

Consolidated Financial Statements of

GALVANIC APPLIED SCIENCES INC.

April 30, 2011 and 2010

INDEPENDENT AUDITOR'S REPORT

To the Shareholders of Galvanic Applied Sciences Inc.

We have audited the accompanying consolidated financial statements of Galvanic Applied Sciences Inc., which comprise the consolidated balance sheets as at April 30, 2011 and 2010, and the consolidated statements of earnings (loss), retained earnings, comprehensive (loss) earnings, accumulated other comprehensive loss and cash flows for the years then ended, and notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of consolidated 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 consolidated 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 audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated 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 consolidated 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 consolidated 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 consolidated financial statements present fairly, in all material respects, the financial position of Galvanic Applied Sciences Inc. as at April 30, 2011 and 2010 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Deloitte & Touche LLP

Chartered Accountants
July 21, 2011
Calgary, Alberta

GALVANIC APPLIED SCIENCES INC.
Consolidated Statements of Earnings (Loss)

Years Ended April 30	2011 \$	2010 \$
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REVENUE		
Sales	11,762,134	11,232,294
Cost of sales	7,030,425	6,818,528
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GROSS MARGIN	4,731,709	4,413,766
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EXPENSES		
Amortization	625,891	674,737
Foreign exchange loss	140,884	334,899
General and administrative	1,542,184	1,716,225
Reorganization costs (Note 17)	-	407,210
Selling and marketing	1,387,481	1,539,373
	3,696,440	4,672,444
	<hr/>	
EARNINGS (LOSS) BEFORE INCOME TAXES	1,035,269	(258,678)
	<hr/>	
PROVISION FOR (RECOVERY OF) INCOME TAXES		
Current	(38,246)	-
Future	139,672	(52,484)
	101,426	(52,484)
	<hr/>	
NET EARNINGS (LOSS)	933,843	(206,194)
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NET EARNINGS (LOSS) PER COMMON SHARE (Note 12)		
Basic	0.06	(0.01)
Diluted	0.06	(0.01)
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GALVANIC APPLIED SCIENCES INC.
Consolidated Balance Sheets

Years Ended April 30	2011 \$	2010 \$
ASSETS		
CURRENT		
Cash and cash equivalents	3,381,759	2,962,655
Restricted funds	1,200	1,200
Accounts receivable - trade	1,881,036	1,623,460
Recoverable income taxes	-	48,117
Inventory (Note 6)	2,773,435	2,450,797
Prepaid expenses	197,816	134,981
	<u>8,235,246</u>	<u>7,221,210</u>
Deferred development costs (Note 7)	2,532,585	2,381,265
Property, plant and equipment (Note 8)	352,100	591,306
Goodwill	3,442,693	3,442,693
	<u>14,562,624</u>	<u>13,636,474</u>
LIABILITIES		
CURRENT		
Accounts payable and accrued liabilities	720,501	777,678
Reorganization accounts payable and accrued liabilities	-	26,039
Income taxes payable	42,552	-
	<u>763,053</u>	<u>803,717</u>
Future income taxes (Note 9)	688,168	521,053
	<u>1,451,221</u>	<u>1,324,770</u>
SHAREHOLDERS' EQUITY		
Retained earnings	7,671,256	6,737,413
Accumulated other comprehensive loss	(520,243)	(372,982)
	<u>7,151,013</u>	<u>6,364,431</u>
Share capital (Note 10)	5,003,473	5,003,473
Contributed surplus (Note 10)	956,917	943,800
	<u>13,111,403</u>	<u>12,311,704</u>
	<u>14,562,624</u>	<u>13,636,474</u>

COMMITMENTS AND CONTINGENCIES (Note 18)

APPROVED BY THE BOARD

 Walter Chayka, **Director**

 Peter Bourgeois, **Director**

GALVANIC APPLIED SCIENCES INC.
Consolidated Statements of Retained Earnings

Years Ended April 30	2011	2010
	\$	\$
Retained Earnings, Beginning of Year	6,737,413	6,943,607
Net Earnings (Loss)	933,843	(206,194)
Retained Earnings, End of Year	7,671,256	6,737,413

Consolidated Statements of Comprehensive (Loss) Earnings

Years Ended April 30	2011	2010
	\$	\$
Net Earnings (Loss)	933,843	(206,194)
Foreign Currency Translation Adjustment	(147,261)	(322,204)
Comprehensive Earnings (Loss)	786,582	(528,398)

