of investments. The variance can also be explained by a decrease in the acquisition of property, plant and equipment between the two periods.

Financing Activities

For the first quarter of 2010, cash flows used for financing activities amounted to $14,813,626 compared to none for the same period in 2009. During the first quarter of 2010, the Company completed a public offering for the sale and issuance of 10,000,000 common shares for cash proceeds of $16,000,000. Issue costs totalled $1,233,027, resulting in net proceeds of $14,766,973. During the quarter, the Company also issued 40,555 common shares following the exercise of stock options, for cash proceeds of $46,653.

CONTRACTUAL COMMITMENTS

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

	2010	2011	2012	2013	2014
Operating leases and service contracts	**$299,174**	$25,515	$15,538	$1,220	$0

SUMMARY OF QUARTERLY RESULTS

(Unaudited)

	2010	2009				2008			
($000 except loss/share)	**Q1**	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Sales	**144**	155	126	511	533	382	725	1,037	91
Other Income	**147**	219	71	54	124	247	204	203	302
Net Loss	**2,034**	2,680	2,288	2,263	1,987	2,898	1,848	2,728	2,160
Net Loss per share (basic and diluted)	**0.04**	0.05	0.05	0.05	0.04	0.06	0.04	0.05	0.05

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

CAPITAL RESOURCES

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

For the three-month period ending March 31, 2010, the monthly burn-rate was approximately $389,000. Excluding the liquidity brought by the 3M™ Agreement in the first quarter of 2010, the monthly burn rate would have been approximately $564,000. Indeed, during first quarter we received payment of US $500,000 from 3M™ for having reached Health Canada authorization late December 2009.

Moreover on March 2, 2010, the Company announced the conclusion of financing with respect to a public offering of 10,000,000 common shares for gross proceeds to the Company of $16,000,000. As additional consideration for services rendered, the Underwriters have been granted by the Company with 750,000 warrants. Each warrant will entitle holders to subscribe to one common share of the Company at a price of $1.60 for a period of 18 months following the closing date of the deal.

The Company believes that its current liquid assets are sufficient to finance its activities into 2013.

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

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

As of March 31, 2010, the number of outstanding shares was 57,908,123.

OFF-BALANCE SHEET TRANSACTION

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

TRANSACTIONS WITH RELATED PARTIES

The Company rents premises from a company held by its related parties. These operations were carried out during the normal course of business and were measured at the exchange value, which is the amount of the consideration agreed to and accepted by the Company and the related party. As of March 31, 2010, no amount was included in accounts payable for transactions made with this related party compared to an amount of $14,946 as of March 31, 2009.

Over the first quarters of 2010 and 2009 and the last two complete fiscal years, the Company made the following transactions with this related party:

	MARCH 31		DECEMBER 31	
	2010	2009	2009	2008
Rent	**$15,792**	$15,698	$62,793	$61,561
Other Rent-related Expenses	**31,191**	36,102	80,175	71,138
	$46,983	$51,800	$142,968	$132,699

ACCOUNTING POLICIES

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

Use of Estimates

The preparation of financial statements in accordance with Canadian GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Since the financial reporting process requires the use of estimates, actual results could differ from these estimates.

Financial Instruments

Financial assets and financial liabilities are initially recognized at fair value and subsequent measurement depends on how they are classified, which is described below. Their classification depends on the purpose for which the financial instruments were acquired or issued, their characteristics, and the designation made by the Company. Settlement date accounting is used.

Classification

Cash and cash equivalents	Held for trading
Temporary investments	Held for trading
Accounts receivable	Loans and receivables
Accounts payable and accrued liabilities	Other liabilities

Cash and Cash Equivalents

Cash and cash equivalents include cash, bonds with maturities of three months or less and money market funds. The Company has classified these instruments as held for trading. These investments are highly liquid and are held for the purpose of meeting short-term cash commitments. They are recorded at fair value. Increases and decreases in fair value are recognized as investment income and presented under “Other revenues” in the statement of earnings.

