



**Q2**

**October 31, 2007**

## **Second Quarter Interim Report for the Period Ending October, 2007**

The accompanying unaudited interim financial statements of Galvanic Applied Sciences Inc. for the second quarter ended October 2007 have been approved by management and approved by the Board of Directors of the Company. These statements have not been reviewed by the Company's external auditors.

# Galvanic Applied Sciences Inc.

## 2<sup>nd</sup> Quarter Report to Shareholders

Fellow Shareholders:

I am pleased to report on the Company's activities for its second quarter ended October 31, 2007. The annual general meeting was held August 28<sup>th</sup> and three new independent directors were elected by the shareholders bringing with them very impressive credentials for moving the Company forward in the challenging global markets that represent our future. As well, Galvanic is fortunate to have secured a seasoned international sales and marketing executive to head up the sales and marketing effort around the world.

Operating results for the quarter returned to more normal sales levels at just below \$4 million after the adverse impact of currency exchange rates. Earnings were again adversely affected by the impact of foreign exchange losses due to the strong Canadian dollar and the fact that 84% of the Company's sales were international and denominated in other than Canadian dollars. With the Canadian dollar at a 30 year high, the Company needs to improve its competitiveness since we no longer have the 30% to 40% cushion in international markets that existed when Galvanic entered these markets. Our competitive ability has been evolving over the past couple of years with upgraded products, features and service. Our product development / support group is first class and our sales group is improving each day.

The Company's financial position remains strong despite the currency exchange losses in the past two quarters. With no debt and more than \$5 million working capital (\$0.37 per share) we look forward to being a more competitive enterprise and growing in our international markets.



G.J. Hipple  
Chief Executive Officer

December 13<sup>th</sup>, 2007

## **MANAGEMENT'S DISCUSSION AND ANALYSIS**

Galvanic Applied Sciences Inc., (the "Company" or "Galvanic") is primarily an instrumentation Company involved in the design, engineering, manufacturing and selling of equipment for measurement in the natural gas, industrial liquids and sulphur processing markets. In this past quarter the Company's activities have been carried out directly in Calgary, Canada and through its wholly owned subsidiary, Galvanic Applied Sciences U.S.A. Inc., headquartered in Lowell, Massachusetts.

The following interim Management's Discussion and Analysis ("MD&A") has been prepared by management as of December 5, 2007 and is a review of the financial condition and results of operations of the Company based on accounting principles generally accepted in Canada. This report is Management's analysis of Galvanic's financial performance for the quarter ended October 31, 2007 and 2006 and should be read in conjunction with the unaudited consolidated financial statements and accompanying notes to the consolidated financial statements for the three-month periods ended October 31, 2007 and 2006. It is also advisable to read the MD&A in conjunction with the Company's 2007 annual report and the audited consolidated financial statements, the accompanying notes to consolidated financial statements and the MD&A for the years ended April 30, 2007 and 2006 contained in the annual report.

The interim report, which includes the MD&A, the unaudited consolidated financial statements and accompanying notes thereto, is reviewed and approved by the Company's Audit Committee and the Board of Directors prior to publication. The interim consolidated financial statements have not been reviewed by the Company's external auditors.

### **OPERATING SEGMENTS**

The Company has two operating segments identified by industry sector: the gas processing and distribution market, "Galvanic Canada;" and the liquids process market, "Galvanic Lowell."

#### **Galvanic Canada**

Galvanic Canada is headquartered in Calgary, Alberta and includes a sales and service centre located in Houston, Texas. Galvanic Canada's operation includes the manufacture and sales of hydrogen sulphide, total sulphur analyzers, gas chromatographs and a chromatograph-based BTU analyzer. These analyzers are marketed primarily into the gas processing market. The product line also includes a line of electronic flow and pressure measurement products sold into the gas distribution market, identified as the "Gas Micro". All the research and development activities for the corporate entity are carried out in Canada.

#### **Galvanic Lowell**

Galvanic Lowell is headquartered in Lowell, Massachusetts, and is primarily a manufacturing base for the liquids product line. This segment also includes a sales and service centre located in Dusseldorf, Germany, necessary to compete with local competitors and to service the European market where the company has a large installed base of Monitek products.

## CONSOLIDATED RESULTS OF OPERATIONS

### SUMMARY OF QUARTERLY RESULTS

	2008		2007				2006			
	Oct 07	July 07	April 07	Jan 07	Oct 06	July 06	April 06	Jan 06	Oct 05	July 05
	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$
Revenue	<b>3,851,326</b>	2,832,569	4,598,347	4,012,634	<b>4,624,437</b>	4,112,879	5,038,728	3,887,355	4,416,045	3,807,751
Gross margin	<b>1,297,521</b>	947,289	1,546,665	1,689,525	<b>1,599,700</b>	1,888,413	1,870,666	1,758,506	1,951,247	1,587,066
Net income	<b>(279,776)</b>	(414,353)	62,317	424,168	<b>237,781</b>	525,361	423,440	467,460	515,255	141,489
<b>Earnings per share</b>										
	<b>(0.01)</b>	(0.03)	0.00	0.03	<b>0.02</b>	0.03	0.03	0.03	0.03	0.01
	<b>(0.01)</b>	(0.03)	0.00	0.02	<b>0.02</b>	0.03	0.03	0.03	0.03	0.01

For the second quarter ended October 31, 2007 consolidated revenues from instrument sales decreased by 17%, to \$3,851,000, from the \$4,624,000 recorded in the previous corresponding quarter. This decrease in revenues was due to fewer instrument deliveries in both operating segments. Canadian operating segment revenues declined by 15%, largely as a result of fewer unit deliveries of the Gas Micro due to the completion of a major replacement program; and Lowell operating segment revenues declined by 21%, as a result of both reduced unit deliveries due to cyclical ordering patterns, coupled with a decline in the average exchange rates utilized to record revenues as a result of the strengthening of the Canadian dollar.