Consolidated Statements of Accumulated Other Comprehensive Loss

Years Ended April 30	2011	2010
	\$	\$
Accumulated Other Comprehensive Loss, Beginning of Year	(372,982)	(50,778)
Foreign Currency Translation Adjustment	(147,261)	(322,204)
Accumulated Other Comprehensive Loss, End of Year	(520,243)	(372,982)

GALVANIC APPLIED SCIENCES INC.
Consolidated Statements of Cash Flows

Years Ended April 30	2011 \$	2010 \$
CASH FLOWS RELATED TO THE FOLLOWING ACTIVITIES:		
OPERATING		
Net earnings (loss)	933,843	(206,194)
Adjustments for non-cash items:		
Amortization	625,891	674,737
Future income taxes (recovery)	167,115	(52,484)
Stock-based compensation (Note 10)	13,117	15,374
Unrealized foreign exchange gain (loss)	29,472	(63,954)
Reorganization costs	-	55,229
	<u>1,769,438</u>	<u>422,708</u>
Changes in non-cash working capital (Note 11)	(635,596)	649,752
	<u>1,133,842</u>	<u>1,072,460</u>
FINANCING	-	-
INVESTING		
Property, plant and equipment	(11,469)	(56,560)
Development costs	(526,535)	(723,486)
Decrease in restricted funds	-	95,327
	<u>(538,004)</u>	<u>(684,719)</u>
Effect of exchange rate changes on cash	(176,734)	(257,847)
NET INCREASE IN CASH AND CASH EQUIVALENTS	419,104	129,894
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	2,962,655	2,832,761
CASH AND CASH EQUIVALENTS, END OF YEAR	3,381,759	2,962,655
Cash and cash equivalents are composed of:		
Cash in banks	1,813,140	1,360,903
Term deposits	1,568,619	1,601,752
	<u>3,381,759</u>	<u>2,962,655</u>
SUPPLEMENTARY INFORMATION		
Cash paid for taxes	-	205,553

GALVANIC APPLIED SCIENCES INC.

Notes to the Consolidated Financial Statements

Years Ended April 30, 2011 and 2010

1. DESCRIPTION OF THE BUSINESS

Galvanic Applied Sciences Inc. (“the Company” or “Galvanic”) was incorporated under the laws of the Province of Alberta. The Company designs, manufactures, services, and sells an array of analytical measurement equipment into the gas processing industry and industrial process markets.

2. BASIS OF PRESENTATION

These consolidated financial statements are prepared in accordance with Canadian generally accepted accounting principles (“GAAP”).

Basis of consolidation

The consolidated financial statements include the accounts of the Company and its subsidiary, Galvanic Applied Sciences USA Inc., which is wholly-owned. All inter-company transactions and accounts are eliminated on consolidation. The Company’s functional currency is Canadian dollars.

Use of estimates

The preparation of these consolidated financial statements and related disclosures in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. Estimates include the provision for doubtful accounts, the assessment of the viability of new product development costs, impairment test for goodwill, amortization period for deferred development costs and property, plant and equipment, provisions for contingent liabilities, measurement of stock-based compensation assumptions, and estimates in the provision for current and future income taxes. Actual results could differ from those estimates. Estimates and assumptions are reviewed periodically and the effects of revisions are reflected in the period that they are determined to be necessary.

3. ADOPTION OF NEW ACCOUNTING POLICIES

Business Combinations, Consolidated Financial Statements, and Non-Controlling Interests

Effective May 1, 2011 the Company will adopt Section 1582, “Business Combinations”, Section 1601, “Consolidated Financial Statements, and Section 1602, “Non-Controlling Interests”. Section 1582 replaces Section 1581 and establishes standards for the accounting for a business combination. It provides the Canadian equivalent to IFRS 3, “Business

GALVANIC APPLIED SCIENCES INC.

Notes to the Consolidated Financial Statements Years Ended April 30, 2011 and 2010

3. ADOPTION OF NEW ACCOUNTING POLICIES (Continued)

Combinations”. Sections 1601 and 1602 together replace Section 1600, “Consolidated Financial Statements”. Section 1601 establishes standards for the preparation of consolidated financial statements. Section 1602 establishes standards for accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. It is equivalent to the corresponding provisions of IFRS IAS-27, “Consolidated and Separate Financial Statements”. The adoption of these standards is not expected to significantly impact the financial statements.