Temporary Investments

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

Effective Interest Method

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

Fair Value

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

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

Inventories

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

When an impairment is recognized, a new assessment of net realizable value is performed in each subsequent period. When the circumstances that justified writing down the inventories below cost no longer exist, or when there is a clear indication of an increase in net realizable value due to a change in the economic situation, the amount of the write-down is reversed such that the new carrying amount is the lower of the cost or the revised net realizable value.

Property, Plant and Equipment

Property, plant and equipment are recorded at cost. Amortization is calculated using the declining balance method except for leasehold improvements and hospital equipment, which are amortized using the straight-line method at the following annual rates or useful life:

Office furniture, stand, equipment and tools for production and R&D	20%
Computer equipment and lift truck	30%
Leasehold improvements	Lease term
Hospital equipment	3 years

Intangible Assets

Intangible assets are recorded at cost. Amortization is calculated using the straight-line method over their estimated useful lives, as follows:

Technology and patents	20 years
Licence	16 years
Software and website	3 years
Trademarks	10 and 15 years

Impairment of long-lived Assets

Long-lived assets are tested for recoverability whenever events or changes in circumstances indicate that their carrying amount may not be recoverable. An impairment loss is recognized when their carrying value exceeds the total undiscounted cash flows expected from their use and eventual disposition. The amount of the impairment loss is determined as the excess of the carrying value of the asset over its fair value.

Foreign Currency Translation

Foreign currency transactions are translated into Canadian dollars as follows: monetary assets and liabilities are translated at the exchange rates in effect at the balance sheet date, non-monetary assets and liabilities are translated at historical rates, revenues and expenses are translated at the exchange rates in effect at the time of the transaction and exchange gains or losses resulting from translation are carried to earnings.

Government Assistance and Research and Development Tax Credits

Government assistance is recorded in the financial statements when there is reasonable assurance that the Company has complied with, and will continue to comply with, all of the conditions necessary to obtain the assistance.

The Company incurs research and development expenses that are eligible for tax credits. The recorded tax credits are based on management's estimates of amounts expected to be recovered and are subject to audit by taxation authorities.

Government assistance, including the tax credits for scientific research and experimental development costs, is presented in "Other revenues."

Revenue Recognition

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

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

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

Provision for Warranties

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

Stock-based Compensation

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

Future accounting changes

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

To prepare for the adoption of IFRS, the Company has developed an IFRS conversion plan. The Company has completed in 2009 the diagnostic phase, which involved a high-level review of the differences between current Canadian GAAP and IFRS, as well as a review of the alternatives available on adoption. Phase 2 of the plan, which will be completed by the end of 2010, allows the Company to evaluate the detailed consequences of the transition. This part of the plan will permit us to implement subsequently the required changes to our information systems and internal control mechanisms. The next phase will be prepare the opening balance sheet, the financial results (current and comparative), reconciliation notes as well as additional notes under IFRS and their initial adoptions.

The following are some of our key changes in accounting policies, which we expect would have impacts with respect to the recognition and measurement of certain balance sheet and income statement items. Unless otherwise indicated, all changes in accounting policy will be applied retrospectively.

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

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

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

RISK FACTORS

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

Risks associated with International Operations

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

Compatibility, Biocompatibility and Research and Development Projects

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

Dependency on Key Personnel

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

Management of Business Growth

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

Intellectual Property and Counterfeiting Risks

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

Competition Risks

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

Product Liability Issues

In the health sector, lawsuits, often claiming substantial damages, are becoming increasingly common. In particular, in the United States, lawsuits are filed by patients, employees or beneficiaries against healthcare providers, as well as authorities operating and managing hospitals in the private and public sectors. During these proceedings, claimants could allege and blame the non-sterility of certain instruments or defective functioning of products sold, installed or derived from TSO3's technology. To address the problems associated with such lawsuits, the Company is of the opinion that it has the necessary insurance coverage.