During the second quarter of fiscal 2008, compared with the same period of fiscal 2007, gross margin remained unchanged at 34%. Despite increased improvement in revenues for the second quarter, profitability was significantly impacted by the strength in the Canadian dollar compared with the U.S. dollar; and as a result a foreign exchange loss of \$322,000 was recorded, as compared with \$27,000 for the corresponding previous period. This contributed to a loss of \$280,000 or (\$0.01) per common share, compared with net earnings of \$238,000 or \$0.02 per common share in the corresponding previous period.

## SEGMENTED OPERATING RESULTS

	For the three-month period ended			For the three-month period ended		
	October 31, 2007			October 31, 2006		
	Galvanic Canada \$	Galvanic Lowell \$	Total \$	Galvanic Canada \$	Galvanic Lowell \$	Total \$
<b>REVENUE</b>						
Analytical measurement equipment	2,620,786	-	2,620,786	2,734,199	-	2,734,199
Electronic flow products	207,326	-	207,326	586,928	-	586,928
Liquids process analyzers	-	1,023,214	1,023,214	-	1,303,310	1,303,310
	<u>2,828,112</u>	<u>1,023,214</u>	<u>3,851,326</u>	<u>3,321,127</u>	<u>1,303,310</u>	<u>4,624,437</u>
<b>COST OF SALES</b>	<u>1,868,562</u>	<u>685,243</u>	<u>2,553,805</u>	<u>2,165,273</u>	<u>859,464</u>	<u>3,024,737</u>
<b>GROSS MARGIN</b>	<u>959,550</u>	<u>337,971</u>	<u>1,297,521</u>	<u>1,155,854</u>	<u>443,846</u>	<u>1,599,700</u>
<b>GROSS MARGIN %</b>	<u>0.34</u>	<u>0.33</u>	<u>0.34</u>	<u>0.35</u>	<u>0.34</u>	<u>0.35</u>
<b>EXPENSES</b>						
Selling and marketing	471,561	137,400	608,961	346,759	218,049	564,808
General and administrative	351,730	169,886	521,616	327,095	177,546	504,641
Interest on long-term debt	541	-	541	4,120	-	4,120
Exchange	398,294	(76,227)	322,067	33,435	(6,459)	26,976
Amortization	198,627	9,183	207,810	172,930	9,520	182,450
	<u>1,420,753</u>	<u>240,242</u>	<u>1,660,995</u>	<u>884,339</u>	<u>398,656</u>	<u>1,282,994</u>
<b>INCOME TAXES</b>						
(Recovery)Current	(106,148)	22,450	(83,698)	64,000	5,925	69,925
Future	-	-	-	9,000	-	9,000
	<u>(106,148)</u>	<u>22,450</u>	<u>(83,698)</u>	<u>73,000</u>	<u>5,925</u>	<u>78,925</u>
<b>NET (LOSS) EARNINGS</b>	<u>(355,055)</u>	<u>75,279</u>	<u>(279,776)</u>	<u>198,515</u>	<u>39,266</u>	<u>237,781</u>

## SEGMENTED OPERATING RESULTS (continued)

	For the six-month period ended			For the six-month period ended		
	October 31, 2007			October 31, 2006		
	Galvanic Canada \$	Galvanic Lowell \$	Total \$	Galvanic Canada \$	Galvanic Lowell \$	Total \$
<b>REVENUE</b>						
Analytical measurement equipment	4,330,924	-	4,330,924	5,236,275	-	5,236,275
Electronic flow products	449,705	-	449,705	895,129	-	895,129
Liquids process analyzers	-	1,903,266	1,903,266	-	2,605,913	2,605,913
	<u>4,780,629</u>	<u>1,903,266</u>	<u>6,683,895</u>	<u>6,131,404</u>	<u>2,605,913</u>	<u>8,737,317</u>
<b>COST OF SALES</b>	<u>3,106,202</u>	<u>1,332,883</u>	<u>4,439,085</u>	<u>3,548,306</u>	<u>1,700,896</u>	<u>5,249,202</u>
<b>GROSS MARGIN</b>	<u>1,674,427</u>	<u>570,383</u>	<u>2,244,810</u>	<u>2,583,098</u>	<u>905,017</u>	<u>3,488,115</u>
<b>GROSS MARGIN %</b>	<u>0.35</u>	<u>0.30</u>	<u>0.34</u>	<u>0.42</u>	<u>0.35</u>	<u>0.40</u>
<b>EXPENSES</b>						
Selling and marketing	872,596	273,932	1,146,528	679,430	397,569	1,076,999
General and administrative	806,858	353,252	1,160,110	619,847	378,719	998,566
Interest on long-term debt	1,957	-	1,957	10,771	-	10,771
Exchange	518,759	(96,512)	422,247	(22,281)	(7,802)	(30,083)
Amortization	395,683	19,881	415,564	341,079	28,949	370,028
	<u>2,595,853</u>	<u>550,553</u>	<u>3,146,406</u>	<u>1,628,846</u>	<u>797,435</u>	<u>2,426,281</u>
<b>INCOME TAXES</b>						
(Recovery) Current	(212,000)	4,533	(207,467)	235,000	41,692	276,692
Future	-	-	-	22,000	-	22,000
	<u>(212,000)</u>	<u>4,533</u>	<u>(207,467)</u>	<u>257,000</u>	<u>41,692</u>	<u>298,692</u>
<b>NET (LOSS) EARNINGS</b>	<u>(709,426)</u>	<u>15,297</u>	<u>(694,129)</u>	<u>697,252</u>	<u>65,890</u>	<u>763,142</u>