Adoption of New Accounting Standards

International Financial Reporting Standards

In February 2008, the CICA’s Accounting Standards Board confirmed that International Financial Reporting Standards (IFRS) will replace Canadian GAAP in 2011 for profit oriented Canadian publically accountable enterprises. The Company will be required to report its results in accordance with IFRS beginning in May 1, 2011.

4. SIGNIFICANT ACCOUNTING POLICIES

The following is a summary of significant accounting policies used in the preparation of these financial statements.

Cash and cash equivalents

The Company’s short-term investments with original maturities of three months or less are considered to be cash equivalents and are recorded at cost, which approximates fair market value.

Inventory

Raw materials and finished goods inventory is carried at the lower of cost and net realizable value. Work-in-process inventory consists of material and labour cost. Cost is determined on a weighted average basis. An estimate for obsolete inventory is made based on the age of specific product inventory, an estimation of the installed product base, and ongoing service requirements. Any provision for obsolescence is written off through cost of sales.

GALVANIC APPLIED SCIENCES INC.

Notes to the Consolidated Financial Statements **Years Ended April 30, 2011 and 2010**

4. SIGNIFICANT ACCOUNTING POLICIES (Continued)

Research and development costs

Research costs are expensed as incurred. Reliably measured development costs incurred on new products are deferred once management determines that a new product is technologically feasible, the Company has the ability and intent to commercially produce the product, and a market exists. These costs are then amortized using the declining balance method over the estimated average sales life of the products once commercial production commences. The Company evaluates the carrying value of the development costs related to each project in order to determine if there has been impairment in value. Such evaluation is based on the marketability of the product and projected cash flows. At any time the product is deemed no longer to be commercially viable, the balance of the related deferred cost is expensed.

Impairment

Development costs, net of amortization, are tested annually for impairment or when events or changes in circumstances indicate that the net carrying amount of the product may not be recoverable. To test for and measure for impairment, assets are grouped by product. An impairment loss is required to be recognized when the carrying amount of the product exceeds the sum of undiscounted expected future cash flows expected to be recovered. Estimates of cash flows are calculated taking into consideration historical knowledge and experience, the market, customer base, sales prices, historical revenues generated, future demand, and product life cycle. When it is determined that the carrying value exceeds the recoverable amounts, the net asset is written down to the net recoverable amount.

Property, plant and equipment

Property, plant and equipment are recorded at cost, net of accumulated amortization and depreciation. Amortization is provided on office, shop, and demonstration equipment at a rate of 20% and computer equipment at 30%, using the declining-balance method.

Manufacturing equipment is amortized on a straight-line basis over a ten-year period. Leasehold improvements are amortized on a straight-line basis over the terms of the leases, ranging from 5 to 7 years.

In the year of disposal, any gain or loss is included in the consolidated statements of earnings and the cost of assets retired or otherwise disposed of and the related accumulated amortization are eliminated from these accounts.

GALVANIC APPLIED SCIENCES INC.

Notes to the Consolidated Financial Statements **Years Ended April 30, 2011 and 2010**

4. SIGNIFICANT ACCOUNTING POLICIES (Continued)

Goodwill

Goodwill is recorded through acquisition and is the excess of the total purchase price over the fair value of the net identifiable assets acquired and the liabilities assumed in business acquisitions. Goodwill is not amortized, but is tested for impairment at least annually or as events occur that could indicate impairment. The goodwill test is carried out in two steps. In the first step, the carrying amount is compared with its fair value. When the fair value exceeds its carrying amount, goodwill is considered not to be impaired and performance of the second step of the impairment test is not warranted. The second set compares the implied fair value of the reporting unit's goodwill with its carrying amount to measure the amount of the impairment loss, if any.

Impairment

The Company assesses goodwill annually, and its potential impairment, on a reporting unit basis. An impairment loss is recognized when the carrying amount of the assets exceeds the sum of undiscounted cash flows expected to be recovered. Reporting units for which identifiable cash flows are calculated are the Lowell operating division, and cash flows expected to be generated from the Company's sales of its Brimstone analyzer. Estimates of future net cash flows are calculated taking into consideration historical revenues generated the market, customer base, future demand, sales prices, operating expenditures and other costs. These estimates are subject to risks and uncertainties, and it is possible that changes in estimates could occur, which may impact the expected recoverability of goodwill. Management's determination at April 30, 2011 and 2010 was that goodwill was not impaired.

