

MANAGEMENT'S DISCUSSION AND ANALYSIS OF OPERATING RESULTS

This report is Management's analysis of Galvanic Applied Sciences Inc., financial results for the third quarter ended January 31, 2005. It should be read in conjunction with the financial statements and accompanying notes for the year ended April 30, 2004.

Fluctuations in the operating results of Galvanic for all three quarter's of fiscal 2005 as compared to the comparative quarter's in fiscal 2004 are generally due to the acquisition of Metrisa Inc., which closed on July 3, 2003, and the subsequent acquisition of Brimstone Instrumentation Inc., which closed October 1, 2004. As a result of the Metrisa acquisition nine month's of operating results are included in the consolidated operating results at January 31, 2005, as compared to seven months of operating results at January 31, 2004. The Brimstone acquisition includes four month's of operating results for the period ended January 31, 2005.

Metrisa was a twenty-year-old Company which manufactured and marketed process analytical instrumentation for the liquids process analyzer market. Process analyzers help the process industry to monitor, manage and optimize their industrial processes. These include the petroleum, chemical, industrial, water, food and beverage markets. The broad application of process analytical solutions presents the Company with new market opportunities in markets such as semi-conductors, potable and industrial wastewater treatment and the bio-processing industry.

This product offering is assembled at a facility in Lowell, Massachusetts, and includes a sales and service support facility in Dusseldorf, Germany. With the acquisition, the Company added seventeen senior technical employees.

ACQUISITION

Effective October 1, 2004 the Company purchased Brimstone Instrumentation Inc., for total consideration of \$769,123 including transaction costs, and financed with term debt. Four month's of operating revenue is therefore included in the consolidated financial statements of the Company. Note 2 to the financial statements provides further details of the acquisition.

Brimstone Instrumentation Inc. designs, manufactures and sells ultraviolet-based analytical analyser systems for sulphur recovery processes in the refining, gas processing and chemical industries.

RESULTS OF OPERATIONS

For the nine months ended January 31, 2005, consolidated revenues were \$12,153,000 compared to \$9,497,000 for the nine month period ended January 31, 2004. Much of this increase in revenues is directly attributable to the two acquisitions which contributed \$2,360,000 to consolidated revenues. The increase in revenues for the third quarter of fiscal 2005 as compared to the second quarter of fiscal 2005 is directly attributable to the Brimstone acquisition which contributed three month's of operating revenue or \$587,000 to the third quarter.

The Lowell operation contributed 34% to third quarter consolidated revenues as compared to 37% to in the second quarter of fiscal 2005 and 43% in the first quarter of fiscal 2005. This decrease in contribution to consolidated revenues in the third quarter of fiscal 2005 is due to the Brimstone acquisition adding to consolidated revenues with three months of operating revenues included in the third quarter. Brimstone sales of \$587,000 for the current fiscal quarter accounted for 13% of consolidated revenues. As the Metrisa sale closed on July 3, 2003, only seven months of operating revenues were recorded in the previous fiscal period of 2004. The comparative percentages for this fiscal period are 42% for the three months period ended January 31, 2004, 35% for the three month period October 31, 2003 and 8% for the period ended July 31, 2003, which only included one month of operating revenue.

Net earnings per common share for the nine month period ended January 31, 2005 were \$814,000 or \$.06 per common share which compared to \$73,000 or \$.00 per common share for the nine month period January 31, 2004. This increase in net earnings per common share over the previous corresponding nine month period has been directly impacted by the Company's operations in the liquids process analyzer market. For the nine month period ending January 31, 2005 the Lowell operation contributed \$441,000 of operating profit compared to a operating loss of \$(327,000) for the same corresponding period in 2004. This turn around in operating results is due to both cost reductions implemented in the previous year and a full nine months of operations included in revenues.

Net earnings for the three month period January 31, 2005 were \$256,000 or \$0.02 per common share as compared with \$315,000 or \$0.02 per common share in the second quarter of fiscal 2005.

Below is a table outlining historical quarterly performance.

	Three months ended January 31		Nine months ended January 31	
	2005	2004	2005	2004
Revenue	4,362,631	3,918,157	12,152,637	9,947,230
Gross margin	1,629,042	<u>1,694,826</u>	4,997,219	<u>3,884,565</u>
Net income	<u>256,327</u>	<u>315,394</u>	<u>813,641</u>	<u>72,841</u>
Earnings per share				
Basic	0.02	0.02	0.06	0.00
Diluted	0.02	0.02	0.06	0.00

CONSOLIDATED REVENUE

The Company's product offering is segmented by market; the liquid process analyzer market and the gas processing and distribution market.

