Annual Report 2012

2012 ANNUAL REPORT

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MESSAGE FROM THE CHAIRMAN OF THE BOARD

Dear Shareholders,

In recent years, TSO_3 has been able to reposition itself for success with an enhanced technology targeted at delivering its vision "to offer the improved standard in healthcare sterile reprocessing".

At the end of 2012, TSO_3 stands with a proven product; one that offers the promised benefits to its users. While the Company has secured both Canadian and European clearances, it has yet to obtain the most significant one for the business: the regulatory clearance in the United States. We are obviously disappointed to experience such delays in securing US clearance; however, we remain convinced in the technology's superior capabilities and confident in our recent simplified approach.

The Board of Directors intends to continue supporting Management and operates in a rigorous way to ensure appropriate oversight and governance is in place. The various Board committees, such as Advisory Committee, Corporate Governance and Nomination Committee, Human Resources Committee and Audit Committee have met on a regular basis throughout the recent year. Key activities have been around risk assessment audit, Board Member review, incentive review and succession plan.

In order to carry out its responsibilities with regard to the financial statements, Management maintains internal control systems that aim to provide a reasonable degree of certainty that transactions are duly authorized, that the assets are well protected, and that adequate records are kept. The Board of Directors' Audit Committee, comprised solely of independent Board Members, ensures that Management assumes its responsibility in that matter and meets regularly with Management and the external auditors to review the financial statements, as well as the systems of internal control and security. It also recommend the appointment of the external auditors and their fees.

As Chairman of the Board, I remain committed to the Company. I am proud to witness the activities that have been undergoing in 2012 and the level of decision making that has taken place. The year 2013 presents both challenges and opportunities; it will be a critical year for the Company. I am confident in TSO_3's chances for success, while it delivers a better technology in the healthcare environment.

Germain Carrière
Chairman of the Board

MESSAGE FROM THE PRESIDENT AND CEO

Dear valued Shareholders,

2012 was an important year for TSO_3. While we did not achieve the US regulatory clearance, we made important and critical decisions in order to protect shareholder value and prepare for key steps forward. We reset our channel strategy and better prepared ourselves for 2013; a year in which we expect a great deal to come together.

The year began with TSO_3 completing the Canadian "upgrade program", in which we offered Canadian users of the original ozone only sterilizer an incentive to upgrade to the STERIZONE® 125L+ Sterilizer. Most of the Canadian customers opted into this very successful program executed by TSO_3, which allowed the placement of several new sterilizers on the Canadian market. These customers, along with new purchasers of the STERIZONE® 125L+ Sterilizer, are experiencing the high throughput, low cost, value of the technology.

As you are aware, in 2012 we did not achieve our stated priority of obtaining US regulatory clearance for the product. While we applied every effort, including supplying a new submission, it became clear towards the end of the year that the Agency desired a simplified approach. We drew this conclusion based on our interactions and our responses to their questions. Late in the year, we made the decision that this would be our path forward and in January 2013, we did file the cleaned-up and simplified version of the document to the Agency.

In 2012, the lack of US regulatory clearance negatively impacted the commercial introduction of the product by 3M in other markets where it had already been approved. According to the terms of the contract in place between the 3M Company and TSO_3, not obtaining the US regulatory clearance within two years of the original filing date allowed TSO_3 to terminate the contract, which the Company did in June 2012. While negotiations took place on a non exclusive basis to define new terms of an agreement, said terms could not be reached and discussions with 3M were closed. 3M disputes TSO_3's right to terminate the agreement. As a result, the companies have entered into a process to mediate the dispute. As of the time this letter is written, the dispute has not yet being resolved.

TSO_3 also opened discussions with Getinge Infection Control (division of Getinge AB). In August 2012, TSO_3 released that we had signed a Letter of Intent (LOI) with Getinge for the global distribution and service of its product line for acute care and life science markets. At the time the LOI was signed, each company believed that the negotiations would be swiftly concluded. While the dialogue between the companies has been productive, we have not yet been able to agree on certain terms and as a result, we continue to attempt to address open items. To be clear, we are not looking for a "quick agreement", but rather for the "right agreement": one that reflects the value of not only the current product, but also of the technology and opportunities for future developments.

During the year, we continued to push forward the development of the Company's second product, the STERIZONE® 80L Sterilizer, a smaller "purpose built" sterilizer for use in the OR sub-sterile area. This program, as previously outlined, saw resources diverted from it to support the work on the STERIZONE®125L+ Sterilizer response to regulatory questions and thus, was slowed during the year. The Company believes it prudent to obtain the US clearance on the STERIZONE® 125L+ Sterilizer, prior to submitting the STERIZONE® 80L Sterilizer for clearance in that market and other international markets. That being said, with the simplified submission for the STERIZONE® 125L+ Sterilizer now in front of the US Regulators as of early 2013, the work on the STERIZONE® 80L Sterilizer is back on track and a more precise timeline for its introduction will be available as we progress into the year.

Once again we would like to thank you, the Shareholders and owners of the Company, for your continued support. I also wish to acknowledge the continued dedication of our employees and thank them for their efforts throughout the year. I also wish to thank the Board of Directors for their input and support. We look forward to updating you on activities over the coming weeks and months.

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 62 people. The Company's activities encompass research, development, commercialization and licensing of sterilization processes and accessories for heat-sensitive medical devices.

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

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

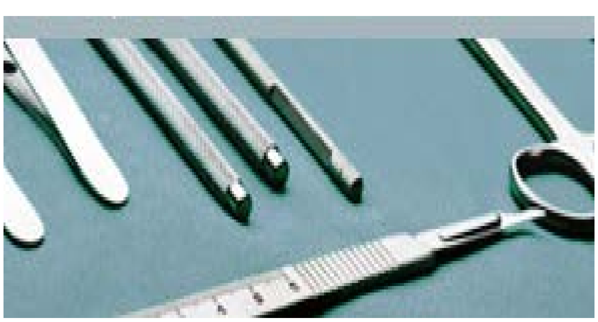
Despite its advantages, the first generation product did not succeed in addressing the overall market needs for fast turn-around times and high throughput and therefore, had limited commercial success achieving only 38 sales in North America by TSO_3's own sales force over a period of five years.

A renewed approach

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

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

Our business environment and the market drivers



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

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

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

Why low temperature sterile reprocessing

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

Today's surgical suite is very different from those of the past. Presently, 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.

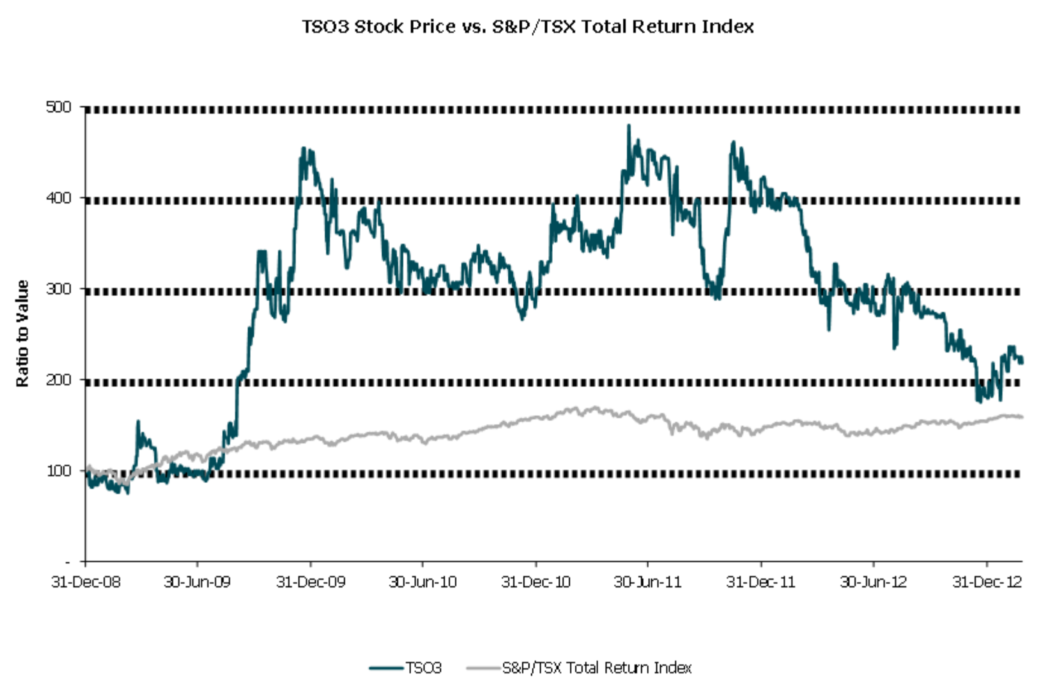
Our competitive landscape

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

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 stock 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 playing an important role in a sub-segment of low temperature sterilization is Liquid Chemical Sterilization. This type of procedure is located directly in the OR as a just-in-time method to complement the CS Department's sterile production. The GI department is also a heavy user of Liquid Chemical Sterilization. Liquid systems are not terminal and require rinsing with extensively treated water that cannot be assured to be sterile. As such, instruments also cannot be assured to be sterile when used on a patient. These products each offer 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.

RECENT HISTORY



The above graph compares TSO_3's stock price against the S&P/TSX Total Return Index and has been constructed by investing on December 31, 2008 $100 in TSO_3 shares and $100 in the S&P/TSX Total Return Index. The date of December 31, 2008 was chosen because it was in 2008 that a new management team was appointed at TSO_3 and a new business plan implemented.

On December 31, 2012, the portfolio invested in TSO_3 shares was worth $179.55, reflecting a compounded annual return of 15.8% since December 2008, whereas the portfolio invested in the S&P/TSX Total Return Index was worth $155.00, reflecting a 11.7% compounded annual return over the same period.

The Company's performance is a direct result of changes that have taken place since 2008 when new management introduced a new strategic direction. Efforts were concentrated on developing a new generation sterilizer, the STERIZONE® 125L+ Sterilizer to be distributed through a channel partner. An exclusive marketing agreement was signed with 3M at the end of 2009 and the new generation product was afterwards rebranded 3M™ Optreoz™ 125-Z Sterilizer and commercialized in cleared territories outside of the United States.

The commercial launch of the 3M™ Optreoz™ 125-Z Sterilizer (STERIZONE® 125L+ Sterilizer) was initiated at the end of Q2-2011. On June 30, 2011, TSO_3 made a new filing in order to obtain clearance from the US Regulatory Authorities for the sale of the 3M™ Optreoz™ 125-Z Sterilizer (STERIZONE® 125L+ Sterilizer), in the United States. At the end of Q3-2011, the Company launched a program to enable Canadian users of the former product to trade in their 125L Ozone Sterilizer for the 3M™ Optreoz™ 125-Z Sterilizer (STERIZONE® 125L+ Sterilizer).

The revenue of TSO_3 increased in Q2-2011. A further increase was seen in Q3-2011 due to additional shipments directed at end-users, as well as initial shipments of consumables. It was not until the end of Q4-2011 that sales were stimulated by the upgrade program launched at the end of Q3-2011.

At the beginning of 2012, the Company experienced sustained revenues as a result of shipments made to the 3M Company and completion of the upgrade program launched in September 2011. However, towards the end of Q2, the size of shipments to the 3M Company weakened significantly. The Company concluded that the delays in securing the clearance for marketing the product within the United States had caused a slower than anticipated roll-out outside the United States by the 3M Company's subsidiaries.

On June 15, 2012, the Company delivered a notice of termination of its agreement with the 3M Company based on the termination rights provided by the agreement to both parties in the event that the US regulatory clearance had not been obtained within 24 months of the original filing date. Subsequent to that termination, sales were virtually eliminated.