Warranty provision

The Company provides warranties on products sold. Estimated warranty costs on these products are accrued based on management's best estimates.

Revenue recognition

Revenue consists mainly of revenue from the sales of measurement instrumentation. The Company recognizes revenue when title transfers, evidence of sales arrangement exists, delivery occurs, the sales price is fixed or determinable, and collectability is reasonably assured.

GALVANIC APPLIED SCIENCES INC.

Notes to the Consolidated Financial Statements **Years Ended April 30, 2011 and 2010**

4. SIGNIFICANT ACCOUNTING POLICIES (Continued)

Income Taxes

The Company follows the asset and liability method of accounting for income taxes. Under this method, the Company records future income taxes for the effect of any difference between the accounting and income tax basis of an asset or liability, using substantively enacted tax rates. Future tax assets are recognized to the extent management determines it more likely than not that they will be realized.

The computation of the provision for income taxes involves tax interpretations, regulations and legislation. The Company is eligible for certain investment tax credits. Based on the technical merit of its claim and managements assessment of the certainty of realization, tax benefits associated with investment tax credits are recorded as part of the current income tax provision. These claims are subject to confirmation by tax authorities; however, management believes the provision for income taxes is reasonable.

The consolidated tax provision for any given year includes adjustments to prior year income tax accruals that are considered appropriate.

Foreign currency transactions

Transactions in foreign currencies are translated at rates in effect at the time of the transaction. Foreign currency monetary assets and liabilities related to foreign currency transactions are initially recorded at the rate of exchange in effect at the balance sheet date. Gains and losses resulting from subsequent changes in exchange rates are included in earnings.

Foreign currency translation

The Company's Lowell operation is considered to be a self-sustaining foreign operation and its accounts are translated into Canadian dollars using the current rate method. Under this method, assets and liabilities are translated at the exchange rate in effect at the balance sheet date and revenue and expenses are translated at average rates for the period. Unrealized gains or losses resulting from these translation adjustments are accumulated in the Consolidated Statement of Other Comprehensive Income (OCI).

Stock-based compensation plan

The Company has a stock option plan open to directors, officers, and employees of the Company. The stock option plan is accounted for using a fair value method using the Black-Scholes option pricing model, whereby the fair value of the stock options are determined on their grant date and recorded as compensation expense over the period that the stock options vest, with a corresponding increase to contributed surplus. When stock options are exercised, related amounts previously accumulated as contributed surplus are credited to share capital.

GALVANIC APPLIED SCIENCES INC.

Notes to the Consolidated Financial Statements Years Ended April 30, 2011 and 2010

4. SIGNIFICANT ACCOUNTING POLICIES (Continued)

Earnings per Share

Basic earnings per common share are computed by dividing earnings by the weighted average number of common shares outstanding for the period. Under the treasury stock method, diluted per share is calculated based on the weighted average number of share issued and outstanding during the year, adjusted by the total of the additional common shares that would have been issued assuming exercise of all stock options with exercise prices at or below the average market price for the year, offset by the reduction in common shares that would be purchased with the exercise proceeds.

Financial Instruments

Financial Instruments - Recognition and Measurement

All financial instruments are measured at fair value upon initial recognition of the transaction and measurement in subsequent periods are dependent on whether the instrument is classified as “held-for-trading”, “available-for-sale”, “held-to-maturity”, “loans and receivables”, or “other liabilities”.

Financial instruments classified as “held-for-trading” are subsequently re-valued to fair market value with changes in the fair value being recognized into earnings; financial instruments classified as “available for sale” are subsequently re-valued to fair market value with changes in the fair value being recognized to OCI; and financial instruments designated as “held-to-maturity”, “loans and receivables”, and “other liabilities” are valued at amortized cost using the effective interest method of amortization.

Financial Instruments – Fair value disclosures

The Company discloses its financial instruments within a hierarchy prioritizing the inputs to fair value measurement at the following three levels.

- Level 1 – quoted prices in active markets for identical assets or liabilities;
- Level 2 – inputs other than quoted prices that are observable for the asset or liability either directly (i.e. as prices) or indirectly (i.e. derived from prices); and
- Level 3 – inputs for the asset or liability that are not based on observable market data.

Financial Instruments

The Company’s financial instruments consist of cash and cash equivalents and restricted funds, which are classified as held for trading; accounts receivable – trade, which is classified as loans and receivables; and accounts payable and accrued liabilities, which are classified as other financial liabilities.

