



**Q1**  
**JULY 31, 2008**

## **First Quarter Interim Report for the Period Ending July 31, 2008**

The accompanying unaudited interim financial statements of the Galvanic Applied Sciences Inc. for the first quarter ending July 31, 2008 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.

### 1<sup>st</sup> Quarter Report to Shareholders

Fellow Shareholders:

The Company completed the 1<sup>st</sup> quarter ending July 31, 2008 with positive momentum as the benefits of the previously announced reorganization resulted in a net income of \$60,000 that reverses the trend of losses from previous quarters. The restructuring measures taken at the end of last quarter have begun to show the desired results in revenue growth, margin expansion and operational excellence that are essential to rebuilding the Company's profitability to historical levels.

Consolidated revenues were less than expected, however there was an increase from the previous quarter and a 12% improvement from the same period a year ago. Revenues from the liquid process market met our goals, whereas the gas processing market continues to be challenging as a result of the mature domestic market and long lead-times for international projects. Gross margin as a percent of sales improved to 36%, compared to 29% in the previous quarter, as cost reduction efforts primarily in the gas processing products were realized. The Company also benefited from lower discretionary spending in its selling and administrative functions while recruitment efforts to increase our direct sales team are ongoing. I believe the 1<sup>st</sup> quarter results confirm we have identified and corrected our cost structure while also providing the needed sales and product development focus to support our future goals.

The 2<sup>nd</sup> quarter outlook is favorable towards meeting our expectations based on a strong backlog and the continuation of cost containment activities. Our team is properly challenged with specific objectives and I am confident they will be achieved with diligence and determination.

With warm regards,



Grant Reeves  
Chief Executive Officer

September 23, 2008

**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**JULY 31, 2008**

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. 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 September 19, 2008, 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 July 31, 2008 and 2007, 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 July 31, 2007 and 2006. It is also advisable to read the MD&A in conjunction with the Company's 2008 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, 2008 and 2007 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.

**FORWARD-LOOKING STATEMENTS**

This Management's Discussions and Analysis contains certain "forward-looking statements." All statements, other than statements of historical fact, that address activities, events or developments that the Company believes, expects or anticipates will or may occur in the future (including, without limitation, statements regarding financial and business prospects and financial outlook) are forward-looking statements. Forward-looking statements are often, but not always, identified by the use of words such as "seek", "anticipated", "plan", "continue", "estimate", "expect", "may", "will", "project", "predict", "potential", "targeting", "intent", "could", "might", "should", "believe" and similar expressions.

These forward-looking statements reflect the current expectations or beliefs of the Company, based on information currently available to the Company. Forward-looking statements are subject to a number of risks, uncertainties and assumptions that may cause the actual results of the Company to differ materially from those discussed in the forward-looking statements and, even if such actual results are realized or substantially realized, there can be no assurance that they will have the expected consequences to, or effects on the Company. Factors that could cause actual results or events to differ materially from current expectations include, among other things, changes in general economic and market conditions, changes to regulations affecting the Company's activities, and uncertainties relating to the availability and costs of financing needed in the future. Any forward-looking statement speaks only as at the date on which it is made and, except as may be required by applicable securities laws, the Company disclaims any intent or obligation to update any forward-looking statement, whether as a result of new information, future events or results or otherwise. Although the Company believe that the assumptions inherent in the forward-looking statements are reasonable, forward-looking statements are not guarantees of future performance and, accordingly, undue reliance should not be put on such statements due to the inherent uncertainty therein.

**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**JULY 31, 2008**

**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 and 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 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.

The liquids product line includes an array of liquid process analytics instrumentation which is marketed under three brands, with each brand targeting a particular market segment, and includes the Tytronics, Nametre and 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 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 optical and acoustic technologies. Substantially all of this operating division's revenue and expenses are denominated in U.S. dollar currency.