Subsequent to termination of the 3M Agreement, TSO_3 has had other non-exclusive discussions aiming to secure an alternative partnership. On August 7, 2012, TSO_3 announced that it had signed a non binding letter of intent with Getinge Infection Control, a division of the Getinge AB, in order to negotiate the terms of a worldwide distribution agreement for Getinge to distribute Company's products.

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Regulatory Status

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

In April 2012, an updated file was submitted to the US Regulatory Authorities. Since then the Company has received follow-up questions and as a results of the answers provided and the interactions with the Agency, announced, in December 2012, the adoption of a simplified strategy in its application for clearance in the United States.

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.

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 has also initiated the development of additional products based on its patented STERIZONE® technology.

The first of these new products, the STERIZONE® 80L Sterilizer, is being developed and is targeting the need for a smaller device, in particular with respect to the operating room and sub-sterile area in North America and as a lower price-point product for some European markets.

This program, as outlined in other communications, saw resources diverted from it during 2012 to support the work on the STERIZONE® 125L+ response to regulatory questions. With the new filing now submitted, the work on the STERIZONE® 80L is being reemphasized and the Company intends to submit that new product for regulatory clearances once the US clearance on the STERIZONE® 125L+ has been obtained.

Partnership Agreement

In 2012, the Company concluded that the delays in securing the US regulatory clearance had caused a slower than anticipated roll-out by 3M subsidiaries in markets outside of the US where the product was already cleared. This resulted in limited orders from the 3M Company during the first half of 2012.

On June 15, 2012, TSO_3 delivered a notice of termination of its agreement with the 3M Company based on the right provided by the agreement to both parties in the event that the US regulatory clearance had not been obtained within 24 months of the original filing date. The 3M Company disputes the right of TSO_3 to terminate the Agreement. Mediation intended to resolve the dispute was initiated in the fourth quarter 2012 and is continuing.

As a result of the termination of the agreement with 3M and in accordance with the Company's accounting policies, on June 30, 2012, TSO_3 recognized as revenue the $1,585,833 unamortized balance of deferred license revenue.

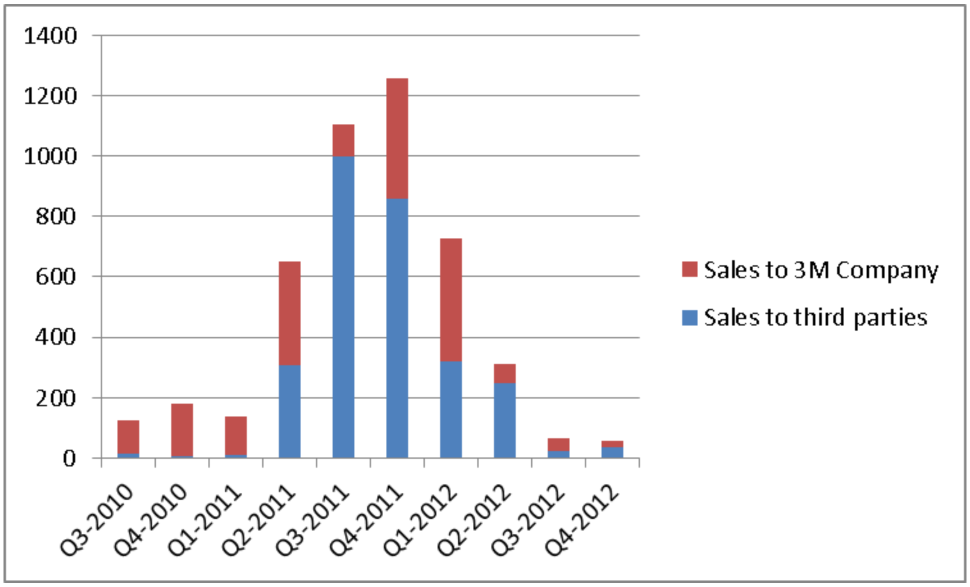
Subsequent to termination of the distribution agreement with the 3M Company, TSO_3 has had other non-exclusive discussions aiming to secure an alternative partnership. On August 7, 2012, TSO_3 announced that it had signed a non-binding letter of intent with Getinge Infection Control, a division of the Getinge AB, in order to negotiate the terms of a worldwide distribution agreement for Getinge to distribute the Company's products. The two companies are still pursuing negotiations at this time. Negotiations have been slower than expected but continue.

Recent Commercial Activities

In order to understand recent events and the financial results of TSO_3, it must be recognized that, for the past two years, the volume of commercial activities has fluctuated significantly. In the first quarter of 2011, sales were very low as the Company was transitioning from supporting the 125L Ozone Sterilizer that had been commercialized up to 2010 in North America to the new STERIZONE® 125L+ Sterilizer.

At the end of the second quarter of 2011, the Company, through its former channel partner, initiated commercial activities for the STERIZONE® 125L+ Sterilizer (3M™ Optreoz™ 125-Z). Sales were then pushed in Q2-2011 to quarterly levels never experienced before by the Company.

($000)	2010		2011				2012			
	Q3	Q4	Q1	Q2	Q3	Q4	**Q1**	**Q2**	**Q3**	**Q4**
Sales to 3M Company	13	6	10	306	996	858	**322**	**246**	**24**	**34**
Sales to third parties	110	172	127	344	105	399	**406**	**64**	**42**	**25**
Total Sales	123	178	137	650	1 101	1 257	**728**	**310**	**66**	**59**



In September 2011, TSO_3 launched an upgrade program whereby Canadian users of the 125L Ozone Sterilizer could exchange their sterilizer for a 3M™ Optreoz™ 125-Z Sterilizer (STERIZONE® 125L+ Sterilizer) by trading it in and paying cash consideration reflecting a significant discount over the retail price of the sterilizer. Shipments in connection with the upgrade program, executed by TSO_3, took place in Q4-2011 and Q1-2012 and are part in the above table of the “Sales to third parties”.

The end of shipments under the upgrade program and a decrease in orders placed by the 3M Company created a sharp contraction in sales in Q2-2012. Sales to the 3M Company during the first semester of 2012 were 69% lower than in the last semester of 2011.

Finally, the termination on June 15, 2012 of the distribution agreement with the 3M Company explains the virtual elimination of sales to TSO_3’s former channel partner. Meanwhile, as the Company discusses on a non-exclusive basis with a third party to establish a new distribution agreement, sales are reduced to 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. Ongoing sales are also comprised of consumables for the 3M™ Optreoz™ 125-Z Sterilizer (STERIZONE® 125L+ Sterilizer).

Financing Activities

On April 24, 2012, the Company closed an equity issue of 6,900,000 units for gross proceeds of $8,970,000. Each Unit is comprised of one common share and one half warrant. Each warrant entitles its holder thereof to purchase one additional common share of the Company at a price of $2.00 per common share no later than April 24, 2013.

On March 4, 2013, the Company closed a common share issue with gross proceeds of $7,000,000 at the price of $1.00 per share.

Twelve month focus

- Obtain United States regulatory clearance for the STERIZONE® 125L+ Sterilizer;
- Secure the right channel partner agreement which reflects both current and post US regulatory clearance opportunities, as well as new products developments;
- File for regulatory clearance for the second product - the STERIZONE® 80L Sterilizer - targeting the need for a smaller device (OR sub-sterile in North America) and initiate commercial activities for that product.

FORWARD LOOKING STATEMENTS

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

The Company believes that the expectations reflected in those forward-looking statements are reasonable, but no assurance can be given that these expectations will prove to be correct. These statements speak only as of the date of this report. Actual results and developments are likely to differ, and may differ materially, from those expressed or implied by the forward-looking statements contained or incorporated by reference. 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.

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 may differ materially from those expressed or implied by such 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 important factors is not exhaustive. Investors and others who base themselves on the Company's forward-looking statements should carefully consider the above factors as well as the uncertainties they represent and the risk they entail. The reader must not unduly rely upon the Company's prospective statements.

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

The Management, Discussion and Analysis has been prepared as at March 19, 2013, Additional information on the Company is available through regular filing of press releases, annual reports, quarterly financial statements and the Annual Information Form on the SEDAR website www.sedar.com.

Benoît Deschamps
Vice President of Finance and
Chief Financial Officer

March 19, 2013

MANAGEMENT DISCUSSION AND ANALYSIS

The Management discussion and analysis (MD&A) is intended to help the readers to assess, through the eyes of management, the financial position and results of operations of TSO_3 Inc. ("TSO_3" or the "Company") for the twelve-month period ended December 31, 2012. This information is dated March 19, 2013 and should be read in conjunction with the Annual Audited Financial Statements and the accompanying notes. Unless specified otherwise, the amounts are stated in Canadian dollars.

The financial information contained in this MD&A and in the Company's Audited Financial Statements has been prepared in accordance with the International Financial Reporting Standards ("IFRS").

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

This MD&A contains forward-looking information. Additional information about the forward-looking information can be found on page 14 as well as the associated risks and uncertainties can be found on pages 29 to 35 of the report.

SUMMARY OF RESULTS

Years ended December 31

(Audited, IFRS Basis)

	2012 **$**	2011 $
Revenues		
Sales	**1,162,922**	3,145,162
License Revenue	**1,690,971**	210,275
Total Revenues	**2,853,893**	3,355,437
Expenses		
Supply Chain	**1,801,735**	2,934,597
Customer Support and Communications	**639,766**	769,862
Research and Development	**2,877,203**	3,999,794
Administrative	**3,476,843**	3,473,215
Financial Income	**(167,708)**	(194,247)
Financial Costs	**21,652**	27,637
Total Expenses	**8,649,491**	11,010,858
Net Loss before Income Taxes	**(5,795,598)**	(7,655,421)
Income Taxes	**-**	-
Net Loss and Total Comprehensive Loss attributable to Shareholders	**(5,795,598)**	(7,655,421)
Basic and Diluted Net Loss per Share	**(0.09)**	(0.13)
Weighted Average Number of Shares Outstanding	**63,675,137**	58,289,996

RESULTS ANALYSIS

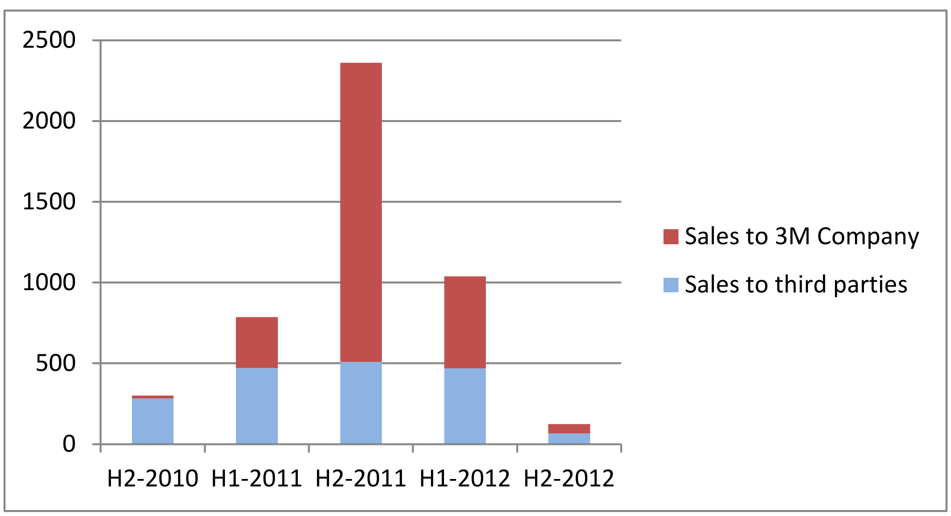
In the following paragraphs, the Company discusses the variations of certain accounts within the 12-month periods ended December 31, 2012 and 2011.