GALVANIC APPLIED SCIENCES INC.

Notes to the Consolidated Financial Statements Years Ended April 30, 2011 and 2010

4. SIGNIFICANT ACCOUNTING POLICIES (Continued)

Hedges

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.

5. CREDIT FACILITY

The Company has a \$2,550,000 uncommitted revolving operating line of credit which bears interest at the prime rate plus 0.850%. This facility is subject to annual review. The availability of the operating facility is subject to a monthly borrowing base calculation that considers eligible accounts receivable. Operating advances are payable on demand and are secured by a general security agreement providing a general charge on all assets of the Company and its subsidiaries.

The Company is not required to meet any financial covenants. At April 30, 2011 and 2010, no amounts were drawn on this facility.

6. INVENTORY

	2011	2010
	\$	\$
Raw materials	2,062,091	1,962,270
Work-in-progress	419,175	207,033
Finished goods	292,169	281,494
	<u>2,773,435</u>	<u>2,450,797</u>

The carrying amount of inventory charged to cost of sales in the year was \$6,614,105 (2010 \$6,241,942). There were no write-downs or write-ups of inventory during 2011 or 2010.

GALVANIC APPLIED SCIENCES INC.

Notes to the Consolidated Financial Statements Years Ended April 30, 2011 and 2010

7. DEFERRED DEVELOPMENT COSTS

	2011	2010
	\$	\$
Deferred development costs, beginning of year	7,709,739	6,986,253
Additions	526,535	723,486
Deferred development costs, end of year	8,236,275	7,709,739
Accumulated amortization, beginning of year	5,328,474	4,912,569
Additions	375,216	415,905
Accumulated amortization, end of year	5,703,690	5,328,474
Net carrying amount, development costs	2,532,585	2,381,265

Amortization expense recorded with respect to development costs in 2011 was \$375,216 (2010 - \$415,905).

8. PROPERTY, PLANT AND EQUIPMENT

	2011		
	Cost	Accumulated	Net Book
	\$	Amortization	Value
	\$	\$	\$
Office, shop and demonstration equipment	1,034,263	923,772	110,491
Computer equipment	599,774	511,769	88,005
Manufacturing equipment	598,803	497,010	101,793
Leasehold improvements	707,905	656,094	51,811
	2,940,745	2,588,645	352,100
	2010		
	Cost	Accumulated	Net Book
	\$	Amortization	Value
	\$	\$	\$
Office, shop and demonstration equipment	1,032,936	877,755	155,181
Computer equipment	586,629	477,622	109,007
Manufacturing equipment	598,804	436,892	161,912
Leasehold improvements	707,905	542,699	165,206
	2,926,274	2,334,968	591,306

Depreciation and amortization expense recorded with respect to property, plant and equipment in 2011 was \$250,675 (2010 - \$273,784).

GALVANIC APPLIED SCIENCES INC.

Notes to the Consolidated Financial Statements Years Ended April 30, 2011 and 2010

9. INCOME TAXES

The provision for income taxes differs from the amount that would be computed by applying the combined federal and provincial income tax rates to earnings (loss) before taxes as shown below:

	<u>2011</u>	<u>2010</u>
	\$	\$
Earnings (loss) before income taxes	1,035,269	(258,678)
Tax statutory rate	28.00%	29.00%
Expected income tax (recovery) expense	289,875	(75,017)
Non-deductible charges	10,568	9,132
Non deductible stock-based compensation	3,673	4,459
Non deductible (deductible) restructuring costs	(10,645)	7,551
Change in previously estimated tax pools	(16,000)	-
Recapture of investment tax credits	20,311	46,632
Tax deductible expenses	(19,529)	(45,241)
Other	(176,827)	
	101,426	(52,484)

The major components of the future income tax liability at April 30, 2011 using a combined federal and provincial rate of 25.5% (2009 – 27.3%) are as follows:

	<u>2011</u>	<u>2010</u>
	\$	\$
Carrying value of deferred development costs in excess of tax values	(691,631)	(650,085)
Difference in capital cost allowance claim for tax purposes	30,906	76,548
Tax loss carry forwards	(27,443)	52,484
	688,168	521,053

Corporate tax returns are subject to audit and reassessment by the CRA and the IRS. The results of any assessments will be accounted for in the year in which they are determined.

GALVANIC APPLIED SCIENCES INC.