Regulatory Approvals

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

Financial Instruments

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

Market Risk

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

At March 31, 2010, if the base rate at that date had been 0.5% lower, all other variables held constant, the after-tax loss and other comprehensive items for the year would have been $13,404 lower, arising mainly as a result of an increase in the fair value of fixed rate financial assets classified as held for trading. If the base rates at that date had been 0.5% higher, all other variables held constant, the after-tax loss and other comprehensive items for the year would have been $14,683 higher, arising mainly as a result of a decrease in the fair value of fixed rate financial assets classified as held for trading. The net loss therefore has a similar sensitivity to interest rate increases and interest rate decreases because of investments with capped interest rates.

Credit Risk

The use of financial instruments can create a credit risk in which there is a risk of financial loss resulting from a counterparty's inability or refusal to fully meet its contractual obligations. The Company has established an investment policy that addresses credit risk management and includes the authorization to perform investment transactions with the Canadian federal or provincial governments, crown corporations, municipalities or financial institutions, either in money market funds, guaranteed investment certificates or bonds with credit ratings of a minimum of A- or more according to Standard and Poor's and another credit rating agencies. This policy defines credit risk limits based on the characteristics of the counterparties. Therefore, the Company manages credit risk by complying with its established investment policy. As at March 31, 2010, the Company's investments were rated by two recognized agencies, and they respected the Company's investment policy.

Concentration Risk

Concentration risk exists when investments are made with multiple entities that share similar characteristics or when a large investment is made with a single entity. At March 31, 2009, in accordance with the Company's investment policy, there were no investments totalling more than 30% that did not provide a government guarantee.

Liquidity Risk

Liquidity risk represents the possibility of the Company not being able to raise the funds needed to meet financial commitments at the appropriate time and under reasonable conditions. The Company manages this risk by maintaining permanent and sufficient liquidity to meet current and future financial obligations, under both normal and exceptional circumstances. The funding strategies used to manage this risk include turning to capital markets to carry out issues of equity and debt securities. The Company can not guarantee that it will be able to put in place such financing.

Currency Risk

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

At March 31, 2010, if the Canadian dollar had weakened 10 percent against the US dollar with all other variables held constant, the after-tax loss and other comprehensive items for the year would have been lower than $55,858. Conversely, if the Canadian dollar had strengthened 10 percent against the US dollar with all other variables held constant, the after-tax loss and other comprehensive items for the year would have been higher than $55,858.

SEGMENTED INFORMATION

Operating revenues are allocated between geographic areas based on the location of the client and are as follows for the three month periods, ended March 31, are as follows:

	FIRST QUARTER			
	2010		2009	
Canada	**$60,514**	**42%**	$158,192	30%
USA	**83,714**	**58%**	375,296	70%
	$144,228	**100%**	$533,488	100%

INTERNAL CONTROL OVER FINANCIAL REPORTING

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

FORWARD LOOKING STATEMENTS

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

Forward-looking information is based upon a number of assumptions and is subject to a number of risks and uncertainties, many of which are beyond the Company's control that could cause actual results to differ materially from those that are disclosed in or implied by such forward-looking information. These risks and uncertainties are described under the section "Risk factors" above.

Although the forward-looking information contained in this MD&A is based upon what the Company believes are reasonable assumptions, investors are cautioned against placing undue reliance on this information since actual results may vary from the forward-looking information. Consequently, all of the forward-looking information contained in this MD&A are qualified by the foregoing cautionary statements, and there can be no guarantee that the results or developments anticipated by the Company will be realized or, even if substantially realized, that they will have the expected consequences or effects on the Company, its business, financial condition or results of operation.
Investors are advised to consult the Company's quarterly and annual reports, as well as the filing of the Company's annual information form for more details on the risks and uncertainties related to these prospective statements. The reader must not unduly rely upon the Company's prospective statements.

This Management, Discussion and Analysis has been prepared as of May 11, 2010. Additional information on the Company is available through regular filing of press releases, annual reports, quarterly financial statements and the Annual Information Form on the SEDAR website www.sedar.com.