TOTAL REVENUES

Sales

In fiscal 2012, sales amounted to $1,162,922, as compared to $3,145,162 in 2011. Most of the sales in 2012, or $1,037,545, were made during the first semester while, in 2011, most of the sales or $2,357,745 were made in the second semester. In 2012, 54% of the sales were to the 3M Company (69% in 2011) that had initiated, in June 2011, marketing the STERIZONE® 125L+ Sterilizer under the brand 3M™ Optreoz™ 125-Z Sterilizer (STERIZONE® 125L+ Sterilizer). Having not received US regulatory clearance within two years of the original filing date, and after it had experienced a large reduction in orders from 3M in Q2-2012, the Company terminated its Distribution Agreement, The lower sales in the second semester of 2012 are the result of a virtual elimination of sales to the 3M Company since the middle of the second quarter of 2012.

In September 2011, the Company launched an upgrade program whereby users of the 125L Ozone Sterilizers could trade-in their sterilizers to acquire, at a discounted price, 3M™ Optreoz™ 125-Z Sterilizers (STERIZONE® 125L+ Sterilizer). Most of the Q4-2011 and Q1-2012 sales made to clients other than 3M were made under that upgrade program. Beginning in Q2-2012, after the program had ended, the smaller installed base of 125L Ozone Sterilizers generated fewer consumables and service revenues to TSO_3 with the consequence that sales to clients other than 3M decreased to minimal levels.



Subsequent to termination of the distribution agreement with the 3M Company, TSO_3 had other non-exclusive discussions to secure an alternative partnership and signed a non binding letter of intent with Getinge Infection Control, a division of the Getinge AB**.** The Company's strategy has not been to invest resources in developing its own sales organization and, as a result of the foregoing, its sales have been reduced to minimum levels.

License Revenue

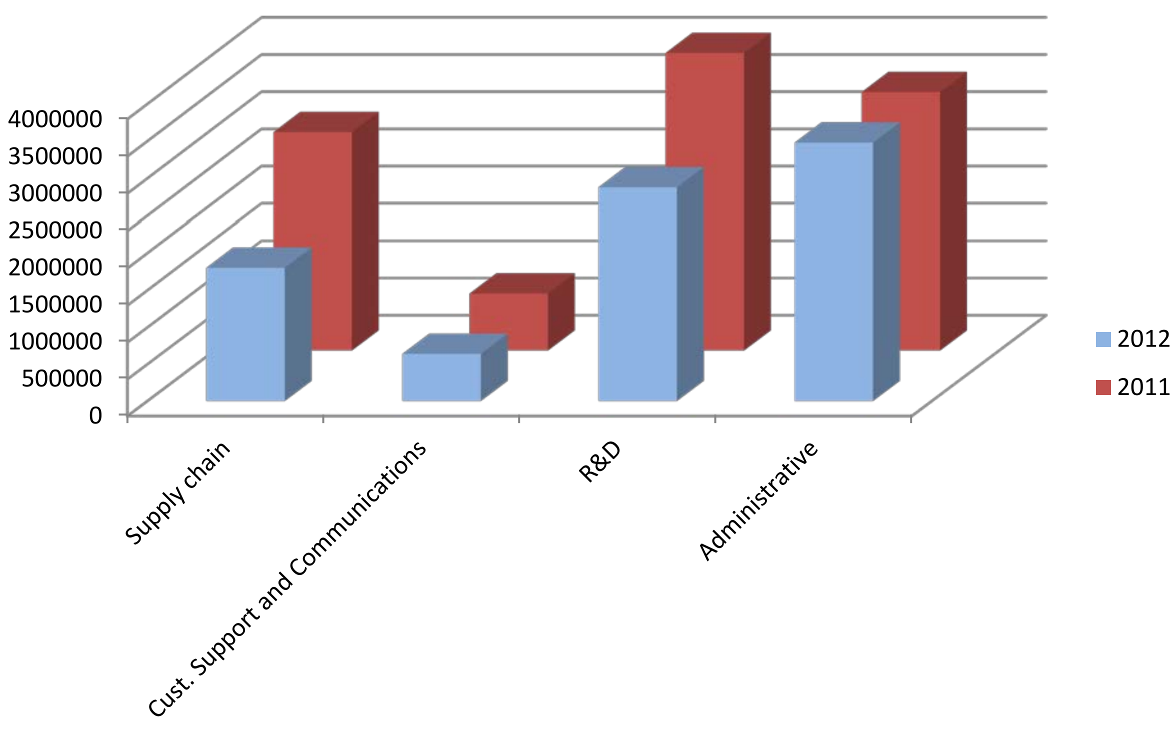
Until June 2012, TSO_3 was recognizing revenue over the expected initial term of its agreement with the 3M Company by amortizing the payments it had received under that agreement. In June 2012, as a result of the termination of the 3M agreement, all unamortized license payments were recognized as revenue.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

For the twelve-month period ended December 31, 2012, license revenue amounted to $1,690,971, as compared to $210,275 for the same period in 2011. The increase from 2011 to 2012 is due to the recognition as income, in June 2012, of the $1,585,833 unamortized deferred license revenue from 3M.

NET LOSS

In fiscal 2012, the Company experienced a loss of $5,795,598 ($0.09 per share), as compared to $7,655,421 ($0.13 per share) in 2011. The decrease in the net loss is primarily due to the recognition as income, in June 2012, of an amount of $1,585,833 in unamortized deferred license revenue.

EXPENSES



Supply Chain

Supply Chain expenses include all of the expenses incurred in connection with (1) the outsourcing of products and services for all departments, (2) production, (3) related quality control and assurance, and (4) shipping.

For the fiscal year ended December 31, 2012, the Supply Chain expenses amounted to $1,801,735, as compared to $2,934,597 in 2011. The variation is due to the reduction in sales which has led to reduced sourcing activities and staff reductions. Staff has been reallocated to other departments.

Customer Support and Communications

Beginning in 2012, TSO_3 has regrouped all activities related to corporate communications, customer service and technical assistance, including support to a former partner in its customer support and communication activities.

For the fiscal year ended December 31, 2012, the customer support and communication expenses amounted to $639,766, as compared to $769,862 in 2011. The cost of customer support activities and corporate communications was lower in 2012 than in 2011 due to smaller technical assistance expenses.

Research and Development

Starting in Q2-2012, there has been a reallocation of research and development resources away from new product development and towards work related to the filings with the US regulatory agency.

For the fiscal year ended December 31, 2012, the research and development expenses amounted to $2,877,203, as compared to $3,999,794 in 2011. During the first three quarters, the R&D expenses were similar in 2012 and in 2011. Lower expenses for the entire year 2012 are primarily the result of (1) $603,521 related to the collection and the recording of unbooked R&D tax credits for the years 2008 to 2011 and (2) a decrease in expenses during the fourth quarter. The unbooked investment tax credits are the result of additional claims made by the Company for years 2008 to 2010 and the company's policy to provision no more than 80% of the amounts claimed as well as. The lower expenses in Q4-2012 were due to several items, including (1) lower maintenance costs for medical devices, (2) fewer compatibility studies, and (3) lower payroll expenses as a result of attrition.

Administrative

For the fiscal year 2012, the administrative expenses amounted to $3,476,843, as compared to $3,473,215 in 2011. These variations were offsetting each other, the largest ones being a reduction in incentive-based compensation and an increase in professional fees and in stock exchange listing fees.

Financial Income

For the year ended December 31, 2012, these revenues amounted to $167,708, as compared to $194,247 in 2011.

The difference is primarily due to lower interest rates as the average maturity of the investments shortened in 2012.

FINANCIAL POSITION ANALYSIS

(Audited, IFRS Basis)

	2012 **$**	2011 $
Cash and Cash Equivalents	**7,758,103**	8,782,207
Short-term Investments	**5,049,087**	2,602,166
Accounts Receivable	**1,029,265**	1,893,470
Inventories	**1,216,721**	1,120,482
Property, Plant and Equipment	**1,208,394**	1,218,381
Intangible Assets	**3,034,213**	3,226,735
Accounts Payable and Accrued Liabilities	**842,867**	1,231,201
Warranty Provision	**62,032**	88,972
Deferred Revenues (Current and Non-Current)	**103,035**	1,906,520
Equity	**18,427,493**	15,693,763

Liquid Assets

As of December 31, 2012, cash, cash equivalents and short-term investments amounted to $12,807,190, as compared to $11,384,373 in 2011.

Accounts Receivable

From their level of $1,893,470 on December 31, 2011, the accounts receivable decreased to $1,029,265 on December 31, 2012. Most of the decrease is due to a reduction in trade receivables as a result of lower sales in Q2, Q3 and Q4 of 2012.

As at December 31, 2011, the receivable amount includes a $589,200 provision for R&D tax credits, which was increased to $893,066 as at December 31, 2012.

Inventories

As at December 31, 2012, inventories amounted to $1,216,721, as compared with $1,120,482 on December 31, 2011.

	2012 **$**	2011 $
Raw Materials	**874,635**	730,465
Work in Progress	**111,470**	198,657
Finished Goods	**230,616**	191,360
	1,216,721	1,120,482

Raw materials inventory has increased primarily in the fourth quarter of 2012 as a result of the Company receiving raw materials and components ordered prior to the termination of the 3M Agreement and on the basis of a production plan reflecting market penetration in those markets where regulatory clearance had been obtained.

In spite of interrupting the production due to an unplanned lack of orders from the 3M Company in the second quarter of 2012, TSO_3 has been able to postpone certain deliveries of raw materials, thereby delaying the corresponding increase in inventories. A certain amount of similar deliveries are still pending, but nothing that would materially change the Company's financial position.

The combined level of work-in-progress and finished goods inventories has decreased by $47,931 from December 31, 2011 to December 31, 2012. The sterilizers that were in inventory at the end of 2011 were shipped in 2012, but partly replaced by units manufactured prior to the termination of the 3M Agreement. Such inventories at the end of 2012 primarily consist of 3M™ Optreoz™ 125-Z Sterilizers (STERIZONE® 125L+ Sterilizer) and branded related accessories but which could easily be rebranded under the TSO_3 trademark STERIZONE®.

	2012 **$**	2011 $
Inventories at the beginning of the period	**1,120,482**	1,460,304
Write-off of raw material inventories	**(72,088)**	(288,972)
Transfer to property, plant and equipment	**(247,980)**	(532,033)
Net addition to inventories	**416,307**	481,183
Inventories as at December 31	**1,216,721**	1,120,482

During 2012, the Company transferred sterilizers worth $247,980 ($532,033 in 2011) from its finished goods inventory to its property, plant and equipment to utilize them as part of its research and development activities. Finally, in 2012, primarily in connection with impaired or slow moving raw material inventories, the Company wrote-off inventories worth $72,088, as compared with $288,972 in 2011.

Property, Plant and Equipment

During 2012, the Company added $480,188 to its Property, Plant and Equipment, including $247,980 added to sterilizers used internally and $113,388 in medical devices used as part of its tests for efficacy and compatibility. For 2011, capital expenditures on Property, Plant and Equipment were $737,818, including $532,033 for sterilizers used internally and $97,560 for medical devices.

Intangible Assets

In 2012, the Company capitalized $109,732 in intangible assets, as compared to $143,947 for the entire year 2011. Most of these expenditures were in connection with software acquisition and registration of patents and trademarks.

Accounts Payable and Accrued Liabilities

Accounts payable and accrued liabilities decreased from $1,231,201 as at December 31, 2011 to $842,867 as at December 31, 2012. This reduction is due to smaller purchases as a result of a lower volume of sales.

Warranty Provision

The warranty provision decreased from $88,972 on December 31, 2011 to $62,032 on December 31, 2012. This reduction is due to a lower volume of sales.

Deferred Revenues

As at December 31, 2012, current and non-current deferred revenues amounted to $103,035, as compared to $1,906,520 as at December 31, 2011.