## **Galvanic Lowell**

The Company's array of process analytics instrumentation is marketed under three brands, with each brand targeting a particular market segment, and includes the Tytronics, the Nametre and the Monitek product lines. The Tytronics product line offers on-line chemical analysis of fluid processes, primarily to the water and chemical industries; due to their patented systems, the analyzers provide highly reliable and repeatable results for a variety of chemical applications. The Nametre product line offers in-line and laboratory viscosity analyzers used to measure the viscosity and viscoelasticity of a wide range of materials; they are sold into polymer manufacturing, petrochemical, food, paints and coatings, and pulp and paper markets. The Monitek line of products uses a variety of technologies to provide in-line turbidity, suspended solids, and oil-on-water measurements using photometric, acoustic, and fluorescence technologies. Typical applications are separation activities, such as pre- and post-filter measurement, pre- and post-centrifuge measurement, and solids carryover from a clarifier.

Substantially all of this operating division's revenue and expenses are denominated in U.S. dollar currency, and any changes in revenues or operating expenses must be assessed in light of the change in the value of the Canadian dollar currency. The average U.S. dollar exchange rate utilized to translate U.S. dollar revenues and expenses for the six-month period of fiscal 2008 was \$1.04 Canadian, a reduction of 8% from the \$1.13 rate that was utilized for the six-month period of fiscal 2007.

For the three-month period ended October 31, 2007, revenues generated from the liquids process analyzer market decreased by 21% to \$1,023,000, compared with the \$1,303,000 recorded for the three-month period ended October 31, 2006. For the six-month period ended October 31, 2007 revenues declined by 27% to \$1,903,000 compared to the \$2,606,000 recorded for the six-month period ended October 31, 2006. This reduction in recorded revenues in the second quarter of fiscal 2008 and year-to date revenues was due to both decreased unit volume shipments, as a result of cyclical ordering patterns, across all product lines; especially the Monitek line, and the decline in average exchange rates utilized to translate revenues as a result of the strengthening of the Canadian dollar in relationship to the U.S. dollar. Average exchange rate differences accounted for 40% of the decline in revenues for the three-month period and 22% for the six-month period ended October 2007.

Gross margins as a percentage of sales were 33% for the three-month period ended October 31, 2007 as compared with 34% for the three-month period ended October 31, 2006. For the six-month period gross margin as a percentage of sales declined by 5% to 30%, as compared with 35% for the corresponding previous period. This decline in gross margin was primarily due to the increase in unit component costs of the Monitek line shipped into the European market.

Marketing and selling expenses for the Lowell operating segment are primarily salaries for marketing administration, a direct sales staff, and representatives' commissions. Selling and marketing expenditures for the three-month period ended October 31, 2007 were \$137,000, a decrease of 37% from the \$218,000 recorded in the three-month period ended October 31, 2006. Selling and marketing expenditures were \$274,000 for the six-month period ended October 31, 2007, a decrease of 31% from the \$398,000 recorded for the comparative period. A decrease in discretionary travel expenditures, both domestically and internationally, accounted for the three-month and year-to-date decrease.

Major expenditures for general and administration in this operating segment have not changed significantly over the comparative prior periods. General and administrative expenses for the three-month period ended October 31, 2007 were \$170,000, a reduction of 7% from the \$178,000 recorded for the three-month period ended October 31, 2006. General and administrative expenses were \$353,000 for the six-month period ended October 31, 2007, a reduction of 5% from the \$379,000 recorded for the six-month period ended October 31, 2006. The decrease in general and administrative expenses recorded for the three-month period and the year-to-date period as compared with the comparative prior periods is largely due to the strengthening of the Canadian dollar in relationship to the U.S. dollar and the decline in the average exchange rates utilized to translate general and administrative expenses.

The unrealized exchange gain of \$76,000 recorded for the three-month period ended October 31, 2007 and of \$96,000 for the six month period compared with \$6,500 and \$7,800 respectively, is due to the strengthening of the Euro dollar in relationship to the U.S. dollar and to changes in the exchange rate utilized to record inter-company advances from the Lowell, Massachusetts, location to Germany.

Largely due to unrealized exchange gains recorded in the amount of \$76,000 for the three-month period and \$96,000 for the six- month period of October 31, 2007 as compared to the corresponding prior period, this operating segment reported net earnings of \$75,000 for the three-month period ended October 31, 2007 and net earnings of \$15,000 for the six-month period ended October 31, 2007 as compared to \$39,000 of net earnings for the three-month period ended October 31, 2006 and \$66,000 of net earnings for the six-month period ended October 31, 2006

### **Galvanic Canada**

Galvanic Canada's operation can be segmented into two product lines: analytical products that measure the composition of gas; and electronic flow and pressure measurement equipment designed to correct the volume reading of gas flow through a meter located at commercial sites, designed for the gas distribution market.

For the three-month period ended October 31, 2007 revenues generated from instrument sales declined by \$493,000, or 15%, to \$2,828,000, compared to \$3,321,000 for the same period in 2006. During the three-month period instrument sales into the Alberta market declined by 69%; which was largely mitigated by increased revenues generated in international markets. 65% of the decline was a result of construction delays related to Alberta tar sands projects and the resulting demand for shelter systems. The balance of the decline is a result of increased competition experienced in the analytical instrument line coupled with the completion of a major replacement program with the Company's major customer in the gas distribution market. For the six months ended October 31, 2007 revenues were \$4,781,000, a decline of \$1,351,000 or 22%, compared to \$6,131,000 for the same period of 2006. This decline in revenues was largely due to reduced analytical instrument sales resulting from the general economic slow down in the Alberta market coupled with increased competition.