**SUMMARY OF QUARTERLY RESULTS**

	2008				2007				2006	
	July 08	April 08	Jan 08	Oct 07	July 07	April 07	Jan 07	Oct 06	July 06	April 06
	Q1	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1	Q4
	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$
Revenue	3,177,844	3,133,035	3,147,891	3,851,326	2,832,569	4,598,347	4,012,634	4,624,437	4,112,879	5,039,728
Gross margin	1,129,817	905,678	999,713	1,297,521	947,289	1,546,665	1,689,525	1,599,700	1,888,413	1,870,666
Net earnings (loss)	60,109	(980,747)	(93,969)	(279,776)	(414,353)	62,317	424,168	237,781	525,361	423,440
Earnings per share										
Basic	0.00	(0.07)	0.00	(0.01)	(0.03)	0.00	0.03	0.02	0.03	0.03
Diluted	0.00	(0.07)	0.00	(0.01)	(0.03)	0.00	0.02	0.02	0.03	0.03

**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**JULY 31, 2008**

For the three-month period ended July 31, 2008, the company reported net earnings of \$60,000 or \$0.00 per common share compared to a net loss of \$414,000 or \$(0.03) per common share. This increase in net income in the three-month period ended July 31, 2008, is largely as a result of cost savings realized due to the restructure and reorganization plan previously announced in fiscal 2008, foreign currency gains as compared to losses in the prior comparative period, and improvement in gross margin as a percentage of sales.

**CONSOLIDATED RESULTS OF OPERATIONS**

**REVENUE**

**Three-months ended July 31,**

	2008			2007		
	Galvanic Canada \$	Galvanic Lowell \$	Total \$	Galvanic Canada \$	Galvanic Lowell \$	Total \$
<b>REVENUE</b>						
Analytical measurement equipment	1,871,438	-	1,871,438	1,710,138	-	1,710,138
Electronic flow products	201,018	-	201,018	242,379	-	242,379
Liquids process analyzers	-	1,105,386	1,105,386	-	880,052	880,052
	<u>2,072,456</u>	<u>1,105,386</u>	<u>3,177,842</u>	<u>1,952,517</u>	<u>880,052</u>	<u>2,832,569</u>
<b>COST OF SALES</b>	<u>1,290,014</u>	<u>758,012</u>	<u>2,048,026</u>	<u>1,237,640</u>	<u>647,640</u>	<u>1,885,280</u>
<b>GROSS MARGIN</b>	<u>782,442</u>	<u>347,374</u>	<u>1,129,816</u>	<u>714,877</u>	<u>232,412</u>	<u>947,289</u>
<b>GROSS MARGIN PERCENTAGE</b>	<u>38%</u>	<u>31%</u>	<u>36%</u>	<u>37%</u>	<u>26%</u>	<u>33%</u>

Consolidated revenues for the first quarter of fiscal 2009 totalled \$3,178,000, an increase of 345,000 or 11%, compared to \$2,833,000 consolidated revenue in the 2008 fiscal quarter. This revenue growth was largely the result of increased demand in the liquids process market from the Lowell operating segment, which increased revenue by \$225,000 or 20%; and in the gas processing market from the Canadian operating segment, which increased revenue by \$161,000 or 10%. Revenue growth was offset by a decrease of \$41,000 of electronic flow products delivered into the gas utility distribution market as a result of lower scheduled maintenance requirements with the Company's major customers in Canada. Revenue from liquids process markets improved as a result of increased demand for the Tytronics analyzer from a long standing OEM arrangement, whereas revenues from the gas processing market improved largely due to continued international demand for high value analytical systems used by refineries. Sales outside of Canada into gas processing and distribution markets accounted for 67% of revenues in the first quarter of fiscal 2009 as compared with 65% in the corresponding previous quarter. The growth in these markets was somewhat slightly offset by the decline in the average United States dollar exchange rate by which the results were translated to Canadian dollars. The average exchange rate declined 5% in the first quarter of fiscal 2009 as compared with the first quarter of fiscal 2008.