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

May 11, 2010

TSO_3 Inc.

QUARTERLY FINANCIAL STATEMENTS
March 31, 2010

Q1

Notice from Management

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

STATEMENTS OF EARNINGS AND COMPRENSIVE LOSS (Unaudited)

Period ended March 31

	FIRST QUARTER	
	2010	2009
SALES	**$144,228**	$533,488
EXPENSES		
Operating	**341,336**	594,273
Sales and Marketing	**313,358**	611,553
Research and Development	**758,344**	739,056
Administrative	**909,793**	695,828
Financial	**2,153**	4,308
	2,324,984	2,645,018
OPERATING LOSS	**2,180,756**	2,111,530
Other Income	**146,824**	124,186
NET LOSS AND COMPREHENSIVE LOSS	**$2,033,932**	$1,987,344
BASIC AND DILUTED NET LOSS PER SHARE (NOTE 10)	**$0.04**	$0.04

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

STATEMENTS OF CONTRIBUTED SURPLUS (Unaudited)
Period ended March 31

	FIRST QUARTER	
	2010	2009
Balance, beginning of period	**$8,110,388**	$7,900,943
Options exercised	**(19,397)**	-
Warrants granted	**620,250**	-
Stock-based Compensation	**38,374**	55,956
Balance, end of period	**$8,749,615**	$7,956,899

STATEMENTS OF DEFICIT (Unaudited)
Period ended March 31

	FIRST QUARTER	
	2010	2009
Balance, beginning of period	**$66,456,957**	$57,239,325
Share issue expenses	**1,233,027**	-
Compensation warrants to underwriters	**620,250**	-
Net Loss	**2,033,932**	1,987,344
Balance, end of period	**$70,344,166**	$59,226,669

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

BALANCE SHEETS
As of

	MARCH 31, 2010 (Unaudited)	DECEMBER 31, 2009 (Audited)
CURRENT ASSETS		
Cash and cash equivalents (Note 4)	**$21,876,087**	$6,727,088
Temporary investments (Note 5)	**2,422,450**	3,944,757
Accounts receivable	**1,034,289**	1,333,178
Inventories	**1,652,752**	1,483,810
Prepaid expenses	**143,882**	111,528
	27,129,460	13,600,361
PROPERTY, PLANT AND EQUIPMENT	**1,205,991**	1,256,339
INTANGIBLE ASSETS	**3,502,254**	3,549,189
	$31,837,705	$18,405,889
CURRENT LIABILITIES		
Accounts payable and accrued liabilities	**$1,771,814**	$1,488,029
Deferred revenues	**585,099**	633,483
	2,356,913	2,121,512
LONG-TERM DEFERRED REVENUES (Note 7)	**1,797,197**	1,418,850
	4,154,110	3,540,362
SHAREHOLDERS' EQUITY		
Share capital (Note 8)	**89,278,146**	73,212,096
Contributed Surplus	**8,749,615**	8,110,388
Deficit	**(70,344,166)**	(66,456,957)
	27,683,595	14,865,527
	$31,837,705	$18,405,889