Gross margin as a percentage of sales was \$959,000, or 34% of revenue, as compared with \$1,156,000, or 35% of revenue, for the three-month period ended October 31, 2006. Gross margin as a percentage of sales was 35% for the six-month period ended October 31, 2007, as compared with 42% for the same period in 2006. As a result of reduced instrument sales the resulting contribution margin was insufficient to fully absorb fixed expenses of the company resulting in the decline in gross margin as a percentage of sales.

Selling and marketing expenses were \$471,000 for the three-month period ended October 31, 2007, compared to \$347,000 for the second quarter of fiscal 2007. Selling and marketing expenditures were \$872,000 for the six-month period ended October 31, 2007, an increase of \$193,000 or 28%, compared with \$679,000 for the comparative prior period. This increase in selling and marketing expenses for the three-month and year-to-date periods over the comparative prior periods is largely due to increased salary and wages due to the addition of sales and service support personnel required in both the Calgary and Houston locations, increased travel expenses required to pursue international opportunities, and royalties committed to Alberta Research Council in respect of the Company's water analyzer.

General and administrative expenses were \$351,000 for the three-month period ended October 31, 2007 as compared with \$327,000 for the three-month period ended October 31, 2006. General and administrative expenditures were \$807,000 for the six-month period ended October 31, 2007, an increase of \$187,000 from the \$620,000 recorded in the comparative prior period. This increase in expenditures in the second quarter and year-to-date is largely due to increased legal fees related to a claim against certain former employees of the Company. The Company expects to incur future expenses related to its claim against former employees of the company.

As of October 31, 2007 the Company had approximately \$4.4 million of U.S. dollar denominated current assets. Changes in the value of the Canadian dollar will result in an adjustment to the carrying value of these assets. At October 31, 2007 the value of the U.S. dollar was \$.9447 Canadian compared with \$1.0668 at July 31, 2007. Accordingly, this devaluation of the U.S. dollar resulted in an unrealized exchange loss of \$398,000 for three-month period ended October 31, 2007 and \$519,000 for the six-month period ended October 31, 2007

This operating segment reported a \$280,000 loss or (\$0.01) cent per common share for the three month period ended October 31, 2007 as compared to net earnings of \$238,000 or \$0.02 per common share for the comparative prior period. A loss of \$694,000 or \$0.04 cents per common share was recorded for the six-month period as compared with net earnings of \$763,000 or \$0.05 per in the comparative prior period. These losses are attributable to both a reduction in gross margins and the significant unrealized exchange losses recorded. These losses reduce prior year income taxes and therefore income taxes recoverable in the amount of \$84,000 and \$207,000 at the effective rate of 23% have been recorded as compared to income taxes payable in the comparative prior periods.

### **OTHER COMPREHENSIVE INCOME**

Included in the consolidated statements of earnings are \$170,000 of unrealized losses for the three-month period ended October 31, 2007 and \$230,000 for the six-month period ending October 31, 2007 on translating the financial statements of the Company's self-sustaining liquid analyzer U.S. operations utilizing the current rate method of translation.

### **LIQUIDITY AND CAPITAL RESOURCES**

Galvanic continues to generate operating cash flow sufficient to fund its ongoing operating requirements, fund its development programs and capital acquisitions. The Company's principal source of liquidity is derived primarily from cash flow from operations and from its working capital. Due the first six-month of fiscal 2008, the Company reduced its net cash position by \$87,000. This reduction in cash balances occurred as a result as a result of funding its ongoing development programs in the amount of \$259,000, investment in property plant and equipment in the amount of \$105,000, and the debt repayment in the amount of \$105,000. Cash was further depleted through losses generated from operations in the amount of \$484,000. During the first six-months of fiscal 2008, non-cash working capital from operations increased by \$865,000 as a result of a decrease in accounts receivable in the amount of \$1,372,000, a \$540,000 decrease in inventory, and advances under the operating line of \$60,000. This was offset of by decrease in accounts payable in the amount of \$474,000, and net decrease in income taxes in the amount of \$63,000, and prepaid expenses in the amount of \$73,000. As of October 31, 2007, the Company maintained a working capital position of \$5,763,000.

Accounts receivable at October 31, 2007 were \$3,158,000 compared to \$4,530,000 at April 30, 2007. As a result of collections, this represents 86 days of sales as compared to 95 days of sales at April 30, 2007.

Inventory levels have decreased by \$540,000 to \$3,665,000 from the \$4,205,000 recorded in April 30, 2007. This is largely due to the shipment of a shelter system and included in work-in-process in the Canadian operating segment.

During 2007 there were no significant changes in the structure of the Company's bank credit facilities. The existing credit facility consists of a revolving bank term loan in the amount of \$2,550,000. The availability of the operating facility is subject to a monthly borrowing base calculation that considers eligible accounts receivable. As of October 31, 2007, \$1,605,000 was advanced against this facility. The loan is collateralized by a charge over all of the assets of the Company, and requires that the Company meet certain covenants. Galvanic was in full compliance with these covenants at October 31, 2007.

Management believes that with its working capital position and access to funds available through its credit facility, together with positive cash from future operations, the Company will be able to meet its near term working capital requirements.

### **Capital Asset Additions**

During the six-month period ending October 31, 2007, the Company invested \$106,000 in capital additions primarily for the completion of its production facilities, compared with \$172,000 expended in the corresponding previous period.