**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**JULY 31, 2008**

**GROSS MARGIN**

Consolidated gross margin improved to \$1,130,000 or 36% of sales for the first quarter of fiscal 2009 as compared with \$947,000 or 33% of revenue for the comparative prior period. This improvement in gross margin is largely as a result of increased revenues in the Lowell operating segment and the resulting contribution. Gross margin as a percentage of sales improved slightly in the Canadian operating segment to 38% for the first quarter of fiscal 2009 as compared with 37% in the corresponding previous quarter.

**EXPENSES**

**Three months ended July 31,**

	2008			2007		
	Galvanic Canada	Galvanic Lowell	Total	Galvanic Canada	Galvanic Lowell	Total
	\$	\$	\$	\$	\$	\$
Selling and marketing	317,962	124,166	442,128	401,035	136,532	537,567
General and administrative	316,890	178,097	494,987	332,506	183,366	515,872
Interest on long-term debt	-	-	-	1,416	-	1,416
Exchange	(51,359)	(5,863)	(57,222)	120,465	(20,285)	100,180
Amortization	166,843	18,098	184,941	197,056	10,698	207,754
	<u>750,336</u>	<u>314,498</u>	<u>1,064,834</u>	<u>1,052,478</u>	<u>310,311</u>	<u>1,362,789</u>

Consolidated expenses for the first quarter of fiscal 2009 totalled \$1,065,000, a decrease of \$298,000 or 22%, compared with \$1,363,000 in the 2008 fiscal quarter. The decrease in the first quarter of fiscal 2009 as compared to fiscal 2008 is primarily due to a reduction in expenses in the Canadian operating segment. Expenses in this operating segment for the first quarter of fiscal 2009 totalled \$750,000, a decrease of \$302,000 or 28%, compared with \$1,052,000 in the corresponding previous fiscal period. The decrease was largely due to:

- a) The impact of the unrealized foreign exchange gain of \$51,000 as compared to the loss of \$120,000 recorded in the comparative prior period. As of July 31, 2008, the Canadian operating segment had approximately \$3,000,000 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 July 31, 2008, the value of the U.S. dollar was \$1.03 Canadian compared with \$1.00 at April 30, 2008. Accordingly, this increase in the value of the U.S. dollar resulted in an unrealized exchange gain.

**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**JULY 31, 2008**

- b) A decrease in selling, and marketing expenditures of \$83,000 or 21% to \$318,000 in the first quarter of fiscal 2009 compared with \$401,000 in the comparative prior period. As a result of the restructure announced in fiscal 2008, the direct sales force was reorganized to focus on higher growth geographic markets and expand the representative network. This resulted in a reduction in salaries and related travel expenditures as compared with the comparative prior period. Further cost savings were realized with the closure of the company's sales office in downtown Calgary, Alta.

As there were no significant changes in the structure or operations of the Lowell operating segment, expenses remained relatively unchanged.

**NET INCOME**

**Three months ended July 31,**

	2008			2007		
	Galvanic Canada	Galvanic Lowell	Total	Galvanic Canada	Galvanic Lowell	Total
	\$	\$	\$	\$	\$	\$
<b>INCOME TAXES</b>		4,874	4,874	(105,852)	(17,917)	(123,769)
<b>NET EARNINGS (LOSS)</b>	32,106	28,002	60,108	(354,371)	(59,982)	(414,353)

Consolidated net earnings for the first quarter of fiscal 2009 quarter increased to \$60,000 compared to the \$414,000 consolidated loss incurred in the comparative prior period. Galvanic Canada recorded net earnings of \$32,000 as compared with a loss of \$354,000 in the corresponding prior period. Galvanic Lowell recorded net earnings after taxes of \$28,000 compared with a loss of \$60,000 in the corresponding prior period. Galvanic Canada's increase in net earnings in the current fiscal quarter was attributable to unrealized foreign exchange gains due to the strengthening of the US dollar, and cost savings in selling, marketing, and general administration. Net earnings improved in Galvanic Lowell as a result of increased revenues and the resulting contribution margin. Income tax expense of \$5,000 is a result of pre-tax earnings in the Lowell operation compared with a pre-tax loss and recoverable income taxes in the corresponding prior period.