Liquids Process Analyzer Market

The Company's array of process analytics instrumentation is marketed under three brands, with each brand specializing in a particular market segment, and include the Tytronics, the Nametre and the Monitek product line.

Sales by product line, for the nine months ended January 31, which include instruments, spare parts and service revenues are as follows:

	Three months ended		Nine months ended	
	January 31		January 31	
	2005	2004	2005	2004
	\$	\$	\$	\$
Monitek products	814,154	743,919	2,327,050	1,387,479
Tytronic products	515,296	731,690	1,751,784	1,282,008
Nametre products	165,951	161,860	531,074	339,944
	<u>1,495,401</u>	<u>1,637,469</u>	<u>4,609,908</u>	<u>3,009,431</u>

** seven months of operations

Sales of the liquid product line remained consistent quarter over quarter, for fiscal 2005, with recorded sales of \$1,495,000 in the third quarter, \$1,514,000 in the second quarter and \$1,601,000 in the first quarter of fiscal 2005. Spare part sales accounted for 19%, 28% and 23% respectively of overall sales.

The Monitek product line is sold primarily into the food and beverage market with a significant base of installed products in Europe. Sales into the European market from the Germany facility accounted for 40% of overall Monitek sales as compared to 46% of the sales in the second quarter of fiscal 2005. This decline in sales from Germany are due to one large order received in the previous quarter.

Gas Processing and Distribution Market

The Canadian company'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 utility distribution market. Included in this market segment is the Brimstone acquisition that designs, manufactures and sells ultraviolet-based analytical instrument systems for sulphur recovery processes in the refining, gas processing and chemical industries. Four month's of operating revenues in the amount of \$759,000 are included in the Company's analytical sales.

For the first nine months of fiscal 2005 the company's sales of analytical measurement products into the gas processing market experienced an overall decline; offset by significant increases of Gas Micro sales into the gas distribution market. Analytical product sales for the nine month fiscal period 2005, excluding the Brimstone acquisition, were \$4,102,000 as compared with \$5,400,00 for fiscal 2004. This decline in sales was due to lower unit sales. A total of 123 units were shipped for current nine month period of fiscal 2005 compared with 165 units in the comparative nine month period of fiscal 2004. This decrease in unit volume sales is due to flat market demand for the chemiluminescence and PLGC analyzer.

During the third quarter of fiscal 2005 the company experienced increased demand for it's core analytical product line, which include the tape analyzer, PLGC, Chemi, and moisture analyzer. Revenues from this product line increased by \$355,000 over the previous quarter, with a total of 53 analytical units shipped compared with 46 for the three months ending October 31, and 24 units in the first quarter of fiscal 2005. This compared with 60, 59 and 46 analytical instruments in the previous fiscal period corresponding quarters.

	Three months ended		Nine months ended	
	January 31		January 31	
	2005	2004	2005	2004
	\$	\$	\$	\$
Analytical measurement equipment	2,115,162	1,785,397	4,860,481	5,407,335
Electronic flow products	752,068	495,291	2,682,248	1,080,464
	<u>2,867,230</u>	<u>2,280,688</u>	<u>7,542,729</u>	<u>6,487,799</u>

Sales of the Gas Micro for the first three quarters of fiscal 2005 remained strong with a total of 1,361 units shipped for the nine month period compared to 727 for the previous corresponding nine month period. The primary market for the Gas Micro continues to be the Alberta market, accounting for 1,120 units compared with 467 units shipped into this market for the corresponding previous period.

Gross Margins

The Company's gross margin, as a percentage of revenue for the nine month period ended January 31, 2005 was 41% as compared to 41% for the corresponding previous fiscal period. Gross margins for the three months ended January 31, 2005 declined to 37% from 44% for the three month period ended October 31, 2004. This compares to gross margins achieved of 43% for the corresponding comparative three month period ended January 31, 2004. This decrease in gross margins over the corresponding previous period is largely attributable to product mix variations between market segments. Weaker margins were experienced in the liquid process market due to decreased volume sales from the German operating division in the current period compared to the corresponding previous period, and to higher labour costs involved in the production of the Brimstone product line.

EXPENSES

Selling and Marketing

The sales and marketing strategy includes a direct sales force and distributors in selected regions in order to extend the geographic coverage.