### **Product Development Costs**

The Company continues to invest in research and development activities to support its continued goal of creating new generations of current products and the design of new products. For the past quarter and the previous year, efforts were directed to continued enhancement and improvement to current product offerings. All product development activities for both the Lowell and Canadian operation are carried out in the Calgary location. Development expenditures consist primarily of technical personnel and material and equipment required to support the ongoing research activities. For the three months ended October 31, 2007, the Company expended \$127,000 on development activities. This compares with \$153,000 for the corresponding previous quarter. This decrease is largely due to specific application work required and included in cost of sales.

### **COMMITMENTS**

The majority of the Company's lease commitments include rental costs to be incurred with respect to building rent in Calgary, Alberta; Lowell, Massachusetts; and Dusseldorf, Germany. The remaining amounts are on account of automobiles utilized for service and sales, and office equipment.

The Company has also committed to a minimum annual royalty for fiscal 2008, in the amount of \$60,000 in respect of its water analyzer.

### **SHARE CAPITAL**

The Company's authorized share capital has remained unchanged during the second quarter of fiscal 2008. The Company's issued and outstanding shares at October 31, 2007, and July 31, 2007 are 15,571,072 common shares.

### **FINANCIAL INSTRUMENTS**

The Company's restricted funds, accounts receivable, operating loan, and accounts payable and accrued liabilities and the long-term accounts receivable relating to deferred revenue, constitute financial instruments. Based on available market information, and relatively short periods to maturity, the carrying value of the Company's financial instruments approximates their fair value. The carrying values of these financial instruments represent their maximum credit risk. Long-term debt approximates its fair value due to the floating rate of interest.

### **OFF-BALANCE SHEET ARRANGEMENTS**

At October 31, 2007 and April 30, 2007, the Company has not entered into any off-balance sheet arrangements.

### **EXECUTIVE COMPENSATION**

Compensation paid by the company to its executive officers for the six-month period ended October 31, 2007 amounted to \$138,000 as compared with \$148,373 for the corresponding previous period. For the period ended October 31, 2007, \$23,000 was paid to the directors of the Company for their services as directors.

## **FORWARD-LOOKING STATEMENTS**

Certain statements included in the Management's Discussion and Analysis and elsewhere in this report contain forward looking statements, which by their nature are necessarily subject to risks and uncertainties and other factors that may cause actual results, performance or achievements of the Company to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Such statements reflect the Company's current views with respect to future events, and are based on information currently available to the Company and on hypotheses which it considers to be reasonable; however, management warns the reader that hypotheses relative to future events which are beyond the control of management could prove to be false, given that they are subject to certain risks and uncertainties.

Additional information relating to the Company may be found on SEDAR @ [www.Sedar.com](http://www.Sedar.com).

*Consolidated Financial Statements of*

**GALVANIC APPLIED SCIENCES INC.**

*(Unaudited)*

*October 31, 2007 and October 31, 2006*

# GALVANIC APPLIED SCIENCES INC.

## Consolidated Statements of Earnings and Retained Earnings (Unaudited)

	Three Months Ended October 31,		Six Months Ended October 31,	
	2007	2006	2007	2006
	\$	\$	\$	\$
<b>REVENUE</b>				
Sales	3,851,326	4,624,437	6,683,895	8,737,317
Cost of sales	2,553,805	3,024,737	4,439,085	5,249,202
Gross margin	1,297,521	1,599,700	2,244,810	3,488,115
<b>EXPENSES</b>				
Amortization	207,810	182,450	415,564	370,028
Foreign exchange loss (gain)	322,067	26,975	422,247	(30,083)
General and administrative	521,616	504,641	1,160,110	998,566
Interest	541	4,120	1,957	10,771
Selling and marketing	608,961	564,808	1,146,528	1,076,999
	1,660,995	1,282,994	3,146,406	2,426,281
(LOSS) EARNINGS BEFORE INCOME TAXES	(363,474)	316,706	(901,596)	1,061,834
PROVISION FOR INCOME TAXES				
Recovery of current income taxes	(83,698)	69,925	(207,467)	276,692
Future	-	9,000	-	22,000
	(83,698)	78,925	(207,467)	298,692
NET (LOSS) EARNINGS	(279,776)	237,781	(694,129)	763,142
OTHER COMPREHENSIVE INCOME (Note 2)	(170,931)	15,292	(230,730)	(3,023)
CUMULATIVE COMPREHENSIVE INCOME	(450,707)	253,073	(924,859)	760,119
RETAINED EARNINGS, BEGINNING OF PERIOD	7,248,929	6,939,016	7,663,282	6,413,655
RETAINED EARNINGS, END OF PERIOD	6,969,153	7,176,797	6,969,153	7,176,797
NET EARNINGS PER COMMON SHARE				
Basic and diluted	(0.01)	0.02	(0.04)	0.05