**OTHER COMPREHENSIVE INCOME**

Included in the consolidated statements of other comprehensive income for the current fiscal quarter was \$28,000 in unrealized gains on translating the financial statements of Galvanic Lowell utilizing the current rate method of translation, as this segment is considered self-sustaining for Canadian GAAP purposes. The U.S dollar appreciated 2.3% against the Canadian dollar, increasing the value of the net asset position in this operating segment in Canadian dollar terms.

## LIQUIDITY AND CAPITAL RESOURCES

### Cash Flow from Operations

The Company's principal source of liquidity is derived primarily from cash flow from operations and from changes in its working capital. For the three-month period ended July 31, 2008, the Company's cash position increased by \$347,000, primarily as a result of the increase in cash provided by operating activities in the amount of \$362,000 as compared to the \$168,000 utilized in the corresponding previous fiscal period. This increase in cash was mostly due to cash generated from operations in the amount of \$211,000, whereas changes in non-cash working capital contributed \$151,000. This compares with \$250,000 consumed by operating activities in the corresponding previous period, offset by changes in non-cash working capital that contributed \$81,000.

### Financing

Cash generated by financing activities totalled \$101,000 in the first quarter of fiscal 2009, compared to \$130,000 of cash utilized in the comparative prior period. Cash was generated through advances under the revolving term loan in the amount of \$120,000 offset by \$19,000 for common share purchases pursuant to the normal course issuer bid.

### Investing

Cash used for investing in product development, and property, plant and equipment totalled \$116,000 in fiscal 2009 as compared to \$153,000 of cash used in 2008.

### Development Costs

The Company continues to invest in development activities to support its current products and the development and introduction of new products. During the first three months of fiscal 2009, the Company invested \$103,000 in development activities. This compares with \$131,000 invested in the corresponding previous quarter. During the fiscal quarter the Company's efforts were primarily focused on projects related to product design for its liquid analyzers.

### Liquidity

During fiscal 2008, there were no significant changes in the structure of the Company's credit facilities. The existing credit facility consists of a revolving 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 July 31, 2008, \$1,025,000 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 July 31, 2008.

As of July 31, 2008, the Company maintained a working capital position of \$5,573,000. 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 should be able to meet its near term working capital requirements.

**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**JULY 31, 2008**

**SHARE CAPITAL**

The Company's authorized share capital has remained unchanged for the first quarter of fiscal 2009.

Share capital transactions include the purchase of 64,000 common shares pursuant to the Normal Course Issuer Bid for total consideration of \$19,000. The Company is entitled to purchase for cancellation up to a maximum of 778,553 of its common shares under the Bid which commenced April 8, 2008 and terminates April 9, 2009.

The Company's issued and outstanding shares at July 31, 2008, are 15,777,072 Common Shares.

During the three-month period ended July 31, 2008, the Company granted options to employees of the Company to purchase 600,000 common shares at the market price of \$0.30 per common share at the date of the grant. The stock options expire May 5, 2013. 200,000 of the options vest immediately and the balance vest equally over a five-year period. The fair value at the date of the grant was computed using the Black-Scholes model. The assumptions used in determining the fair value of the stock option included risk free interest rate of 3.95%, expected life of the stock option of 5 years, annualised volatility rate of 69% and an annualised dividend rate of 0%. The fair value of the options amounted to \$131,919.

**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.

**CRITICAL ACCOUNTING ESTIMATES**

The Company's significant account policies are described in Note 1 to the consolidated financial statements for the year ended April 30, 2008, contained in the Company's 2008 Annual report. The interim consolidated financial statements have been prepared follow the same accounting policies and methods of computation as the consolidated financial statements for the year ended April 30, 2008, except as noted below. The preparation of the consolidated financial statements requires that certain estimates and judgments be made with respect to the reported amounts of revenue and expenses and the carrying value of assets and liabilities. These estimates are based on historical experience and Management's judgments, and as a result, the estimates used by Management involve uncertainty and may change, as additional experience is required.