Analytical sales in the Canadian operation are performed through a direct sales force selling directly to customers in Canada, with analytical sales into the United States pursued from the Houston office, utilizing a both a distribution network and direct sales. This location is staffed by two sales/service personnel with no changes in personnel from fiscal 2004. With the acquisition of Brimstone the company added two additional senior technical sales people both located in Calgary.

The major expenditures in the Lowell operation remain salaries for marketing administration and a direct sales staff, which includes three sales personnel, one internationally and two in the United States. The Company also maintains a sales and service center located in Dusseldorf, Germany and identified with this operating segment.

	Three months ended		Nine months ended	
	January 31		January 31	
	2005	2004	2005	2004
	\$	\$	\$	\$
Lowell operation	185,799	270,639	594,176	623,919
Calgary	365,908	340,422	1,100,762	1,044,201
	<u>551,707</u>	<u>611,061</u>	<u>1,694,938</u>	<u>1,668,120</u>

The Company incurred \$551,000 in respect of sales and marketing expenditures for the three months ended January 31, 2005 a \$3,000 decrease over the previous quarter. The increase in Calgary sales and marketing expenditures for the current nine month period as compared to the previous fiscal period are directly attributable to the Brimstone acquisition which added \$63,000 to sales and marketing expenditures.

General and Administration

	Three months ended		Nine months ended	
	January 31		January 31	
	2005	2004	2005	2004
	\$	\$	\$	\$
Lowell operation	197,245	167,155	646,617	429,288
Calgary operation	441,442	326,945	987,183	719,890
	<u>638,687</u>	<u>494,100</u>	<u>1,633,800</u>	<u>1,149,178</u>

General and administrative expenses for the nine months ending January 31, 2005 have increased by \$434,000 over the comparative prior period. Of this amount \$125,000 is additional general and administrative costs related to the Brimstone acquisition. The balance of the increase is due to increased salaries and employee benefits in Lowell and Calgary the amount of \$166,000. Of this amount \$115,000 was incurred in Calgary, and included additional executive compensation in the amount of \$24,000, and stock compensation expense in the amount of \$27,000 related to the cost of options as calculated by the Black-Scholes option pricing model. General and administrative costs in Lowell for the current fiscal period reflect a full nine months of operation whereby the previous fiscal period reflects seven month's of operation. General and administrative expenses increased in the Lowell operation due to the restructuring, and subsequently re-categorizing of general expenses that had been in the previous year included in other categories. Increases in Lowell were \$40,000 for professional services, \$26,000 for insurance, and \$18,000 in additional interest costs related to the operating line of credit. Other increases in general and administration costs include \$40,000 in the Canadian operation required to upgrade it's computer systems and networks.

The Company incurred \$592,000 in general and administrative expenses for the three month period ended January 31, 2005 compared to \$521,000 for the three month period ended October 31, 2004 an increase of \$71,000. This increase over the previous quarter in fiscal 2005 is directly attributable to the Canadian operations, whereby general and administrative costs increased by \$104,000 largely due to additional general and administrative related to the Brimstone operation.

Foreign Exchange

For the three month period ended January 31, 2005 the Company recorded a gain of \$56,000 compared to \$167,000 loss for the corresponding previous quarter, and compared to \$30,000 and \$199,000 for the corresponding previous periods. This gain or loss arises from the conversion or realization of foreign currency assets at rates, which are lower or higher than those prevailing when a revenue transaction is recorded.

Amortization

	Three months ended		Nine months ended	
	January 31		January 31	
	2005	2004	2005	2004
	\$	\$	\$	\$
Amortization of development costs	138,639	146,038	309,613	438,308
Depreciation of capital assets	58,059	42,016	152,237	127,875
	<u>196,698</u>	<u>188,054</u>	<u>461,850</u>	<u>566,183</u>

Amortization is comprised of two components; amortization of development costs and depreciation and amortization of capital assets. Costs relating to the development of the Company's product line are capitalized until commercial production commences. These costs are then amortized using the declining balance method over the estimated average sales life of the product.

Amortization of development costs at January 31, 2005 was \$139,000 compared with \$85,000 for the previous quarter, and related to development activities carried out in Calgary, and consistent with amortization for this segment in comparative prior periods. In fiscal 2004 the Lowell operation had staff members dedicated to development activities, since re-located to Calgary, which accounts for the decrease in amortization over the previous comparative period.

Income Taxes

Future income taxes of \$22,000 for the quarter ended January 31, 2005 and \$39,000 for October 31, 2004 and compared to nil and \$20,000 respectively for corresponding previous period, and the related liability on the balance sheet, is primarily as a result of the Canadian operation utilizing research and development tax deductions for income tax purposes in amounts greater than those taken in determining net earnings for accounting purposes.