The variation in deferred revenues in 2012 is explained by the recognition, in June 2012, of the unamortized balance of the license revenue for an amount of $1,585,833.

Any remaining deferred revenues stem from the prepaid portion of service contracts on the 125L Ozone Sterilizers commercialized by the Company up to the beginning of 2010.

Shareholders' Equity

For the fiscal year ended December 31, 2012, shareholders' equity increased by $2,733,730. This increase is primarily the net result of (1) the equity issue closed on April 24, 2012 providing net cash proceeds of $8,151,365, (2) the exercise of stock options, and (3) the absorption of the $5,795,598 deficit for the year 2012.

CASH FLOWS ANALYSIS

(Audited, IFRS Basis)

	2012 $	2011 $
Operating Activities	**(6,469,004)**	(8,644,500)
Investing Activities	**(2,762,720)**	10,092,882
Financing Activities	**8,207,620**	1,218,528

Operating Activities

Cash absorbed by Operating Activities amounted to $6,469,004 for the fiscal year ended December 31, 2012, as compared to $8,644,500 in 2011.

The lower amount of cash absorbed by operations during 2012 is explained by the fact that the reduction in receivables, inventories and payables generated $379,632 in 2012, while the same items had absorbed $1,058,486 during the same period in 2011. On a year-to-year basis, the movements of these operating working capital components have experienced a reversal of more than $1, 438,118, thereby explaining most of the variation between 2012 and 2011. This variation was due to the fact that in 2011, sales and working capital were increasing, while they were decreasing in 2012.

Investing Activities

For the fiscal year ended December 31, 2012, cash flows absorbed by the Investing Activities amounted to $2,762,720 as compared to $10,092,882 generated for the same period in 2011.

The variation is primarily due to the monetization of short-term financial investments during 2011.

Financing Activities

For the fiscal year ended December 31, 2012, cash flows from Financing Activities amounted to $8,207,620, as compared to $1,218,528 for the same period in 2011.

The 2012 amount is primarily due to the net cash proceeds of $8,151,365 from the equity issue closed on April 24, 2012 while the 2011 amount was primarily the result of the $1,200,000 proceeds from the exercise of warrants.

SUMMARY OF QUARTERLY RESULTS

(Unaudited, IFRS Basis)

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

($000 except loss/share)	2012				2011			
	Q4	**Q3**	**Q2**	**Q1**	Q4	Q3	Q2	Q1
Sales	59	66	310	728	1,257	1,101	650	137
License Revenue	-	-	1,639	52	52,5	52,5	52,5	52,5
Net Loss	1,100	2,160	526	2,009	1,398	2,261	2,116	1,880
Net Loss per Share (basic and diluted)	0.02	0.03	0.01	0.03	0.02	0.04	0.04	0.03

FOURTH QUARTER ANALYSIS

(Unaudited, IFRS Basis)

Three-month period ending December 31, 2012, compared to the three-month period ending December 31, 2011.

	2012 $	2011 $
Revenues		
Sales	**59,140**	1,256,854
License Revenue	**-**	52,569
Total Revenues	**59,140**	1,309,423
Expenses		
Supply Chain	**270,543**	960,456
Customer Support and Communications	**168,170**	104,366
Research and Development	**(184,923)**	965,605
Administrative	**948,152**	713,074
Financial Income	**(37,815)**	(39,952)
Financial Costs	**(5,013)**	4,067
Total Expenses	**1,159,114**	2,707,616
Net Loss before Income Taxes	**(1,099,974)**	(1,398,193)
Income Taxes	**-**	-
Net Loss and Total Comprehensive Loss attributable to Shareholders	**(1,099,974)**	(1,398,193)
Basic and Diluted Net Loss per Share	**(0.02)**	(0.02)
Weighted Average Number of Shares Outstanding	**65,888,182**	58,782,423

TOTAL REVENUES

For the three-month period ended December 31, 2012, total revenues amounted to $59,140 representing the sale of sterilizers, consumable supplies, accessories, service contracts, training and after-sales service, and license revenues as compared to $1,309,423 for the corresponding period in 2011. The decrease in revenue is primarily due to a lack of sales in the absence of a channel partner since the termination by the Company of its agreement with the 3M Company on June 15, 2012.

NET LOSS

For the three-month period ended December 31, 2012, the Company recorded a net loss of $1,099,974, or $0.02 per share, compared to a net loss of $1,398,193 or $0.02 per share for the same period in 2011. The variation between 2012 and 2011 is explained by the reduction of revenues to minimal levels in Q4-2012.

EXPENSES

Supply Chain

For the three-month period ended December 31, 2012, supply chain expenses amounted to $270,543 compared to $960,456 for the same period in 2011. The variation is due to the reduction in sales which has led to reduced sourcing activities and staff reductions through attrition and reallocation of personnel to other departments.

Customer Support and Communications

For the three-month period ended December 31, 2012, customer support and communications expenses amounted to $168,170 compared to $104,366 for the same period in 2011. The increase in Q4-2012 as compared to Q4-2011 is due to fewer chargeable billable activities such as warranty work which is charged against the warranty provision.

Research and Development

For the three-month period ended December 31, 2012, research and development amounted to revenue of $184,923, as compared research and development expenses of $965,605 for the same period in 2011. The lower R&D expenses during the fourth quarter of 2012 was primarily the result of (1) $603,521 related to the collection and the recording of unbooked R&D tax credits for the years 2008 to 2011 and (2) a decrease in expenses during the fourth quarter. The unbooked investment tax credits are the result of additional claims made by the Company for years 2008 to 2010 and the company's policy to provision no more than 80% of the amounts claimed as well as. The unbooked investment tax credits are the result of additional claims made by the Company for years anterior to 2011 and the company's policy to provision no more than 80% of the amounts claimed. The lower expenses in Q4-2012 were due to several items, including (1) lower maintenance costs for medical devices, (2) fewer compatibility studies, and (3) lower payroll expenses as a result of attrition.

Administrative

For the three-month period ended December 31, 2012, administrative expenses amounted to $948,152 compared to $713,074 for the same period in 2011. The difference between the two periods is primarily explained by an increase in professional fees partly offset by a decrease in incentive-based compensation.

CASH FLOWS ANALYSIS

(Unaudited, IFRS Basis)

	2012 **$**	2011 $
Operating Activities	**(1,888,599)**	(1,430,148)
Investing Activities	**(106,828)**	1,371,930
Financing Activities	**(828)**	9,665

Operating Activities

Cash absorbed by operating activities amounted to $1,888,599 for the three-month period ended December 31, 2012, as compared to $1,430,148 for the same period in 2011. This was primarily the result of a larger loss from operations in 2012 stemming from a reduction in sales to minimal levels.

Investing Activities

For the three-month period ended December 31, 2012, cash flows absorbed by investing activities amounted to $106,828 as compared to a cash generation of $1,371,930 for the same period in 2011. The variation is primarily due to the monetization of short-term financial investments during 2011.

Financing Activities

For the three month period ended December 31, 2012, cash flows absorbed by financing activities amounted to $828, as compared to a cash generation of $9,665 for the same period in 2011.

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 invoiced client and are as follows for periods ended December 31:

	FOURTH QUARTER				TWELVE MONTHS			
	2012		2011		**2012**		2011	
	$	**%**	$	%	**$**	**%**	$	%
Canada	**47,021**	**80**	1,089,063	87	**961,520**	**83**	2,667,751	85
Worldwide	**12,119**	**20**	167,791	13	**201,402**	**17**	477,411	15
	59,140	**100**	1,256,854	100	**1,162,922**	**100**	3,145,162	100

License revenue related to the former long-term distribution agreement with 3M Company is, for its part, allocated in the worldwide area.

Up until June 30, 2012, the Company generated an important part of its revenues from sales to the 3M Company under a long-term distribution agreement which was terminated by TSO_3 on June 15, 2012.

For the year 2012, revenues from them represented 54% of the Company's sales (69% for the same period in 2011).

Shipments to the 3M Company were made in Canada and elsewhere in the world.

CONTRACTUAL COMMITMENTS

As of December 31, 2012, the contractual commitments in the fiscal years to come are as follows:

	2013	**2014**	**2015**	**2016**	**2017**	**2018**
	$	**$**	**$**	**$**	**$**	**$**
Operating leases and service contracts	132,000	127,000	17,000	15,000	15,000	1,000

On October 18, 2012, the Company renewed the lease for its facilities for a two-year term. The lease contains a clause providing for its renewal for successive one-year terms at its expiry.

OFF-BALANCE SHEET ARRANGEMENT

Other than disclosed under the heading "Contractual Commitments" and purchase orders issued in the normal course of business, the Company made no off-balance sheet arrangement during the fiscal year 2012.

ADDITIONAL DISCLOSURE – UNRECORDED TAX ASSETS

The Company has accumulated a substantial amount of losses, unclaimed expenses and tax credits that could be claimed in the future to reduce income taxes on profits. The related deferred income tax assets would be recorded in the financial statements only when the Company concludes that these loses will probably be materialized by shielding profits from taxes, or otherwise. If the Company has had this conclusion on December 31, 2012, an amount of $22,443,000 in tax assets would have been recorded based on an effective rate of 15% for federal taxes and 11.9% for provincial taxes.

CAPITAL RESOURCES

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

In the past, the Company has financed its activities through various rounds of public and private financing as well as through government grants and tax credits. 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.

For the twelve-month period ending December 31, 2012, the average monthly burn rate was $565,400, as compared with $746,180 in 2011. The lower burn rate for 2012 was primarily due to the $379,632 decrease in receivables, inventories and payables described under the heading "Operating Activities", while the same operating working capital items had absorbed $1,058,486 during the same period in 2011. The $1,438,118 reversal in the cash absorbed by the operating working capital explains most of the reduction in the burn rate. In addition, during the fourth quarter, the Company has recognized $603,521 in unprovisioned R&D tax credits applicable to years prior to 2012. On a year-to-year basis, the variation in operating working capital components and the non recurrent R&D tax credits explain a decrease of $170,137 in the monthly burn rate between 2012 and 2011.

When adjusting the burn rate to eliminate the impact of these two elements, the average monthly burn rate in 2012 is increased to $735,737 and is more in line with the monthly average of about $750,000 in 2011.

At that burn rate, the liquidities as at December 31, 2012 would be sufficient to finance the Company's activities until early 2014. However, given the $7 million equity issue closed on March 14, 2013, based on that burn rate, the Company has enough liquidity to finance its activities until the beginning of 2015.

The Company invests its liquidities in highly-liquid, short and medium 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. Income generated from the investments is a secondary consideration.

As at December 31, 2012, the number of outstanding shares was 65,888,182.

SUBSEQUENT EVENT

The Company has entered into a bought deal agreement with a syndicate of underwriters co-led by Desjardins Securities Inc. and Canaccord Genuity Corp. and including Byron Capital Markets Ltd. and Laurentian Bank Securities Inc., pursuant to which the Underwriters have agreed to purchase 7,000,000 common shares in the capital of the Company at the price of $1.00 per Common Share for aggregate gross proceeds to the Company of $7,000,000.

The Company has also agreed to grant the Underwriters an Over-Allotment Option exercisable for a period of 30 days following the Closing of the Offering. Such option allows the Underwriters to purchase up to 1,050,000 Common Shares, representing 15% of the Offering, at the Issue Price. If the Over-Allotment Option is exercised in full, the aggregate gross proceeds to The Company will be $8,050,000.

The Company has also agreed to grant the Underwriters an option to purchase 350,000 common shares (402,500 if the Over-Allotment Option is exercised) at $1.00 by common share. The Compensation Option expires on September 4, 2014. Closing of the issue occurred on March 4, 2013.