# GALVANIC APPLIED SCIENCES INC.

## Consolidated Balance Sheets

	October 31, 2007 (Unaudited) \$	April 30, 2007 (Audited) \$
<b>ASSETS</b>		
<b>CURRENT</b>		
Cash	1,218,103	1,305,373
Restricted funds	112,750	113,950
Accounts receivable - trade	3,157,603	4,529,659
Recoverable income tax	248,826	-
Inventory	3,664,864	4,205,001
Prepaid expenses	200,174	127,507
	<b>8,602,320</b>	<b>10,281,490</b>
Long-term accounts receivable	-	34,521
Deferred development costs	2,701,257	2,686,134
Property, plant and equipment	1,266,013	1,332,555
Goodwill	3,442,693	3,442,693
	<b>16,012,283</b>	<b>17,777,393</b>
<b>LIABILITIES</b>		
<b>CURRENT</b>		
Operating loan	1,605,000	1,545,000
Accounts payable and accrued liabilities	1,233,885	1,708,059
Income taxes payable	-	312,640
Current portion of long-term debt	-	104,495
	<b>2,838,885</b>	<b>3,670,194</b>
Deferred revenue	-	34,521
Future income taxes	897,166	897,166
	<b>3,736,051</b>	<b>4,601,881</b>
<b>COMMITMENTS AND CONTINGENCIES (Note 6)</b>		
<b>SHAREHOLDERS' EQUITY</b>		
Share capital (Note 3)	4,806,423	4,806,423
Contributed surplus	943,142	917,563
Retained earnings	6,969,153	7,663,282
Cumulative comprehensive income	(442,486)	(211,756)
	<b>12,276,232</b>	<b>13,175,512</b>
	<b>16,012,283</b>	<b>17,777,393</b>

### APPROVED BY THE BOARD



Director



Director

# GALVANIC APPLIED SCIENCES INC.

## Consolidated Statements of Cash Flows (Unaudited)

	Three Months Ended October 31,		Six Months Ended October 31,	
	2007	2006	2007	2006
	\$	\$	\$	\$
<b>CASH FLOWS RELATED TO THE FOLLOWING ACTIVITIES:</b>				
<b>OPERATING</b>				
Net (loss) earnings	(279,776)	237,781	(694,129)	763,142
Adjustments for:				
Amortization	207,810	182,450	415,564	370,028
Future income taxes	-	9,000	-	22,000
Stock-based compensation	8,608	16,971	25,579	33,942
Unrealized foreign exchange loss	(170,931)	(15,292)	(230,730)	(3,023)
	(234,289)	430,910	(483,716)	1,186,089
Changes in non-cash working capital	598,872	65,575	865,086	(160,697)
	364,583	496,485	381,370	1,025,392
<b>FINANCING</b>				
Repayment of long-term debt	(49,671)	(49,676)	(104,495)	(122,773)
Issuance of share capital under stock option plan	-	19,350	-	19,350
	(49,671)	(30,326)	(104,495)	(103,423)
<b>INVESTING</b>				
Property, plant and equipment	(84,025)	(69,025)	(105,539)	(171,709)
Development costs	(127,051)	(152,994)	(258,606)	(303,626)
	(211,076)	(222,019)	(364,145)	(475,335)
<b>NET INCREASE (DECREASE) IN CASH</b>	<b>103,836</b>	<b>244,140</b>	<b>(87,270)</b>	<b>446,634</b>
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD</b>	<b>1,114,267</b>	<b>1,545,908</b>	<b>1,305,373</b>	<b>1,343,414</b>
<b>CASH AND CASH EQUIVALENTS, END OF PERIOD</b>	<b>1,218,103</b>	<b>1,790,048</b>	<b>1,218,103</b>	<b>1,790,048</b>
<b>SUPPLEMENTARY INFORMATION</b>				
Cash paid for interest	541	4,120	1,957	10,771
Cash paid for taxes	316,000	-	316,000	249,786

# **GALVANIC APPLIED SCIENCES INC.**

## **Notes to the Consolidated Financial Statements**

**Six Months Ended October 31, 2007**

**(Unaudited)**

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### **1. ACCOUNTING POLICIES**

#### *Interim financial statements*

The accompanying interim consolidated financial statements of Galvanic Applied Sciences Inc. have been prepared in accordance with Canadian generally accepted accounting principles consistent with those used in the Company's consolidated financial statements for the year ended April 30, 2007. These interim financial statements and notes thereto should be read in conjunction with the Company's consolidated financial statements contained in its Annual Report for the year ended April 30, 2007.

Accounting measurements at interim dates inherently involve greater reliance on estimates than at year-end and the results of operations for the interim periods shown in this report are not necessarily indicative of results to be expected for the fiscal year. In the opinion of management, the accompanying unaudited interim consolidated financial statements include all adjustments (of a recurring nature) necessary to present fairly the consolidated financial position of the Company at October 31, 2007 and the consolidated results of its operations and cash flows for the six months ended October 31, 2007 and 2006.

### **2. FINANCIAL INSTRUMENTS AND COMPREHENSIVE INCOME**

Effective May 1, 2006, the Company adopted the following new standards issued by the Canadian Institute of Chartered Accountants (CICA) in 2006. CICA Handbook Sections 3855 and 3861 – Financial Instruments: This section describes the requirement to report all financial instruments at fair value in the financial statements unless certain criteria are met. CICA Handbook Section 1530 – Comprehensive Income: This section establishes standards for reporting and disclosing Comprehensive Income that arises from changes in the equity of an enterprise during the period but is not included in net income. CICA Handbook Section 1506 – Changes in Accounting Policies, Accounting Estimates and Errors: This section prescribes the criteria for changing accounting policies, together with the accounting treatment and disclosure of changing accounting policies, changes in accounting estimates and correction of errors

#### **Financial Instruments**

Under the new standards, financial assets and liabilities are initially recognized at fair value and are subsequently accounted for based on their classification as described below. The classification depends on the purpose for which the financial instruments were acquired and their characteristics.