As a result of profitable operations in Canada, Lowell, and Brimstone, current period income taxes have increased by \$148,000 to \$204,000.

RELATED PARTY TRANSACTIONS

Transactions with related parties have been measured at their exchange amounts. The exchange amount is the amount of consideration established and agreed to by the related parties.

During the normal course of business, the Company purchased filters and regulators from a Company controlled by a director. Purchases for the quarter ended January 31, 2005 amounted to \$33,562 as compared to \$67,250 for the quarter ended October 31, 2004 and \$15,824 for July 31, 2004. This compares to \$53,507, \$29,381 and \$112,221 respectively, for the corresponding previous quarters.

CAPITAL EXPENDITURES

The Company continues to invest in research and development activities to support its continued goal of improving current products and development and introducing new products. The goal is to provide a total solution for natural gas metering stations. For the past three quarters efforts were directed to continued enhancement and improvement to current product offerings.

All product development activities for both the Lowell and Canadian operation are currently being 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 January 31, 2005 the company incurred development costs of \$186,000 an increase of \$27,000 over the previous quarter. This compares to \$157,000 and \$199,000 for the corresponding comparative quarters. This increase is directly attributable to the amount of materials consumed in the development process.

During the quarter, the Company continued on with its program of improvement and enhancement of its current product line, which includes the DIMAC platform for process measurement applications, and feature enhancement of the PLGC II. The company is also in the process of re-designing the Tytronic's Sentinel product line with feature upgrades and streamlining of the Tytronic line product offerings. Communication integration work is continuing on the Gas Micro and project work was completed to evaluate and decrease component costs for the Gas Micro.

LIQUIDITY AND CAPITAL RESOURCES

The Company's principal source of liquidity is derived primarily from cash flow from operations and from its working capital. The company's cash position increased by \$382,000 during the third quarter. This was largely due to the increase in operating cash flow. Other sources of cash included the proceeds from the exercise of stock options in the amount of \$21,000.

On September 30, 2004, the Company's entered into a four year term loan agreement with it's principal banker for the amount \$671,000 in order to finance the Brimstone acquisition. Monthly principal payments are \$18,274 and interest is calculated on a floating rate of prime plus 0.5% per annum, and is currently at 4.5%. Principal repayments during the quarter amounted to \$73,000.

Accounts receivable increased by \$118,000 during the third quarter to reach \$3,168,000 which represents 70 days of sales consistent to the 70 days of sales at the end of the second quarter. The Company's collection period has not improved due to slower paying international accounts. Accounts receivable related to the liquid analyzer amounted to \$908,000 compared to \$991,000 in the second quarter of fiscal 2005, and accounts receivable related to the Brimstone acquisition amounted to \$538,000.

Inventories at the end of the second and third quarter remained consistent at \$3,517,000.

The existing short-term credit facility consists of a bank operating line in the amount of \$2,050,000. The amount available is calculated by reference to accounts receivable. As of January 31, 2005 \$1,395,000 was advanced against this facility as compared to \$985,000 in the second quarter of fiscal 2005. This increase in the operating facility is due to additional operating loans resulting from the Brimstone acquisition.

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

FINANCIAL INSTRUMENTS

The Company's accounts receivable and accounts payable and accrued liabilities constitute financial instruments. Based on available market information, the carrying value of the Company's financial instruments approximates their fair value.

OFF-BALANCE SHEET ARRANGEMENTS

At of January 31, 2005 and April 30, 2004 the Company has not entered into any off-balance sheet arrangements.

RECENT ACCOUNTING PRONOUNCEMENTS

Stock-based Compensation Plan

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. For the year ended April 30, 2004,

the Company had granted 250,000 stock options to employees. The fair value of each stock option granted during the year ended April 30, 2004 is estimated on the date of grant using the Black-Scholes option-pricing model resulting in the recognition of \$19,050 as an expense at April 30, 2004 and an additional \$13,207 at January 31, 2005, \$8,984 at October 31, 2004 and \$4,761 at July 31, 2004. The increase in the expense recognized is due to the Company granting additional options to Directors and Officers of the Company. On September 16, 2004 the company granted 810,000 options at a fair value price of \$0.50 per common share.

FORWARD-LOOKING STATEMENTS

Certain statements included in this Management Discussion and Analysis and elsewhere in this annual 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.