## **ACCOUNTING CHANGE**

Beginning in the first quarter of fiscal 2009, the Company adopted the new Section 1535 "Capital Disclosures" standard and Section 3862 "Financial Instruments – Disclosures" and Section 3863 "Financial Instrument-Presentation" standard issued by the Canadian Institute of Chartered Accountants (CICA). None of these changes had a significant effect on the Company's first quarter 2008 financial results. Details of the new accounting standard are included in Notes 1 and 4 and in the July 31, 2008, Consolidated Financial Statements

## **FUTURE ACCOUNTING CHANGES**

### **Research and Development Costs**

The CICA issued Section 3064 "Goodwill and Intangible Assets" replacing Section 3450 "Research and Development Costs". The new standard, which the Company will adopt May 1, 2009, establishes guidelines for the recognition, measurement, presentation and disclosure of research and development costs. Management is in the process of assessing the impact of this new standard and believes it will not have a material impact on the Company's consolidated statements.

### **Convergence with International Financial Reporting Standards**

Canada's Accounting Standards Board ratified a plan that will result in Canadian generally accepted accounting principles (GAAP) being converged with International Financial Reporting Standards (IFRS) by 2011. The impact on the Company's consolidated financial statements has not yet been determined.

## **RISK FACTORS**

The Company operates in a highly competitive market, and demand for the Company's products is largely a function of pipeline expansions, plant and equipment upgrades, and many other factors that may affect the fortunes of the business either positively or negatively. Shareholders should carefully consider the following factors, many of which are inherent of a company carrying out activities connected to the design, manufacture and sale of instrumentation equipment.

- a) Several instrumentation companies target the same customers as Galvanic. Some of these competitors are large, multi-national companies with greater access to resources to apply to research and development, and marketing and operations.
- b) If commodity prices decrease or fail to meet expectations, pipeline expansion and equipment upgrades may be reduced significantly, which can have a material adverse effect on the Company's operations.
- c) The Company's products are marketed internationally and are to a large extent priced in US dollars, which exposes the Company to international and US dollar currency exchange risks.
- d) The Company's products are subject to domestic and international regulatory approvals. There can be no assurances that such approvals will be granted in a timely fashion or at all. Delay in securing such approvals may adversely impact the timing of introducing the Company's products into these markets.
- e) The Company may utilize single source suppliers which could cause the Company to experience short-term vulnerability to supply disruptions.

**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**JULY 31, 2008**

- f) The Company is focused on providing products and services to a limited geographic market. The Company's efforts to expand such market area will subject the Company to significant competition from established competitors. There can be no assurance that the Company's marketing strategy will be successful.
- g) The success of the Company is dependent upon the efforts and abilities of its management team. The loss of any member of the management team could have material adverse effect upon the Company's business and prospects.
- h) The business of the Company is subject to the operating risks inherent to the industry. On occasion, substantial liabilities to third parties may be incurred. The Company will have benefit of insurance maintained by it; however, it may become liable for damages against which it cannot adequately insure or against which it may elect not to insure because of high costs or other reasons.
- i) The Company is vulnerable to market prices. Fixed costs, including costs associated with operations, leases, labor costs, and depreciation account for a significant portion of the Company's costs and expenses. As a result, reduced productivity resulting from reduced demand, equipment failure, or other factors could significantly affect its revenues and financial results.
- j) The Company sells its products domestically and to foreign customers and generally extends unsecured credit to these customers. The Company therefore remains subject to possible default in respect to customers to whom credit is extended.