The Company's primary financial instruments consist of cash, accounts receivable, operating loan, and accounts payable and accrued liabilities. The fair value of these assets approximates their respective carrying amounts due to their short-term nature, and the expectation that these financial instruments will be held to maturity. Under the new

# GALVANIC APPLIED SCIENCES INC.

## Notes to the Consolidated Financial Statements

Six Months Ended October 31, 2007

(Unaudited)

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accounting standards other financial instruments are classified as i) Held for trading, or ii) Available for sale. Financial instruments in these classifications would be carried at fair value. The Company does not currently hold any financial instruments that would be included in these classifications.

The Company has not entered into any hedge contracts or other derivative arrangements. Management has also reviewed the Company's other significant contractual arrangements and determined that there are no embedded derivatives that would require disclosure and accounting for as financial instruments under the new accounting standards.

### Comprehensive income

Under the new standards, additional financial statement disclosure has been introduced which identifies certain gains and losses, which in the company's case include only foreign currency translation adjustments arising from translation of the company's US subsidiary which is considered to be self-sustaining, that are recorded outside the income statement. Additionally, a separate component of equity, Accumulated Other Comprehensive Income ("AOCI"), has been introduced in the consolidated balance sheet to record the continuity of other comprehensive income balances on a cumulative basis.

The adoption of comprehensive income has been made in accordance with the applicable transitional provisions. Accordingly, the April 30, 2007 period end accumulated foreign currency translation adjustment balance of \$211,756 has been reclassified to AOCI. In addition, the change in the accumulated foreign currency translation adjustment balance for the period ended October 31, 2007 of \$230,730 is now included as Comprehensive Income.

### 3. SHARE CAPITAL

	<u>Number of</u> <u>Shares</u>	<u>Amount</u> <u>\$</u>
Authorized		
Unlimited number of common and preferred shares without nominal or par value		
Issued		
Common shares		
<b>Balance Oct 31, 2007, July 31, 2007, and April 30, 2007</b>	<b><u>15,571,072</u></b>	<b><u>4,806,423</u></b>

# GALVANIC APPLIED SCIENCES INC.

## Notes to the Consolidated Financial Statements

Six Months Ended October 31, 2007

(Unaudited)

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### *Stock options*

At October 31, 2007, the Company has a fixed stock option plan open to directors, officers and employees of the Company. Under this plan, the Company may grant options to a maximum of 10% of the issued and outstanding common share of the Company on a non-diluted basis. Under the plan, the exercise price generally equals the market price of the Company's stock on the day prior to the date of grant and an option's maximum term is five years. The options granted have the following expiry dates: July 31, 2008 and September 16, 2010.

	<b>Number of Shares</b>	<b>Weighted Average Exercise Price \$</b>
<b>Options outstanding Oct 31, 2007, July 31, 2007, and April 30, 2007</b>	<b>990,000</b>	<b>0.50</b>

In 2004, the Company adopted the fair value based method of accounting for its stock based compensation plan whereby the fair value of stock options granted is recognized as an expense of the period with a corresponding amount credited to contributed surplus at October 31, 2007 of \$8,608 (July 31, 2007 - \$16,971) (April 30, 2007 - \$67,884).

# **GALVANIC APPLIED SCIENCES INC.**

## **Notes to the Consolidated Financial Statements**

**Six Months Ended October 31, 2007**

**(Unaudited)**

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### **4. SEGMENTED INFORMATION**

The Company currently has two reportable business segments identified primarily by market segment. These include instrumentation for the natural gas industry, which includes both the processing and distribution market, Galvanic Canada; and the liquid analyser process market, Galvanic Lowell.

The operations for the natural gas industry are primarily conducted by the Company through its Calgary and Houston offices, and its products include instrumentation for the measurement of the composition of natural gas. The Brimstone acquisition further expanded the Company's product offering in this market, and is included in this operating segment. Brimstone Instrumentation Ltd. Manufactures analyser systems that analyze and track sulphur species content.

This operating segment's product line can be broadly categorized into two groups. The first is analytical products, which measure hydrogen sulfide (H<sub>2</sub>S) total sulfur, sulfur species utilizing ultra violet-based systems, and carbon dioxide (CO<sub>2</sub>) with infrared technology. The market for such products is the natural gas processing industry, sulphur recovery plants, tail gas clean-up units, gas sweetening process and sulfur degassing and forming.

The second product line is electronic flow and pressure measurement products, which consist primarily of equipment that is designed to correct the volume reading of gas flow through a meter located at a commercial site.

The Company's operation in the liquids process market is operated from Lowell, Massachusetts and Dusseldorf, Germany. This operation includes three product lines that utilize varying technologies that measure chemical concentrations, viscosity, turbidity and suspended solids for the liquids process industry.

# GALVANIC APPLIED SCIENCES INC.

## Notes to the Consolidated Financial Statements

Six Months Ended October 31, 2007

(Unaudited)

### 4. SEGMENTED INFORMATION (Continued)

The Company evaluates the performance of its operating segments based on earnings before income taxes. Good will associated with the Brimstone Instrumentation Inc., acquisition is included in the Galvanic Canada operating segment and the goodwill associated with the Metrisa, Inc. acquisition is included in the Galvanic Lowell operating segment.