Notes to the Consolidated Financial Statements Years Ended April 30, 2011 and 2010

10. SHARE CAPITAL

Authorized

Unlimited number of common and preferred shares, without nominal or par value

Issued

Common shares

	Number of Shares	Amount \$
Balance, April 30, 2011 and 2010	<u>15,741,072</u>	<u>5,003,473</u>

Stock Option Plan

At April 30, 2011, 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 shares 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. Options generally vest over a three to five year period, expiring between 2013 and 2016 as follows:

	<u>2011</u>		<u>2010</u>	
	Number of Shares Under Option	Weighted Average Exercise Price \$	Number of Shares Under Option	Weighted Average Exercise Price \$
Options outstanding, beginning of year	840,000	0.37	720,000	0.33
Forfeited	-	-	(200,000)	0.30
Expired	(120,000)	-	-	-
Granted	<u>60,000</u>	0.47	<u>320,000</u>	0.35
Options outstanding, end of year	<u>780,000</u>	0.33	<u>840,000</u>	0.37
Options exercisable, end of year	<u>386,666</u>	0.31	<u>360,000</u>	0.37

GALVANIC APPLIED SCIENCES INC.

Notes to the Consolidated Financial Statements Years Ended April 30, 2011 and 2010

10. SHARE CAPITAL (Continued)

Stock Option Grant

During the fiscal year the Company granted options to employees of the Company to purchase 60,000 common shares at the market price of \$0.47 per common share at the date of the grant. The options vest equally over a three year period and have a five year life. The fair value at the date of the grant was calculated using the Black-Scholes model and amounted to \$20,858. The assumptions used in determining the fair value of the stock option included a risk free interest rate of 2.00%, expected life of the stock option of 5 years, annualized volatility rate of 97.89% and an annualized dividend rate of 0%. The fair value of the stock option grant is recognized as an expense with a corresponding amount credited to contributed surplus.

The following table summarizes outstanding options at April 30, 2011:

Exercise Price \$	Number Outstanding April 30, 2011	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price \$
0.30	400,000	2.00	0.30
0.35	320,000	3.33	0.35
0.47	60,000	4.92	0.47
	780,000		

All stock options issued have been accounted for using the fair-value method estimated on the date of the grant using the Black-Scholes option-pricing model. Stock-based compensation expense with a corresponding amount credited to contributed surplus of \$13,117 (April 30, 2010 - \$15,374), was recorded in the Consolidated Statements of Operations.

Contributed Surplus

The following table presents a summary of activity related to the Company's contributed surplus for the periods ended April 30:

	2011	2010
Balance, Contributed Surplus, beginning of year	943,800	928,426
Stock option expense	13,117	15,374
Balance, Contributed Surplus, end of year	956,917	943,800

GALVANIC APPLIED SCIENCES INC.

Notes to the Consolidated Financial Statements Years Ended April 30, 2011 and 2010

11. CHANGES IN NON-CASH WORKING CAPITAL

	2011	2010
	\$	\$
Recoverable income taxes	48,117	(48,117)
Accounts receivable – trade	(257,576)	777,495
Inventory	(322,638)	280,302
Prepaid expenses	(62,835)	21,976
Reorganization accounts payable and accrued liabilities	(26,039)	(14,789)
Accounts payable and accrued liabilities	(57,177)	(195,307)
Income taxes payable	42,552	(171,808)
	<u>(635,596)</u>	<u>649,752</u>

12. PER SHARE AMOUNTS

Basic earnings per share have been calculated using 15,741,072 (2010 – 15,741,072) weighted average number of common shares outstanding during the year.

Diluted earnings per share have been calculated based on the treasury stock method using the weighted average number of common shares and dilutive equity instruments, representing stock options. 126,231 shares were added to the weighted average number of common shares outstanding for the dilutive effect of stock options (2010 – nil).

13. SEGMENTED INFORMATION

The Company currently has two reportable business segments identified primarily by market segment. These include (1) instrumentation for the natural gas industry, which includes the processing and distribution market, Galvanic Canada; and (2) the liquid analyzer market, Galvanic Lowell.

(1) Galvanic Canada

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.

This operating segment's product line can be broadly categorized into two groups. The first is analytical products, which measure hydrogen sulfide (H₂S) sulfur and total sulfur, and gas chromatographs. The markets for such products are the natural gas processing industry, sulfur recovery plants, tail gas clean-up units, gas sweetening process and sulphur degassing and forming.