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

STATEMENTS OF CASH FLOWS (Unaudited)
Period ended March 31

	FIRST QUARTER	
	2010	2009
OPERATING ACTIVITIES		
Net Loss	**($2,033,932)**	($1,987,344)
Adjustment for:		
Amortization of property, plant and equipment	**71,135**	46,962
Amortization of intangible assets	**80,390**	77,390
Change in the value of temporary investments	**18,474**	149,226
Stock-based compensation	**38,374**	55,956
Loss (gain) on disposal of property, plant and equipment	**-**	4,374
	($1,825,559)	($1,653,436)
Changes in non-cash operating working capital items	**711,341**	145,327
Transfer to R&D	**-**	(115,609)
Cash flows applied to operating activities	**(1,114,218)**	(1,623,718)
INVESTING ACTIVITIES		
Acquisition of property, plant and equipment	**(20,788)**	(165,522)
Acquisition of intangible assets	**(33,454)**	(24,910)
Disposal of temporary investments	**13,503,833**	2,631,887
Acquisition of temporary investments	**(12,000,000)**	-
Cash flows applied to investing activities	**1,449,591**	2,441,455
FINANCING ACTIVITIES		
Options exercised	**46,653**	-
Share issue expenses	**(1,233,027)**	-
Share issue	**16,000,000**	-
Cash flows from financing activities	**14,813,626**	**-**
INCREASE IN CASH AND CASH EQUIVALENTS	**15,148,999**	817,737
CASH AND CASH EQUIVALENTS AT BEGINNING	**6,727,088**	9,186,202
CASH AND CASH EQUIVALENTS AT THE END	**$21,876,087**	$10,003,939
Comprised of:		
Cash	**$6,169,357**	$5,063,875
Cash equivalents	**15,706,730**	4,940,064
CASH AND CASH EQUIVALENTS	**$21,876,087**	$10,003,939

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

NOTES TO THE FINANCIAL STATEMENTS (Unaudited)
Period ended March 31

1. Description of Business

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

2. Accounting Policies

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

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

3. Changes in Accounting Policies

Future Accounting Changes

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

4. Cash and Cash Equivalents

	MARCH 31, 2010	DECEMBER 31, 2009
Cash and cash equivalents are composed of:		
Cash	**$6,169,357**	$1,528,375
Short-term investments less than three months		
Bonds	**10,500,938**	2,997,931
Money market funds	**5,205,792**	2,200,782
	$21,876,087	$6,727,088

Bonds maturing at various dates through June 2010 and having an average yield of 0.31%

5. Temporary Investments

	MARCH 31, 2010	DECEMBER 31, 2009
Temporary investments are composed of:		
Bonds	**$2,422,450**	$3,944,757

Bonds maturing at various dates through August 2010 and having an average yield of 0.46%

6. Credit Facilities

The Company has a line of credit to obtain advances up to a maximum of $350,000. As of March 31, 2010, this line of credit was undrawn.

7. Long-term Deferred Revenues

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

During the first quarter, the Company completed an objective and record the third payment of $526,250. This amount is recorded in accounts receivable.

These deferred revenues are recognized on a straight line basis over the term of the agreement. During the first quarter, the Company recognized $44,046 under other income (3M™ License revenue amortization). On March 31, 2010, $2,007,472 is recorded in the deferred revenue, including an amount of $210,275 in short-term.

8. Share-Capital

	MARCH 31, 2010		DECEMBER 31, 2009	
Issued and paid	**Number**	**$**	Number	$
Balance at beginning	**47,867,568**	**$73,212,096**	47,863,402	$73,210,291
New Issue	**10,000,000**	**16,000,000**	-	-
Options exercised	**40,555**	**66,050**	4,166	1,805
Balance at end	**57,908,123**	**$89,278,146**	47,867,568	$73,212,096

On March 2, 2010, the Company closed a financing of $16,000,000 from the sale of 10,000,000 shares. In 2010, holders exercised certain options; they subscribed for 40,555 shares for a book value of $66,050. During 2009, they subscribed for 4,166 shares for a book value of $1,805.

Stock Options and Warrants

a) Stock Options

For the three-month period ended March 31, 2010, the Company awarded 28,000 stock options to its directors, at a weighted average exercise price of $1.55. The weighted fair value of these stock options was $1.24 per option.

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

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

The Black-Scholes options pricing model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable, a practice significantly different from how stock options are granted by the Company. In addition, option pricing models require highly subjective valuations and include the expected stock price volatility of the underlying shares. Any changes in the assumptions can materially affect the fair value estimates.