**STATEMENT REGARDING INTERNAL CONTROLS OVER FINANCIAL REPORTING AND  
DISCLOSURE CONTROLS**

As of July 31, 2008, the Chief Executive Officer and the Chief Financial Officer have determined that the design and operation of Galvanic Applied Sciences Inc. disclosure controls were effective as at July 31, 2008.

During fiscal 2009, there have been no changes in internal controls over financial reporting that have materially affected or are reasonably likely to materially affect, the Company's control over financial reporting.

**OFF-BALANCE SHEET ARRANGEMENTS**

At July 31, 2008, and April 30, 2008, the Company has not entered into any off-balance sheet arrangements.

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)*

*July 31, 2008*

**GALVANIC APPLIED SCIENCES INC.****Consolidated Statements of Earnings, Comprehensive (Loss) Income, Retained Earnings, and Accumulated Other Comprehensive Loss**

	<b>Three Months Ended July 31,</b>	
	<b>2008</b>	<b>2007</b>
	<b>\$</b>	<b>\$</b>
<b>REVENUE</b>		
Sales	<b>3,177,844</b>	2,832,569
Cost of sales	<b>2,048,027</b>	1,885,280
<b>GROSS MARGIN</b>	<b>1,129,817</b>	947,289
<b>EXPENSES</b>		
Amortization	<b>184,941</b>	207,754
Foreign exchange (gain) loss	<b>(57,221)</b>	100,180
General and administrative	<b>494,987</b>	638,494
Interest	-	1,416
Selling and marketing	<b>442,128</b>	537,567
	<b>1,064,834</b>	1,485,411
<b>EARNINGS (LOSS) BEFORE INCOME TAXES</b>	<b>64,983</b>	(538,122)
<b>PROVISION (RECOVERY OF) INCOME TAXES</b>		
Current	<b>4,874</b>	(123,769)
Future	-	-
	<b>4,874</b>	(123,769)
<b>NET EARNINGS (LOSS)</b>	<b>60,109</b>	(414,353)
<b>OTHER COMPREHENSIVE INCOME (LOSS)</b>	<b>27,482</b>	(59,799)
<b>COMPREHENSIVE INCOME (LOSS)</b>	<b>87,591</b>	(474,152)
<b>RETAINED EARNINGS, BEGINNING OF PERIOD</b>	<b>5,894,437</b>	7,663,282
<b>RETAINED EARNINGS, END OF PERIOD</b>	<b>5,954,545</b>	7,248,929
<b>ACCUMULATED OTHER COMPREHENSIVE (LOSS) GAIN, BEGINNING OF PERIOD</b>	<b>(356,549)</b>	(211,756)
<b>OTHER COMPREHENSIVE GAIN (LOSS)</b>	<b>27,482</b>	(59,799)
<b>ACCUMULATED OTHER COMPREHENSIVE (LOSS) GAIN, END OF PERIOD</b>	<b>(329,067)</b>	(271,555)
<b>NET EARNINGS (LOSS) PER COMMON SHARE</b>		
Basic	<b>0.00</b>	(0.03)
Diluted	<b>0.00</b>	(0.03)

**GALVANIC APPLIED SCIENCES INC.**  
**Consolidated Balance Sheets**

	July 31, 2008 (Unaudited) \$	April 30, 2008 (Audited) \$
<b>ASSETS</b>		
<b>CURRENT</b>		
Cash and cash equivalents	633,321	286,257
Restricted funds	123,829	123,829
Accounts receivable - trade	3,336,806	3,673,983
Recoverable income taxes	396,049	390,928
Inventory	3,149,809	3,109,015
Prepaid expenses	181,238	97,964
	<b>7,821,052</b>	<b>7,681,976</b>
Deferred development costs	2,040,780	2,040,309
Property, plant and equipment	1,031,686	1,101,832
Goodwill	3,442,693	3,442,693
	<b>14,336,211</b>	<b>14,266,810</b>
<b>LIABILITIES</b>		
<b>CURRENT</b>		
Operating loan	1,025,000	905,000
Accounts payable and accrued liabilities	1,040,210	1,097,188
Restructuring accounts payable and accrued liabilities	182,966	263,432
	<b>2,248,176</b>	<b>2,265,620</b>
Future income taxes	577,237	577,237
	<b>2,825,413</b>	<b>2,842,857</b>
<b>COMMITMENTS AND CONTINGENCIES</b>		
<b>SHAREHOLDERS' EQUITY</b>		
Share capital (Note 2)	5,012,673	5,032,023
Contributed surplus	872,638	854,042
Retained earnings	5,954,545	5,894,437
Accumulated other comprehensive income	(329,067)	(356,549)
	<b>11,510,798</b>	<b>11,423,953</b>
	<b>14,336,211</b>	<b>14,266,810</b>