GALVANIC APPLIED SCIENCES INC.

Notes to the Consolidated Financial Statements Years Ended April 30, 2011 and 2010

13. SEGMENTED INFORMATION (Continued)

(1) Galvanic Canada (continued)

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.

(2) Galvanic Lowell

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

The Company evaluates its performance of its operating segments based on earnings before income taxes.

Segmented Financial Information

	2011			
	Galvanic Canada \$	Galvanic Lowell \$	Inter- Company \$	Enterprise Total \$
Revenue	8,309,629	3,550,243	(97,738)	11,762,134
Operating expenses	2,616,898	1,079,542	-	3,696,440
Net segmented earnings / (loss)	775,594	171,563	(13,314)	933,843
Amortization	616,366	9,525	-	625,891
Total assets of segments	10,223,230	4,352,707	(13,314)	14,562,623
Expenditures for property, plant and equipment	11,469	-	-	11,469
Expenditures for development costs	526,535	-	-	526,535

GALVANIC APPLIED SCIENCES INC.

Notes to the Consolidated Financial Statements Years Ended April 30, 2011 and 2010

13. SEGMENTED INFORMATION (Continued)

		Galvanic Lowell \$	Inter- Company \$	Enterprise Total \$
Revenue	6,662,834	4,569,460	-	11,232,294
Operating expenses	2,967,124	1,705,320	-	4,672,444
Net segmented earnings / (loss)	(145,297)	(60,897)	-	(206,194)
Amortization	659,785	14,952	-	674,737
Total assets of segments	9,325,026	4,311,448	-	13,636,474
Expenditures for property, plant and equipment	49,754	6,806	-	56,560
Expenditures for development costs	723,486	-	-	723,486

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

	2011 \$	2010 \$
Canada	3,463,506	2,814,542
United States	4,245,085	4,389,488
Other international sales	4,053,543	4,028,264
	11,762,134	11,232,294

No external customers' amount individually to greater than 10% of the Company's revenue for the year ended April 30, 2011 and 2010.

GALVANIC APPLIED SCIENCES INC.

Notes to the Consolidated Financial Statements Years Ended April 30, 2011 and 2010

14. CAPITAL DISCLOSURES

The Company considers its capital structure to include shareholders' equity and working capital.

	2011	2010
	\$	\$
Working Capital	7,472,193	6,417,493
Shareholders' Equity	13,111,403	12,311,704

The Company's objectives when managing its capital structure are to:

- a) finance internally generated growth; and
- b) maintain financial flexibility to preserve its ability to meet its financial obligations and preserve investor and creditor confidence.

The Company manages its capital structure and makes adjustments based on changes in market conditions. To manage the capital structure, the company may from time to time adjust its capital spending, revise the terms of its operating lines of credit, issue new shares, or purchase shares for cancellation pursuant to a normal course issuer bid.

There were no changes in the Company's approach to capital management during the year.

15. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Financial Instruments

The Company's financial instruments consist of cash and cash equivalents, restricted funds, accounts receivable - trade, accounts payable and accrued liabilities, and reorganization accounts payable and accrued liabilities. The following classifications were in effect for 2011:

- Cash and cash equivalents and restricted funds are classified as a financial asset held for trading
- Accounts receivable – trade are classified as loans or receivables
- Accounts payable and accrued liabilities and reorganization accounts payable and accrued liabilities are all classified as other financial liabilities

GALVANIC APPLIED SCIENCES INC.

Notes to the Consolidated Financial Statements Years Ended April 30, 2011 and 2010

15. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (Cont'd)

Fair Value of Financial Assets and Liabilities

The fair value of all financial instruments included in the consolidated balance sheets approximates their carrying amount due to the short-term nature of these items.

Credit Risk

Credit risk refers to the possibility that a customer will fail to meet its contractual obligations, resulting in the Company incurring a financial loss. Financial instruments that potentially 15. 15. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (Continued subject the Company to credit risk consist primarily of its accounts receivable balances. The carrying amount of these assets included on the balance sheet represents the maximum credit exposure.

The Company assesses the credit worthiness of its customers on an ongoing basis, and establishes credit limits for each customer based on internal analysis, historical experience with the customer, and external credit reports. The Company also monitors the amount and aging of accounts receivable balances on an ongoing basis.