During the period ended March 31, 2010, Stock Options varied as follows:

	THREE MONTHS	
Stock Options	**Number**	**Weighted Average Exercice Price**
Outstanding at the beginning of three month period	**4,179,544**	**$1.20**
Granted	**28,000**	**$1.55**
Exercised	**(40,555)**	**$1.15**
Forfeited	**(13,747)**	**$0.77**
Outstanding at the end of period	**4,153,242**	**$1.20**
Exercisable at the end of period	**2,653,000**	**$1.61**

b) Warrants and Compensation

During the period ended March 31, 2010, Warrants varied as follows:

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

Following the round of financing, as additional consideration for services rendered, the Underwriters have been granted 750,000 warrants by the Company. Each warrant can be used to purchase one common share of the Company at a price of $1.60 for a period of 18 months following the closing date of the deal. The weighted fair value of these stock warrants was $0.83 per warrant.

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

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

9. Capital Management

The Company needs capital primarily to finance its research and development activity, its operating, administrative and marketing expenses, its working capital and its capital expenditures. In the past, the Company has financed its activities through various rounds of public and private financing as well as through government grants.

For the three-month period ended March 31, 2010, the monthly burn-rate was approximately $389,000. In the current conditions, the Company believes that its current liquid assets are sufficient to finance its activities into 2013. Excluding the liquidity brought by the 3M™ Agreement in the first quarter of 2010, the monthly burn rate would have been approximately $564,000.

10. Earnings per Share

The following table reconciles the basic and the diluted earnings per share for the three month period ended March 31:

	FIRST QUARTER	
	2010	2009
Net Loss		
Basic and Diluted	**$2,033,932**	$1,987,344
Number of shares		
Weighted average number of outstanding shares (1)	**51,227,865**	47,863,402
Loss per Share		
Basic	**$0.04**	$0.04
Diluted (2)	**$0.04**	$0.04

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

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

11. Financial Instruments

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

Market Risk

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

At March 31, 2010, if the base rate at that date had been 0.5% lower, all other variables held constant, the after-tax loss and other comprehensive items for the year would have been $13,404 lower, arising mainly as a result of an increase in the fair value of fixed rate financial assets classified as held for trading. If the base rates at that date had been 0.5% higher, all other variables held constant, the after-tax loss and other comprehensive items for the year would have been $14,683 higher, arising mainly as a result of a decrease in the fair value of fixed rate financial assets classified as held for trading. The net loss therefore has a similar sensitivity to interest rate increases and interest rate decreases because of investments with capped interest rates.

Credit Risk

The use of financial instruments can create a credit risk in which there is a risk of financial loss resulting from a counterparty's inability or refusal to fully meet its contractual obligations. The Company has established an investment policy that addresses credit risk management and includes the authorization to perform investment transactions with the Canadian federal or provincial governments, crown corporations, municipalities or financial institutions, either in money market funds, guaranteed investment certificates or bonds with credit ratings of a minimum of A- or more according to Standard and Poor's or other credit rating agencies. This policy defines credit risk limits based on the characteristics of the counterparties. Therefore, the Company manages credit risk by complying with its established investment policy. As at March 31, 2010, the Company's investments were rated by two recognized agencies, and they respected the Company's investment policy.

Concentration Risk

Concentration risk exists when investments are made with multiple entities that share similar characteristics or when a large investment is made with a single entity. At March 31, 2009, in accordance with the Company's investment policy, there were no investments totalling more than 30% that did not provide a government guarantee.

Liquidity Risk

Liquidity risk represents the possibility of the Company not being able to raise the funds needed to meet financial commitments at the appropriate time and under reasonable conditions. The Company manages this risk by maintaining permanent and sufficient liquidity to meet current and future financial obligations, under both normal and exceptional circumstances. The funding strategies used to manage this risk include turning to capital markets to carry out issues of equity and debt securities. The Company can not guarantee that it will be able to put in place such financing.

Currency risk

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

At March 31, 2010, if the Canadian dollar had weakened 10 percent against the US dollar with all other variables held constant, the net loss, for the three-month period, would have been $55,858 lower. Conversely, if the Canadian dollar had strengthened 10 percent against the US dollar with all other variables held constant, the net loss, for the three-month period, would have been $55,858 higher.

12. Comparative Figures

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