ACCOUNTING POLICIES

See note 2 and 3 of our annual audited financial statements for the year ended December 31, 2012 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 the 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 may not be exhaustive but investors should carefully consider them before purchasing securities of the Company. Accordingly, the Company does not, and nor should shareholders of the Company or purchasers of Common Shares, rely on forward-looking statements as a prediction of actual results. In addition, investors should understand that the Company operates in a rapidly changing business, economic and regulated environment, and new risk factors emerge from time to time. The risks described below are not the only ones the Company faces as additional risks not currently known to the Company or believed to be immaterial may also significantly impair its business operations.

Limited Revenue History and a History of Previous Losses

Founded 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 investment in research and development are required to support the application for clearance in the United States of America, 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 of America. Further, when and if it reaches a commercial agreement with a new channel partner, the Company may have to support some of its marketing efforts.

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 the TSO_3 may encounter difficulties or delays in operations or marketing efforts 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, 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 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.

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 partner, and the conditions of a distribution agreement with that channel partner. Until June 15, 2012, TSO_3 had a distribution 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, its channel partner at that time. On August 7, 2012, the Company announced that it had signed a letter of intent with Getinge Infection Control AB to initiate the negotiation for a worldwide distribution agreement. Since then, negotiations have been taking place but no final agreement has been reached.

There is no guarantee that an agreement with the right conditions will be reached with Getinge. 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 in certain territories.

To the extent that the Company relies on third parties, such as the 3M Company until June 15, 2012, to market and distribute its products, the commercial success of such products may be 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 reduce to a minimum the frequency and duration that the devices are exposed to hydrogen peroxide and 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 continue to demonstrate the compatibility of its technology with a wide range of medical instruments. Even though the tests and studies undertaken to date by TSO_3 have shown that its STERIZONE® Sterilization Process is compatible with the majority of medical instruments currently used in the hospital environment, the Company must maintain ongoing studies in this respect.

Intellectual Property and Technologies

The Company's success will depend, 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 contest the protection granted by the patent, or that the patents of third parties will not be detrimental to the Company's commercial activities.

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.

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 Company's exclusive proprietary rights. The Company may also need to obtain rights for other technologies belonging to third parties, but there is no guarantee that such technologies will be offered to the Company on acceptable terms. If the Company does not obtain such licenses, the commercialization of one or more of its products could be delayed. In addition, the Company could incur considerable costs to prosecute or defend proceedings in which the Company asserts its proprietary rights against third parties.

Dependency on Key Personnel

TSO_3 believes that its success will continue to depend on its ability to attract and retain qualified managers and other key personnel. Losing a key employee could have a major negative impact on TSO_3. The Board of Directors and Management have reviewed in 2012 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 than a new channel partner may make available to the common 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.

Risk of Litigation with the 3M Company

Further to the termination of the distribution agreement with the 3M Company by the Company on June 15, 2012, the 3M Company has challenged the right by TSO_3 to terminate the Agreement. Mediation of that dispute has been requested by the 3M Company in accordance with the provisions of the Agreement. A mediation session was held in December 2012, but was unsuccessful. However, the Company and the 3M Company have continued discussions through their legal counsels in order to achieve an amicable resolution of the dispute. Should that negotiation be unsuccessful, either party may bring the dispute before the Courts of the State of New York, or abandon the proceedings.

Global Political and Economical Conditions

Challenging global market and economic conditions with a tighter credit environment and anemic growth in most major economies continued in 2012. Continued concerns about the systemic impact of potential long-term and wide-spread recession, energy costs, geopolitical issues, the availability and cost of credit have contributed to increased market volatility and diminished expectations for western and emerging economies. These conditions, combined with declining business and consumer confidence and increased unemployment, have contributed to increase volatility to unprecedented levels. As a result of these market conditions, the cost and availability of credit has been and may continue to be adversely affected by illiquid credit markets and wider credits spreads. Concern about the stability of the markets generally and the strength of counterparties specifically has led many lenders and institutional investors to reduce. These factors have lead to a decrease in spending by businesses and consumers alike, and a corresponding decrease in global infrastructure spending. Continued turbulence in North America and international markets and economies and prolonged declines in business consumer spending may adversely affect TSO_3's liquidity and financial condition. The Company has no control over changes in inflation and interest rates, foreign currency exchange rates and controls or other economic factors affecting its businesses or the possibility of political unrest, legal and regulatory changes in jurisdictions in which the Company operates. These factors could negatively affect the Company's future results of operation in those national markets, but is not expected to be material for the Company overall.

Uncertainty Regarding Access to Additional Funds

With its unallocated funds and the proceeds from a stock issue completed in March 2013, management is of the opinion that it currently has adequate cash resources and will monitor its cash level in order to achieve its short and mid-term goals. However, the Company may be unable to obtain additional financing on acceptable terms if market and economic conditions, the financial condition or operating performance of the Company or investor sentiment are unfavorable. If the Company was unable to obtain the necessary capital required to finance any special situations, it is possible that this would adversely affect the Company's ability to complete certain internal development and commercialization projects or complete its submissions with regulatory agencies.

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 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.

Interest rate risk

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

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

Credit risk

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

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

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

Concentration risk

Concentration risk exists when investments are made with multiple entities that share similar characteristics or when a large investment is made with a single entity. As at December 31, 2012, there was no single investment, other than bank deposits held with the Company's main bank that exceeded the limit (higher of 30% of the Company's liquid assets or $5 million) required under the Company's Investment Policy.

Liquidity risk

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

The Company's maximum exposure to liquidity risk is equal to the amounts recognized as accounts payable and accrued liabilities and these amounts will be paid in the following year. The Company manages this risk by maintaining permanent and sufficient liquidity to meet current and future financial obligations, under both normal and exceptional circumstances. The funding strategies used to manage this risk include turning to capital markets to carry out issues of securities.

Currency risk

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

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

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. In absence of such prices, 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 and accounts payable and accrued liabilities approximates their carrying values due to the short-term maturities of these items.

DISCLOSURE AND INTERNAL CONTROLS

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

Disclosure controls and procedures

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

At the end of the year ended December 31, 2012, an evaluation was carried out, under the supervision of the CEO and the CFO, of the design and effectiveness of our disclosure controls and procedures. Based on this evaluation, the CEO and the CFO concluded that the disclosure controls and procedures are effective.

Internal controls over financial reporting

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

At the end of the year ended December 31, 2012, an evaluation was carried out, under the supervision of the CEO and the CFO, of the design and effectiveness of our internal controls over financial reporting. Based on this evaluation, the CEO and the CFO concluded that the internal controls over financial reporting are effective, using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) on Internal Control – Integrated Framework.

Changes in internal controls over financial reporting

No changes were made to our internal controls over financial reporting that occurred during the quarter and fiscal year ended December 31, 2012 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

MANAGEMENT REPORT

RESPONSIBILITY OF THE FINANCIAL STATEMENTS

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

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

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

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

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

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

The external auditors are appointed to report to the shareholders regarding the fairness of presentation of the Company's financial statements. The auditors fulfill this responsibility by carrying out an independent audit of these statements in accordance with Canadian Generally Accepted Auditing Standards.

On behalf of Management,

Richard M. Rumble
President and CEO

Benoît Deschamps
Vice President of Finance and
Chief Financial Officer

March 19, 2013

FINANCIAL STATEMENTS

DECEMBER 31, 2012 AND 2011

Deloitte, s.e.n.c.r.l.
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Canada

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Independent auditor's report

To the shareholders of
TSO_3 inc.

We have audited the accompanying financial statements of TSO_3 inc., which comprise the statements of financial position as at December 31, 2012, and December 31, 2011, and the statements of loss and total comprehensive loss, statements of changes in equity and statements of cash flows for the years ended December 31, 2012 and December 31, 2011, and a summary of significant accounting policies and other explanatory information.

Management's responsibility for the financial statements

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

Auditor's responsibility

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

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

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

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of TSO_3 inc. as at December 31, 2012 and December 31, 2011, and its financial performance and its cash flows for the years ended December 31, 2012 and December 31, 2011 in accordance with International Financial Reporting Standards.

March 19, 2013
Quebec, Canada

Deloitte s.e.n.c.r.l.[1]

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[1] CPA auditor, CA, public accountancy permit No. A112991

STATEMENTS OF LOSS AND TOTAL COMPREHENSIVE LOSS
Years ended December 31
(In Canadian $)

	Notes	**2012** **$**	2011 $
Revenues			
Sales	21	**1,162,922**	3,145,162
License Revenue	12	**1,690,971**	210,275
Total Revenues		**2,853,893**	3,355,437
Expenses	5		
Supply Chain		**1,801,735**	2,934,597
Customer Service and Communications		**639,766**	769,862
Research and Development		**2,877,203**	3,999,794
Administrative		**3,476,843**	3,473,215
Financial Income	4	**(167,708)**	(194,247)
Financial Costs	4	**21,652**	27,637
Total Expenses		**8,649,491**	11,010,858
Net Loss before Income Taxes		**(5,795,598)**	(7,655,421)
Income Taxes	19	**-**	-
Net Loss and Total Comprehensive Loss attributable to Shareholders		**(5,795,598)**	(7,655,421)
Basic and Diluted Net Loss per Share	22	**(0.09)**	(0.13)

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

STATEMENTS OF CHANGES IN EQUITY
(In Canadian $)

	Notes	Share capital $	Reserve – Share-Based compen-sation $	Reserve – Warrants $	Deficit $	Total $
Balance at January 1, 2011		88,067,517	3,326,330	5,490,429	(74,974,657)	21,909,619
Options exercised	13	32,765	(14,237)	-	-	18,528
Warrants exercised	13	1,820,250	-	(620,250)	-	1,200,000
Transfer to Deficit	15	-	-	(4,870,179)	4,870,179	-
Share-based Compensation	14	-	221,037	-	-	221,037
Net Loss for the year		-	-	-	(7,655,421)	(7,655,421)
Balance at December 31, 2011		89,920,532	3,533,130	-	(77,759,899)	15,693,763
Balance at January 1, 2012		89,920,532	3,533,130	-	(77,759,899)	15,693,763
Issuance of Share Capital and warrants	13	8,694,000	-	276,000	-	8,970,000
Options exercised	13	96,121	(39,866)	-	-	56,255
Share-based Compensation	14	-	321,708	-	-	321,708
Compensation to underwriters	15	(117,300)	-	117,300	-	-
Share issue expenses	13	(818,635)	-	-	-	(818,635)
Net Loss for the year		-	-	-	(5,795,598)	(5,795,598)
Balance at December 31, 2012		97,774,718	3,814,972	393,300	(83,555,497)	18,427,493

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

STATEMENTS OF FINANCIAL POSITION
(In Canadian $)

	Notes	**2012 $**	2011 $
Current Assets			
Cash and Cash Equivalents	6	**7,758,103**	8,782,207
Short-term Investments	6	**5,049,087**	2,602,166
Accounts Receivable	7	**1,029,265**	1,893,470
Inventories	8	**1,216,721**	1,120,482
Prepaid Expenses		**139,644**	77,015
		15,192,820	14,475,340
Non-current Assets			
Property, Plant and Equipment	9	**1,208,394**	1,218,381
Intangible Assets	10	**3,034,213**	3,226,735
		4,242,607	4,445,116
		19,435,427	18,920,456
Current Liabilities			
Accounts Payable and Accrued Liabilities		**842,867**	1,231,201
Warranty Provision	11	**62,032**	88,972
Deferred Revenues	12	**55,093**	425,824
		959,992	1,745,997
Non-current Liabilities			
Deferred Revenues	12	**47,942**	1,480,696
		1,007,934	3,226,693
Equity			
Share Capital	13	**97,774,718**	89,920,532
Reserve – Share-based Compensation	14	**3,814,972**	3,533,130
Reserve – Warrants	15	**393,300**	-
Deficit		**(83,555,497)**	(77,759,899)
		18,427,493	15,693,763
		19,435,427	18,920,456

The accompanying notes are an integral part of these financial statements.
Please refer to contingent liability presented on note 23.