Standard payment terms are 30 days from invoice date, however this may vary by region and contract. Historically, payment terms for international customers allow for payment up to 90 days. Management believes that accounts receivable balances from international customers that extend beyond 90 days are overdue and present a credit risk. As of April 30, 2011, fifteen international customers had accounts receivable balance totalling \$120,000 or 6.4% of the accounts receivable balance which were more than 90 days overdue. In the event that these fifteen customers are unable to meet their financial obligations the Company would incur a financial loss. As of April 30, 2011, the Company has recorded an allowance for doubtful accounts of \$124,469 (\$101,430 - April 30, 2010).

Liquidity Risk

Liquidity risk is the risk that the company may not to be able to meet its financial obligations as they become due. The Company manages liquidity risk through cash management which includes monitoring forecasts of the Company's cash on the basis of projected cash flows. It also maintains sufficient operating lines of credit to meet financing requirements that exceed anticipated internally generated funds. The Company believes it has sufficient cash and cash equivalents combined with its operating lines of credit to fund its short-term and long-term liabilities.

GALVANIC APPLIED SCIENCES INC.

Notes to the Consolidated Financial Statements Years Ended April 30, 2011 and 2010

15. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (Continued)

Market Risk

Market risk is the risk that changes in market prices, such as interest rates and foreign exchange rates, may affect the Company's net income or the value of the financial instruments.

Interest Rate Risk

The Company is exposed to interest rate risk with respect to its short-term invested cash and cash equivalents and revolving operating lines of credit that bear interest at floating market rates. Fluctuations in the interest rate may impact the company's borrowing costs. As at April 30, 2011, any change in the prime rate would have had no impact on income before income taxes as the Company has not drawn upon its revolving operating line of credit. Any changes in the interest rate will not cause the value of the short-term investments to change and any increases or decreases in the interest rate will have a nominal impact on interest income.

Currency Risk

The Company's international business activities are primarily denominated in U.S. dollars and as a result there is a foreign exchange currency risk relative to the U.S. dollar. The types of foreign exchange currency risk can be categorized as follows:

Transaction exposure

The Canadian Company sells its instruments both domestically and internationally, and as a result is exposed to currency risk on U.S. denominated financial assets and liabilities with fluctuations in the rates recognized as foreign exchange gains or losses in the consolidated statements of earnings.

Translation exposure

The Company's foreign subsidiary is considered self-sustaining. Accordingly, assets and liabilities are translated into Canadian dollars using the exchange rates in effect at the balance sheet dates. Unrealized translation gains and losses are deferred and included in accumulated other comprehensive income.

For the year ended April 30, 2011, had the Canadian dollar weakened or strengthened by 1% against the U.S. dollar, with all other variables held constant, earnings and other comprehensive income would have been impacted as follows:

GALVANIC APPLIED SCIENCES INC.

Notes to the Consolidated Financial Statements Years Ended April 30, 2011 and 2010

15. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (Continued)

	(Loss) Earnings \$	Other Comprehensive Earnings (Loss) \$
	<hr/>	<hr/>
1% decrease in value of Canadian dollar	30,446	20,768
1% increase in value of Canadian dollar	(30,446)	(20,768)

16. RELATED PARTY TRANSACTIONS

Related Parties

The Company's related party is its wholly owned subsidiary, Galvanic Applied Sciences U.S.A. Inc.

Transactions with Subsidiary

In the normal course of business the Company purchases and sells certain components to its wholly owned subsidiary. These transactions are not considered to be material and have been eliminated through consolidation. These transactions are recorded at the exchange amount which approximates comparable transactions with third parties.

17. REORGANIZATION COSTS

In fiscal 2010 the Company announced the reorganization of its European distribution of its Monitek product line supported by its office in Dusseldorf, Germany. Costs which include employee severances, office closure costs, professional services, travel, equipment write-offs, and third party distribution claims, were \$407,210.

GALVANIC APPLIED SCIENCES INC.

Notes to the Consolidated Financial Statements Years Ended April 30, 2011 and 2010

18. COMMITMENTS AND CONTINGENCIES

- a) Pursuant to its international sales agreements, the Company is sometimes required to post performance bonds as a guarantee that products shipped will be received in good working order. Performance bonds outstanding at year end have been recorded as restricted funds. Any performance bonds that expire during the fiscal year will be transferred to the Company's general cash position.
- b) The Company is committed to payments under its various leases and contracts. Payments required are as follows:

	<u>\$</u>
2012	422,064
2013	335,290
2014	80,153
2015	812
Thereafter	-