	Three Months Ended October 31, 2007			Three Months Ended October 31, 2006		
	Galvanic Canada \$	Galvanic Lowell \$	Enterprise Total \$	Galvanic Canada \$	Galvanic Lowell \$	Enterprise Total \$
Revenue	2,828,112	1,023,214	3,851,326	3,321,127	1,303,310	4,624,437
Segment net (loss) earnings	(355,055)	75,279	(279,776)	198,515	39,266	237,781
Amortization	198,627	9,183	207,810	172,930	9,520	182,450
Total assets of segments	(619,764)	(221,976)	(841,740)	(354,854)	(84,181)	(439,035)
Goodwill allocated to segment	-	-	-	-	-	-
	(619,764)	(221,976)	(841,740)	(354,854)	(84,181)	(439,035)
Elimination of inter-divisional receivables			-			883,961
Total enterprise assets			(841,740)			441,926
Expenditures for capital assets	(84,626)	601	(84,025)	(79,736)	10,711	(69,025)
Expenditures for development costs	(127,051)	-	(127,051)	(152,995)	-	(152,995)

# GALVANIC APPLIED SCIENCES INC.

## Notes to the Consolidated Financial Statements

Six Months Ended October 31, 2007

(Unaudited)

### 4. SEGMENTED INFORMATION (Continued)

	Six Months Ended October 31, 2007			Six Months Ended October 31, 2006		
	Galvanic Canada \$	Galvanic Lowell \$	Enterprise Total \$	Galvanic Canada \$	Galvanic Lowell \$	Enterprise Total \$
Revenue	<b>4,780,629</b>	<b>1,903,266</b>	<b>6,683,895</b>	6,131,404	2,605,913	8,737,317
Segment net (loss)earnings	<b>(709,426)</b>	<b>15,297</b>	<b>(694,129)</b>	697,252	65,890	763,142
Amortization	<b>395,683</b>	<b>19,881</b>	<b>415,564</b>	341,079	28,949	370,028
Total assets of segments	<b>11,205,184</b>	<b>1,364,406</b>	<b>12,569,590</b>	12,406,344	1,749,125	14,155,469
Goodwill allocated to segment	<b>608,983</b>	<b>2,833,710</b>	<b>3,442,693</b>	608,983	2,833,710	3,442,693
Total enterprise assets	<b>11,814,167</b>	<b>4,198,116</b>	<b>16,012,283</b>	13,015,327	4,582,835	17,598,162
Expenditures for capital assets	<b>(102,016)</b>	<b>(3,523)</b>	<b>(105,539)</b>	(166,896)	(4,813)	(171,709)
Expenditures for development costs	<b>(258,606)</b>	-	<b>(258,606)</b>	(303,626)	-	(303,626)

# GALVANIC APPLIED SCIENCES INC.

## Notes to the Consolidated Financial Statements

Six Months Ended October 31, 2007

(Unaudited)

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### 4. SEGMENTED INFORMATION (Continued)

The following table represents revenues by geographic area based on the location of the use of the product.

	Three Months Ended		Six Months Ended	
	October 31,		October 31,	
	2007	2006	2007	2006
	\$	\$	\$	\$
Canada	<b>623,394</b>	1,906,675	<b>1,384,782</b>	3,484,454
United States	<b>1,290,151</b>	1,397,169	<b>2,247,103</b>	3,047,910
Germany	<b>264,156</b>	239,611	<b>500,603</b>	431,248
Other international sales	<b>1,673,626</b>	1,080,982	<b>2,551,407</b>	1,773,705
	<b>3,851,327</b>	4,624,437	<b>6,683,895</b>	8,737,317

### 5. PER SHARE AMOUNTS

The number of shares used in the weighted average diluted calculation at October 31, 2007, 16,068,572 (July 31, 2007 – 16,068,572) (April 30, 2007 – 16,048,662).

### 6. COMMITMENTS AND GUARANTEES

The Company has various guarantees and indemnifications in place in the ordinary course of business, none of which, as assessed by management, are expected to have a significant impact on the Company's financial statements or operation.

## **CORPORATE INFORMATION**

### **DIRECTORS**

Peter C. Bourgeois (2) (3) (4)  
Mississauga, Ontario

Gerald J. Hipple (1)  
Calgary, Alberta

Walter Chayka (2) (3) (4)  
Calgary, Alberta

S. Grant Reeves (2) (3) (4)  
North Charleston, South Carolina

- (1) Chairman of the Board
- (2) Compensation Committee
- (3) Audit Committee
- (4) Corporate Governance Committee

### **CORPORATE OFFICERS**

Gerald J. Hipple (1)  
Chief Executive Officer  
Calgary, Alberta

### **REGISTRAR AND TRANSFER**

Computershare Trust Company of Canada

Helen Cornett, C.A.  
Vice-President and Chief Financial Officer

### **AUDITORS**

Deloitte & Touche LLP  
Chartered Accountants  
Calgary, Alberta

### **STOCK EXCHANGE LISTING**

The TSX Venture Exchange  
Trading Symbol: GAV

### **BANKERS**

TD Canada Trust Bank  
Calgary, Alberta

### **SOLICITOR**

Macleod Dixon  
Calgary, Alberta



**Galvanic Applied Sciences Inc.**

7000 Fisher Rd. S.E.  
Calgary, Alberta T2H 0W3  
Telephone: 403-252-8470  
Fax: 403-255-6287

**Sales & Service**

**Calgary, Alberta**

1200, 715-5th Ave. S.W.  
Calgary, Alberta T2P 2X6  
Telephone: 403-252-8470  
Fax: 403-571-2684

**Dusseldorf, Germany**

Ackerstraße 144  
Dusseldorf, 40233, Germany  
Telephone: + 49-211-68780-40  
Fax: + 49-211-68780- 430/5  
Nightline: +49-211-68780-425

**Galvanic Applied Sciences USA Inc.**

41 Wellman Street  
Lowell, MA 01851  
Telephone: 978-848-2701  
Fax: 978-848-2713

**Houston, Texas**

13211K Windfern Road  
Houston, Texas 77064  
Tel: 281-477-9002  
Fax: 281-477-9004

**TOLL FREE 1-866-252-8470 (USA & CANADA ONLY)**  
**www.galvanic.com info@galvanic.com**