Approved by the Board

Director

Director

STATEMENTS OF CASH FLOWS
Years ended December 31
(In Canadian $)

	Notes	**2012 $**	2011 $
Cash Flows from Operating Activities			
Net Loss before Income Taxes		**(5,795,598)**	(7,655,421)
Adjustments for:			
Depreciation of Property, Plant and Equipment		**444,664**	377,096
Amortization of Intangible Assets		**302,254**	317,391
Change in the value of Short-term Investments		**(26,141)**	(40,070)
Write-off of Property, Plant and Equipment		**45,511**	39,228
Share-based Compensation		**321,708**	221,037
Financial Income		**(149,447)**	(174,302)
		(4,857,049)	(6,915,041)
Changes in non-cash operating working capital items	17	**(1,761,402)**	(1,903,761)
Interests received		**149,447**	174,302
Cash Flows used in Operating Activities		**(6,469,004)**	(8,644,500)
Cash Flows from Investing Activities			
Acquisition of Short-term Investments		**(8,614,190)**	(2,578,955)
Disposal of Short-term Investments		**6,193,410**	13,021,569
Acquisition of Property, Plant and Equipment		**(232,208)**	(205,785)
Acquisition of Intangible Assets		**(109,732)**	(143,947)
Cash Flows generated by (used in) Investing Activities		**(2,762,720)**	10,092,882
Cash Flows from Financing Activities			
Issuance of Share Capital and warrants	13	**8,970,000**	-
Payment for share issue expenses	13	**(818,635)**	-
Options exercised	13	**56,255**	18,528
Warrants exercised	13	**-**	1,200,000
Cash Flows generated by Financing Activities		**8,207,620**	1,218,528
Increase (decrease) in Cash and Cash Equivalents		**(1,024,104)**	2,666,910
Cash and Cash Equivalents at the beginning		**8,782,207**	6,115,297
Cash and Cash Equivalents at the End		**7,758,103**	8,782,207

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

NOTES TO THE FINANCIAL STATEMENTS
Years ended December 31, 2012 and 2011

1. Description of Business

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

2. Accounting Policies

Statement of Compliance

The Financial Statements have been prepared in accordance with International Financial Reporting Standards (IFRS).

Basis of preparation

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

The principal accounting policies are set out below.

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 carried to net income.

NOTES TO THE FINANCIAL STATEMENTS
Years ended December 31, 2012 and 2011

2. Accounting Policies (cont'd)

Revenue Recognition

Sales

The Company generates revenue from the sale of sterilization units as well as parts, consumable supplies and accessories related to these units. For such sales, the Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred, the price to the buyer is fixed or determinable and collection is reasonably assured.

In addition, the Company earns revenue from service contracts that is recognized using the straight-line method over the term of each contract.

Financial Income

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

License Revenues

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

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 FINANCIAL STATEMENTS
Years ended December 31, 2012 and 2011

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 realization is considered probable.

Government Assistance and Research and Development Tax Credits

The Company incurs research and development expenses that are eligible for tax credits. The recorded tax credits are based on management's estimates of amounts expected to be recovered and are subject to audit by tax authorities. Government assistance, including the tax credits for scientific research and experimental development costs, is presented as a reduction of the related expense.

Inventories

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

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

Property, Plant and Equipment

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

Office furniture and lift truck	10 years
Equipment and tools	7 years
Sterilizers used internally	5 years
Stand	5 years
Medical devices	3 years
Computer equipment	3 years
Leasehold improvements	2 years

NOTES TO THE FINANCIAL STATEMENTS
Years ended December 31, 2012 and 2011

2. Accounting policies (cont'd)

Property, Plant and Equipment (cont'd)

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

Intangible Assets

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

Acquired in a business combination	
Technology	20 years
Acquired externally	
Patents	20 years
License	16 years
Software	3 years
Trademarks	10 and 15 years
Web site	3 years

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

Impairment of Property, Plant and Equipment and Intangible Assets

At the end of each reporting period, assets are reviewed for indication of any impairment. In such case, the asset's recoverable value is calculated to establish the amount of the impairment loss, if any. If it is not possible to determine the recoverable value for an individual asset, then the recoverable value of the asset is determined on the basis of its cash generating unit.

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

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

NOTES TO THE FINANCIAL STATEMENTS
Years ended December 31, 2012 and 2011

2. Accounting policies (cont'd)

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

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.

Warranty Provision

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

Warrants

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

Financial Instruments

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

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

NOTES TO THE FINANCIAL STATEMENTS
Years ended December 31, 2012 and 2011

2. Accounting Policies (cont'd)

Financial Instruments (cont'd)

Classification of Financial Instruments

Category	Classification
Cash	Loans and Receivables
Cash Equivalents	Fair value through profit or loss
Short-term Investments	Fair value through profit or loss
Accounts Receivable	Loans and Receivables
Accounts Payable and Accrued Liabilities	Other Liabilities

Cash and Cash Equivalents

Cash and cash equivalents include cash, bonds with maturities of three months or less from the date of acquisition and money market funds. These investments are highly liquid and are held for the purpose of meeting short-term cash commitments. Cash equivalents are recorded at fair value. Increases and decreases in fair value are recognized through net income and presented under "Change in the Value of Investments held as Cash Equivalents" in the "Financial Income" of the Statement of Loss and Total Comprehensive Loss (see Note 4).

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 needs. These investments are recorded at fair value. Increases and decreases in fair value are recognized as investment income and presented under "Change in the Value of Short-term Investments" in the "Financial Income" of the Statement of Loss and Total Comprehensive Loss (see Note 4).

Loans and Receivables

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

Other Liabilities

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

NOTES TO THE FINANCIAL STATEMENTS
Years ended December 31, 2012 and 2011

2. Accounting Policies (cont'd)

Financial Instruments (cont'd)

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 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. In absence of such prices, 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 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 estimation:

1. *Recoverability of intangible assets:*

   On an annual basis the Company evaluates if there are indicators of impairment. When such indicators are identified, the Company is required to perform an impairment test in order to measure the recoverable amount of its intangible assets. The main judgments made by management for the impairment test performed as of December 31, 2012 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;

NOTES TO THE FINANCIAL STATEMENTS
Years ended December 31, 2012 and 2011

2. Accounting Policies (cont'd)

Critical Accounting Judgments and Key Source of Estimates Uncertainty (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.

2. *Inventory valuation:*

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

3. *Government assistance and research and development tax credits:*

Government assistance and research and development tax credits are recorded in the financial statements when there is reasonable assurance that the Company has complied with, and will continue to comply with, all of the conditions necessary to obtain the assistance. In general, the Company recognizes 80 % of the amount that it expects to receive.

4. *Share-Based Compensation:*

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

5. *Deferred Taxes Income:*

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

6. *Contingent Liability:*

The Company terminated its distribution agreement with the 3M Company based on the lack of regulatory approval in the United States, as the Company believes was permitted by the Agreement. The Company considers that it is not possible to assess the likelihood or terms of a settlement at this point, and consequently, has not recorded any provisions in the financial statements (see note 23).

NOTES TO THE FINANCIAL STATEMENTS
Years ended December 31, 2012 and 2011

2. Accounting Policies (cont'd)

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

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," with regard to 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. Early adoption is permitted. The Company is currently evaluating the impact of this new standard on its financial statements.
IFRS 13 – Fair value measurement, issued in May 2011, establishes a single framework for measuring fair value where such required measure was under other IFRS. IFRS 13 will be effective for the annual period beginning on January 1, 2013, with earlier application permitted. IFRS 13 will apply to financial and non-financial items measured at fair value. Under IFRS 13, fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The Company will adopt IFRS 13 for the annual period beginning January 1, 2013. A detailed review will be completed in the future in order to determine if this Standard will have any significant impact.

In May 2011, the IASB issued IFRS 10 – Consolidated Financial Statements, IFRS 11 – Joint Arrangements, IFRS 12 – Disclosures of Interests in Other Entities, and amended IAS 27 – Separate Financial Statements and IAS 28 – Investments in Associates and Joint Ventures, all applicable for annual period beginning on or after January 1, 2013. However, these standards do not need to be addressed in this note because they deal with situations that are not currently applicable to the Company.

In June 2011, the IASB also issued an amendment to IAS 1 – Presentation of Items of Other Comprehensive Income that will be effective for the annual period beginning on of after July 1, 2012. This amendment requires items of other comprehensive income to be grouped into those that will and will not be reclassified to profit and loss in the future. Retrospective application is required. Earlier application of this standard is permitted. As the Company does not have any element of reconciliation between Net Loss and Total Comprehensive Loss, there will be no impact.

NOTES TO THE FINANCIAL STATEMENTS
Years ended December 31, 2012 and 2011

4. Financial Income and Costs

	2012 $	2011 $
Financial Income		
Investment Income	**(167,754)**	(211,066)
Change in the Value of Investments held as Cash Equivalents	**26,187**	56,889
Change in the Value of Short-term Investments	**(26,141)**	(40,070)
	(167,708)	(194,247)
Financial Costs		
Bank Charges	**12,161**	5,165
Foreign Exchange Loss	**9,837**	26,540
Miscellaneous	**(346)**	(4,068)
	21,652	27,637

5. Additional Information on Statement of Loss and Total Comprehensive Loss

Expenses included in functions	2012 $	2011 $
Salary & Other Benefits Supply Chain Customer service and communications Research & Development Administrative	**5,079,592**	5,448,333
Depreciation of Property, Plant and Equipment Supply Chain Customer service and communications Research & Development Administrative	**444,664**	377,096
Amortization of Intangible Assets Supply Chain Customer service and communications Research & Development Administrative	**302,254**	317,391

NOTES TO THE FINANCIAL STATEMENTS
Years ended December 31, 2012 and 2011

6. Financial Instruments

Cash and Cash Equivalents

	2012 $	2011 $
Cash	**6,305,645**	3,791,250
Bank - Guaranteed Investment Certificate	**-**	3,556,566
Short-term Investments less than three months		
Money Market Funds	**1,452,458**	1,434,391
	7,758,103	8,782,207

As of December 31, 2012, Money Market Funds were rated AA- (AA- as of December 31, 2011). There were no Bank Guaranteed Investment Certificates as of December 31, 2012 (rated AA- or better and had a yield of 1.55 % as of December 31, 2011).

Short-term Investments

	2012 $	2011 $
Bonds	-	2,602,166
Bank-Guaranteed Investment Certificate	**5,049,087**	-
	5,049,087	2,602,166

As of December 31, 2012, Bank-Guaranteed Investment Certificates were rated AA- or better and had a yield of 1.60 % (no Bank-Guaranteed Investment Certificates as of December 31, 2011). As of December 31, 2012, there were no bonds (as of December 31, 2011, bonds held were rated AA- to A+ and had an average yield to maturity of 1.29%).

Money market funds held by the Company are classified as level 1 under IFRS 7. The Bank – Guaranteed Investment Certificate and Bonds held by the Company are classified as level 2 under IFRS 7.

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:

NOTES TO THE FINANCIAL STATEMENTS
Years ended December 31, 2012 and 2011

6. Financial Instruments (cont'd)

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.

At December 31, 2012, if interest rates on that date had been 0.5% lower, and all other variables held constant, the net loss and total comprehensive loss for the year would have been $3,247 lower ($3,093 as of December 31, 2011), arising mainly as a result of an increase in the fair value of fixed rate financial assets classified at fair value through profit or loss. If the interest rates on that date had been 0.5% higher, all other variables being held constant, the net loss and total comprehensive loss for the year would have been $3,229 higher ($3,110 as of December 31, 2011), arising mainly as a result of a decrease in the fair value of fixed rate financial assets classified at fair value through profit or loss. The net loss therefore has a similar sensitivity to interest rate increases and interest rate decreases.

Credit risk

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

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

As at December 31, 2012, and December 31, 2011, the Company's investments were rated by two recognized agencies, and were within the credit metrics required by the Company's investment policy.

NOTES TO THE FINANCIAL STATEMENTS
Years ended December 31, 2012 and 2011

6. Financial instruments (cont'd)

Concentration risk

Concentration risk exists when investments are made with multiple entities that share similar characteristics or when a large investment is made with a single entity. As at December 31, 2012, and December 31, 2011, there was no single investment, other than bank deposits held with the Company's main bank that exceeded the limit (higher of 30% of the Company's liquid assets or $5 million) required under the Company's Investment Policy.

Liquidity risk

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

The Company's maximum exposure to liquidity risk is equal to the amounts recognized as accounts payable and accrued liabilities and these amounts will be paid in the following year. The Company manages this risk by maintaining permanent and sufficient liquidity to meet current and future financial obligations, under both normal and exceptional circumstances. The funding strategies used to manage this risk include turning to capital markets to carry out issues of securities.

Currency risk

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

As of December 31, 2012, if the Canadian dollar had weakened 10 percent against the US dollar with all other variables held constant, the net loss and total comprehensive loss for the year would have been $26,979 lower ($655 as of December 31, 2011). Conversely, if the Canadian dollar had strengthened 10 percent against the US dollar with all other variables held constant, the net loss and total comprehensive loss for the year would have been $26,979 higher ($655 as of December 31, 2011).

NOTES TO THE FINANCIAL STATEMENTS
Years ended December 31, 2012 and 2011

7. Accounts receivable

	2012	2011
	$	$
Accounts Receivable	**55,034**	1,206,551
Government Credits Receivable	**968,820**	589,200
Other	**5,411**	97,719
	1,029,265	1,893,470

As of December 31, 2012, an amount of $49,383 is receivable from the 3M Company ($456,952 as of December 31, 2011).

There were no bad debt allowances as of December 31, 2012 (none as of December 31, 2011).

8. Inventories

	2012	2011
	$	$
Raw Materials	**874,635**	730,465
Work in Progress	**111,470**	198,657
Finished Goods	**230,616**	191,360
	1,216,721	1,120,482

Supply Chain expenses include a write-down of raw materials of $72,088 for the year ended December 31, 2012 ($288,972 for the same period in 2011).

During the year 2012, the Company transferred $247,980 to its property, plant and equipment to account for sterilizers used internally ($532,033 for the same period in 2011).

NOTES TO THE FINANCIAL STATEMENTS
Years ended December 31, 2012 and 2011

9. Property, Plant and Equipment

	Office furniture $	Lift truck $	Equipment and tools for production and R&D $	Sterilizers used internally $	Stand $	Medical Devices $	Computer equipment $	Leasehold Improvements $	Total $
Cost									
Balance at January 1, 2012	186,189	14,115	1,121,985	794,509	22,735	278,370	528,305	197,788	3,143,996
Additions	932	-	51,235	247,980	-	113,388	66,653	-	480,188
Write-off	-	-	-	(55,727)[1]	-	-	-	-	(55,727)
Balance at December 31, 2012	187,121	14,115	1,173,220	986,762	22,735	391,758	594,958	197,788	3,568,457
Accumulated depreciation									
Balance at January 1, 2012	121,493	13,410	787,549	189,184	20,497	114,896	488,785	189,801	1,925,615
Depreciation	13,813	705	101,381	182,247	895	107,573	30,611	7,439	444,664
Eliminated on write-off of assets	-	-	-	(10,216)[1]	-	-	-	-	(10,216)
Balance at December 31, 2012	135,306	14,115	888,930	361,215	21,392	222,469	519,396	197,240	2,360,063
Carrying amount at December 31, 2012	51,815	-	284,290	625,547	1,343	169,289	75,562	548	1,208,394

1) In 2012, the Company wrote-off an amount of $55,727 for sterilizers of the former generation which were no longer used in its Technical Service activities

NOTES TO THE FINANCIAL STATEMENTS
Years ended December 31, 2012 and 2011

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

	Office furniture $	Lift truck $	Equipment and tools for production and R&D $	Sterilizers used internally $	Stand $	Medical devices $	Computer equipment $	Leasehold Improvements $	Total $
Cost									
Balance at January 1, 2011	185,970	14,115	1,053,298	431,445	22,735	180,810	491,176	195,598	2,575,147
Additions	219	-	68,687	532,033	-	97,560	37,129	2,190	737,818
Write-off	-	-	-	(168,969)[1]	-	-	-	-	(168,969)
Balance at December 31, 2011	186,189	14,115	1,121,985	794,509	22,735	278,370	528,305	197,788	3,143,996
Accumulated depreciation									
Balance at January 1, 2011	105,329	11,998	689,672	189,294	18,593	38,366	458,677	166,331	1,678,260
Depreciation	16,164	1,412	97,877	129,631	1,904	76,530	30,108	23,470	377,096
Eliminated on write-off of assets	-	-	-	(129,741)[1]	-	-	-	-	(129,741)
Balance at December 31, 2011	121,493	13,410	787,549	189,184	20,497	114,896	488,785	189,801	1,925,615
Carrying amount at December 31, 2011	64,696	705	334,436	605,325	2,238	163,474	39,520	7,987	1,218,381

1) In 2011, the Company wrote-off an amount of $168,969 for sterilizers of the former generation which were no longer used in its R&D activities

NOTES TO THE FINANCIAL STATEMENTS
Years ended December 31, 2012 and 2011

10. Intangible Assets

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

	Technology $	Patents $	License $	Software $	Trademarks $	Web site $	Total $
Cost							
Balance at January 1, 2011	2,978,874	743,870	991,063	520,375	76,642	54,691	5,365,515
Additions	-	45,304	-	73,750	24,893	-	143,947
Balance at December 31, 2011	2,978,874	789,174	991,063	594,125	101,535	54,691	5,509,462
Accumulated amortization							
Balance at January 1, 2011	893,663	113,858	433,590	461,552	13,289	49,384	1,965,336
Amortization	148,944	38,327	61,941	56,366	8,275	3,538	317,391
Balance at December 31, 2011	1,042,607	152,185	495,531	517,918	21,564	52,922	2,282,727
Carrying amount at December 31, 2011	1,936,267	636,989	495,532	76,207	79,971	1,769	3,226,735

NOTES TO THE FINANCIAL STATEMENTS
Years ended December 31, 2012 and 2011

11. Warranty Provision

	2012 $	2011 $
Balance at beginning	**88,972**	27,189
Additional provisions recognized	**30,314**	105,154
Amounts used during the year	**(51,974)**	(16,127)
Unused amounts reversed during the year	**(5,280)**	(27,244)
Balance at the end	**62,032**	88,972

12. License Revenues and Deferred Revenues related to License

On June 15, 2012, the Company issued a notice to 3M Company to terminate the Distribution Agreement entered into on December 15, 2009. As a result of the termination of the Agreement, on June 30, 2012, the unamortized amount of $1,585,833 of the license paid by 3M Company pursuant to the Distribution Agreement was recognized as revenue in accordance with the Company's accounting policies.

Any remaining deferred revenues stem from the prepaid portion of service contracts on the 125L Ozone Sterilizers commercialized by the Company up to the beginning of 2010.

13. Share Capital

Authorized

An unlimited number of shares

Common, voting, participating, without par value

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

		2012		2011
Issued and paid	**Number of Common Shares**	**$**	Number of Common Shares	$
Balance at beginning	**58,785,682**	**89,920,532**	58,022,451	88,067,517
New issue	**6,900,000**	**7,758,065**	-	-
Options exercised	**202,500**	**96,121**	13,231	32,765
Warrants exercised	**-**	**-**	750,000	1,820,250
Balance at end	**65,888,182**	**97,774,718**	58,785,682	89,920,532

NOTES TO THE FINANCIAL STATEMENTS
Years ended December 31, 2012 and 2011

13. Share Capital (Cont'd)

On April 24, 2012, the Company closed a financing with gross proceeds of $8,970,000 from the sale units that comprise 6,900,000 shares and 3,450,000 warrants. This amount includes $276,000 as warrants' fair value.

The stock issue component was allocated $8,694,000 of the gross proceeds and $935,935 in expenses related to the issue. Therefore, the net proceed allocated to the share issue were $7,758,065.

During the year ended December 31, 2012, pursuant to the Company's Stock Option Plan, holders exercised certain options and subscribed for 202,500 shares for a cash consideration of $56,255. For the same period in 2011, holders subscribed for 13,231 shares for a cash consideration of $18,528.

For the year ended December 31, 2012, no warrants were exercised by their holders. For the same period in 2011, holders subscribed for 750,000 shares for a cash consideration of $1,200,000.

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.

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.

NOTES TO THE FINANCIAL STATEMENTS
Years ended December 31, 2012 and 2011

13. Share Capital (Cont'd)

Shareholder Rights Plan Agreement (Cont'd)

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

The agreement has no impact on the financial statements.

Employee Stock Purchasing Plan

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

14. Reserve – Share-based Compensation

The Company's board of directors adopted a share-based compensation plan 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 of December 31, 2012, 5,375,073 (4,381,293 as of December 31, 2011). The options awarded pursuant to this plan generally vest over a three-year period and may be exercised within a maximum of 10 years of the date of award.

During the year ended December 31, 2012, the Company awarded 238,000 stock options (709,400 for the year ended December 31, 2011) at a weighted average exercise price of $1.33 ($1.74 for the year ended December 31, 2011). The weighted average fair value of these stock options was $0.61 per option ($0.74 for the year ended December 31, 2011).

The Share-Based Compensation expense pertaining to the options awarded has been amortized using the graded vesting method and represents a Share-Based Compensation expense of $321,708 as of December 31, 2012 ($221,037 as of December 31, 2011) presented as part of the "Administrative Expenses".

NOTES TO THE FINANCIAL STATEMENTS
Years ended December 31, 2012 and 2011

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:

	2012	2011
Weighted Average Share Price	**$1.32**	$1.70
Exercise Price	**$1.33**	$1.74
Risk Free Interest Rate	**2.23%**	2.95%
Estimated Share Price Volatility	**39%**	34%
Expected Life	**8 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 2012 and 2011 awards on the basis of the historical volatility of the Company's share price prior to the date of award. Any change in the assumptions can materially affect the fair value estimates.

	Number	**2012 Weighted Average Exercise Price $**	Number	2011 Weighted Average Exercise Price $
Outstanding at beginning	**3,748,645**	**1.08**	3,338,415	1.05
Granted	**238,000**	**1.33**	709,400	1.74
Exercised	**(202,500)**	**0.27**	(13,231)	1.40
Expired	**(19,000)**	**2.30**	(125,265)	1.85
Forfeited	**(51,000)**	**0.78**	(160,674)	2.59
Outstanding at end	**3,714,145**	**1.13**	3,748,645	1.08
Exercisable at end	**2,975,212**	**1.00**	2,950,578	0.93

NOTES TO THE FINANCIAL STATEMENTS
Years ended December 31, 2012 and 2011

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

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

	Outstanding options		Exercisable options	
Exercise price	Number	Average remaining contractual life (years)	Number	Average remaining contractual life (years)
$0.37 to $0.94	1,816,769	5.29	1,816,769	5.29
$1.08 to $1.97	1,629,860	5.50	890,927	2.80
$2.20 to $3.45	267,516	3.66	267,516	3.66
	3,714,145	5.28	2,975,212	4.41

The following table summarizes certain information regarding the stock options of the Company as of December 31, 2011:

	Outstanding options		Exercisable options	
Exercise price	Number	Average remaining contractual life (years)	Number	Average remaining contractual life (years)
$0.24 to $1.97	3,465,629	6.19	2,667,562	5.26
$2.20 to $2.90	204,011	5.03	204,011	5.03
$3.10 to $3.45	79,005	3.50	79,005	3.50
	3,748,645	6.09	2,950,578	5.21

15. Reserve - Warrants

	Number	2012 Exercise Price $	Number	2011 Exercise Price $
Outstanding at beginning	**-**	**-**	750,000	1.60
Granted	**3,795,000**	**1.94**	-	-
Exercised	**-**	**-**	(750,000)	1.60
Outstanding at end	**3,795,000**	**1.94**	-	-
Exercisable at end	**3,795,000**	**1.94**	-	-

The warrants issued in 2012 were 3,450,000 warrants issued to purchasers of the bought deal private placement closed on April 24, 2012, and 345,000 warrants issued as part of the compensation to Underwriters.

NOTES TO THE FINANCIAL STATEMENTS
Years ended December 31, 2012 and 2011

15. Reserve - Warrants (cont'd)

Each of the 3,450,000 warrants issued to the purchasers of the private placement allows its holder to purchase one common share at the price of $2.00 and expires on the earlier of (1) April 24, 2013, and (2) on the 30th day following written notice of early expiry from the Company, which notice may be given if, at any time after August 24, 2012, the closing price of the common shares on the TSX is equal or higher than $2.50 for any 10 consecutive trading days.

Each of the 345,000 compensation warrant will be exercisable to acquire one common share at the exercise price of $1.30 until September 24, 2013.

The fair value of these compensation warrants was $0.10 per warrant. The fair value of the warrants at the grant date was estimated using the Black-Scholes option pricing model under the following assumptions:

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

Concurrently with the issue of 10,000,000 shares on March 2, 2010, 750,000 warrants were granted. Each warrant allowed to purchase one common share of the Company at a price of $1.60 and all warrants were exercised in 2011 prior to their September 2, 2011 expiry date.

At any time when warrants expire without being exercised or are being cancelled, the Company is authorized to transfer to the Accumulated Deficit the amount corresponding to such warrants that would be in the balance of the Reserve for Warrants. Such authorization has not been used in 2012 (used in 2011 for a total amount of $4,870,179).

NOTES TO THE FINANCIAL STATEMENTS
Years ended December 31, 2012 and 2011

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 capital is comprised of share capital, share-based compensation and warrants. In the past, the Company has financed its activities through various rounds of public and private financing as well as through government grants and tax credits. 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.

17. Additional information relating to Cash Flows

	2012 **$**	2011 $
Change in non-cash operating working capital items		
Decrease (increase) in currents assets		
Accounts receivable	**864,205**	(1,455,654)
Inventories	**(96,239)**	339,822
Prepaid expenses	**(62,629)**	(18,503)
Increase (decrease) in liabilities		
Accounts payable and accrued liabilities	**(388,334)**	57,346
Warranty provision	**(26,940)**	61,783
Deferred revenues	**(1,803,485)**	(356,522)
	(1,513,422)	(1,371,728)
Non-cash items transferred to property, plant and equipment	**(247,980)**	(532,033)
	(1,761,402)	(1,903,761)
Research and development tax credits		
Received	**627,042**	-

NOTES TO THE FINANCIAL STATEMENTS
Years ended December 31, 2012 and 2011

18. Related party transactions

During 2012, the Company has made severance payments to some of its employees for a total of $76,608 for the year 2012 ($147,755 in 2011).

Compensation of key management personnel

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

	2012 **$**	2011 $
Short-term salaries and other benefits	**1,179,659**	1,272,744
Post-employment benefits	**12,278**	15,317
Share-based payments	**4,971**	8,532
Option-based awards[1]	**126,540**	441,183
	1,323,448	1,737,776

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

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

NOTES TO THE FINANCIAL STATEMENTS
Years ended December 31, 2012 and 2011

19. Income Taxes

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

As of December 31, 2012, the accumulated tax losses that can be carried forward are as follows:

Expiry Date	Loss carry-forwards Federal $	 Provincial $
2032	5,106,000	4,890,000
2031	7,648,000	7,648,000
2030	6,594,000	6,327,000
2029	7,569,000	7,122,000
2028	8,053,000	8,040,000
2027	6,224,000	6,822,000
2026	5,481,000	5,820,000
2015	5,009,000	4,961,000
2014	4,601,000	4,591,000
	56,285,000	56,221,000

As of December 31, 2012, based on an effective rate of 15% for federal taxes and 11.9% for provincial taxes, the undiscounted value of tax losses carried forward is $15,133,000.

As at December 2012, in addition to these tax losses carried forward, the Company has unclaimed research and development expenses ($10,800,000 at the federal level and $16,200,000 at the provincial level) and $1,400,000 in financing costs that can be carried forward to reduce future taxable income. The unrealized tax benefit related to these items is estimated at $3,900,000.

With respect to property, plant and equipment, the Company has a deferred income tax asset related to the tax cost that is higher than the carrying amount of these capital assets. The unrecorded eventual tax benefit related to that difference is evaluated at $1,016,000.

In addition, as of December 31, 2012, the Company has $2,800,000 in additional tax credits, representing the outstanding and unrecorded portion of the federal research and development tax credit receivable.

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

NOTES TO THE FINANCIAL STATEMENTS
Years ended December 31, 2012 and 2011

19. Income taxes (cont'd)

Furthermore, the cost of intangible assets for tax purposes was $560,000 (carrying amount of $2,979,000) resulting from the Company taking advantage of provisions in the federal and provincial income tax laws with respect to rollovers. Deferred income taxes liability of $454,000 resulting from the difference between the carrying value and the tax value of intangible assets has been recorded. As well, a deferred income taxes asset of the same amount has been recorded relating to the items previously presented.

The deferred income tax assets related to such losses and non-refundable investment tax credits will not be recognized in the financial statements, then resulting in an increase in earnings and shareholders' equity, until the Company is enabled to conclude that these unrecorded tax assets are probable to be materialized by shielding profits from taxes or otherwise. If the Company had concluded on December 31, 2012 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 $22,443,000 in tax assets ($20,657,000 as at December 31, 2011).

20. Research and development tax credits

The Company claims two different kinds of tax credits, one kind which is refundable regardless of the level of taxable income, and the other kind which can be obtained only to offset a tax liability. The non-refundable credits are not booked as a deferred tax asset.

For tax credit purposes, eligible research and development expenditures incurred during the year 2012 totaled $884,000 ($773,000 in 2011); of these eligible research and development expenditures, none as of December 31, 2012 (none in 2011) is related to property, plant and equipment.

Some of these eligible expenses qualify for refundable scientific research tax credits amounting to $409,000 as of December 31, 2012 ($290,000 in 2011).

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

NOTES TO THE FINANCIAL STATEMENTS
Years ended December 31, 2012 and 2011

21. Segmented Information

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

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

	2012		2011	
	$	**%**	$	%
Canada	**961,520**	**83**	2,667,751	85
Worldwide	**201,402**	**17**	477,411	15
	1,162,922	**100**	3,145,162	100

License revenue related to the former long-term distribution agreement with 3M Company is, for its part, allocated in the worldwide area.

Up until June 15, 2012, the Company has earned an important part of its revenues under the now-terminated long-term distribution agreement with the 3M Company. For the year 2012, these revenues represented 54 % of the Company's sales (55 % for the same period in 2011). Shipments to that client were made in Canada and elsewhere in the world.

22. Loss per Share

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

	2012	2011
	$	$
Net Loss		
Basic and Diluted	**(5,795,598)**	(7,655,421)
Number of Shares		
Weighted Average Number of Outstanding Shares[1)]	**63,675,137**	58,289,996
Loss per Share		
Basic	**(0.09)**	(0.13)
Diluted [2)]	**(0.09)**	(0.13)

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

NOTES TO THE FINANCIAL STATEMENTS
Years ended December 31, 2012 and 2011

23. Contractual Commitments and Contingent Liability

Contractual Commitments

As of December 31, 2012, the contractual commitments in the fiscal years to come are as follows**:**

	2013 $	2014 $	2015 $	2016 $	2017 $	2018 $
Operating leases and service contracts	132,000	127,000	17,000	15,000	15,000	1,000

On October 18, 2012, the Company renewed the lease for its facilities for a two-year term. The lease contains a clause providing for its renewal for successive one-year terms at its expiry.

Dispute regarding the termination of the distribution agreement

On June 15, 2012, the Company terminated its distribution agreement with the 3M Company based on the lack of regulatory approval in the United States, as the Company believes was permitted by the Agreement. The 3M Company has disputed the Company's right to terminate the Agreement. In accordance with the provisions of the Agreement, a mediation session was held in December 2012, but no settlement was reached. The Company and the 3M Company have had further discussions based on that mediation in order to achieve a settlement of the dispute. At this point, it is not possible to assess the likelihood or terms of a settlement. Should settlement efforts be unsuccessful, either party may bring the dispute before the Courts of the State of New York. At this time, the Company is unable to predict whether an amount important or not will be paid by either party, or whether or when the dispute will be resolved.

24. Other Disclosure

On August 7, 2012, the Company signed a letter of intent with Getinge Infection Control initiating the negotiation for a worldwide distribution agreement for the products of the Company. The terms of such distribution agreement have not been finalized yet and are subject to an ongoing negotiation. There is no guarantee that such negotiation will be successful.

NOTES TO THE FINANCIAL STATEMENTS
Years ended December 31, 2012 and 2011

25. Subsequent Event

The Company has entered into a bought deal agreement with a syndicate of underwriters co-led by Desjardins Securities Inc. and Canaccord Genuity Corp. and including Byron Capital Markets Ltd. and Laurentian Bank Securities Inc., pursuant to which the Underwriters have agreed to purchase 7,000,000 common shares in the capital of the Company at the price of $1.00 per Common Share for aggregate gross proceeds to the Company of $7,000,000.

The Company has also agreed to grant the Underwriters an Over-Allotment Option exercisable for a period of 30 days following the Closing of the Offering. Such option allows the Underwriters to purchase up to 1,050,000 Common Shares, representing 15% of the Offering, at the Issue Price. If the Over-Allotment Option is exercised in full, the aggregate gross proceeds to The Company will be $8,050,000.

The Company has also agreed to grant the Underwriters an option to purchase 350,000 common shares (402,500 if the Over-Allotment Option is exercised) at $1.00 by common share. The Compensation Option expires on September 4, 2014. Closing of the issue occurred on March 4, 2013.

26. Approval of Financial Statements

The financial statements were approved by the Board of Directors on March 19, 2013.

DIRECTORS

Germain Carrière [1) 2) 3) 4)]
Chairman of the Board of Directors
Corporate Director

André de Villers [2) 4)]
President
CEMA

Pierre Désy [1) 2) 3) 4)]
Corporate Director

James Husman [2) 3)]
Corporate Director

Jacques Marcotte [3) 4)]
President
HWY Finance Inc.

W. Barry McDonald [1) 4)]
Consultant and Corporate Director

Richard M. Rumble
President and Chief Executive Officer, TSO_3

Simon Robitaille
Corporate Director and TSO3's Co-Founder

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

INVESTOR'S INFORMATION

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Listing: TSX

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Corporate Solicitors
Lavery, de Billy, LLP

Intellectual Property Solicitors
Borden Ladner Gervais LLP, Ottawa

Bank
National Bank of Canada

Annual Shareholder Meeting
Wednesday, May 8, 2013 at 15:00 pm
Musée McCord, theater J. Armand Bombardier
690, rue Sherbrooke Ouest
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TSO_3 STERIZONE® Sterilizer U.S. Pat. No. 7,128,872 / 7,582,257 / 7,588,720 / 7,608,217
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Licensed under U.S. Pat. No. 6,387,241 by Lynntech.
Other patents pending