**APPROVED BY THE BOARD**

 **Director**

 **Director**

# GALVANIC APPLIED SCIENCES INC.

## Consolidated Statements of Cash Flows (Unaudited)

	Three Months Ended July 31,	
	2008	2007
	\$	\$
<b>CASH FLOWS RELATED TO THE FOLLOWING ACTIVITIES:</b>		
<b>OPERATING</b>		
Net earnings (loss)	60,109	(414,353)
Adjustments for:		
Amortization	184,941	207,754
Restructuring costs, net of cash payments	(80,465)	-
Stock-based compensation	18,596	16,971
Unrealized foreign exchange gain (loss)	27,482	(59,799)
	<u>210,663</u>	<u>(249,427)</u>
Changes in non-cash working capital	151,017	81,214
	<u>361,680</u>	<u>(168,213)</u>
<b>FINANCING</b>		
Increase in operating loan	120,000	185,000
Common share purchases pursuant to the normal course issuer bid	(19,350)	-
Repayment of long-term debt	-	(54,824)
	<u>100,650</u>	<u>130,176</u>
<b>INVESTING</b>		
Capital assets	(11,798)	(21,514)
Development costs	(103,468)	(131,555)
	<u>(115,266)</u>	<u>(153,069)</u>
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b>347,064</b>	<b>(191,106)</b>
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD</b>	<b>286,257</b>	<b>1,305,373</b>
<b>CASH AND CASH EQUIVALENTS, END OF PERIOD</b>	<b>633,321</b>	<b>1,114,267</b>
<b>SUPPLEMENTARY INFORMATION</b>		
Cash paid for interest	24,726	37,574
Cash paid for taxes	24,726	37,574

# **GALVANIC APPLIED SCIENCES INC.**

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

**Three Months Ended July 31, 2008 (Unaudited)**

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### **1. SIGNIFICANT ACCOUNTING POLICIES**

#### *Interim consolidated financial statements*

The 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, 2008, except as noted below. These interim financial statements do not include all disclosure normally provided in the annual financial statements and should be read in conjunction with the consolidated financial statements and notes thereto contained in the Company's annual report for the year ended April 30, 2008.

#### *Adoption of new accounting standards*

##### **Capital disclosures**

Effective May 1, 2008, the Company adopted the new Section 1535 "Capital Disclosures" standard issued by the Canadian Institute of Chartered Accountants (CICA). This section established standards for disclosing information about the Company's capital and how it is managed. The impact of this change is described in Note 4 to the consolidated financial statements as of July 31, 2008.

##### **Financial instruments**

Effective May 1, 2008, the Company adopted the new Section 3862 "Financial Instruments – Disclosures" and Section 3863 "Financial Instruments – Presentation" which replaced Section 3861, "Financial Instruments – Disclosure and Presentation". Section 3862 outlines the disclosure requirements for financial instruments and non-financial derivatives. This guidance prescribes an increased importance on the nature of risks arising from financial instruments and how the Company manages those risks. The presentation requirements under Section 3863 are relatively unchanged from Section 3861.

##### **Inventories**

Effective May 1, 2008 the Company adopted CICA Handbook Section 3031 "Inventories", which replaced CICA Section 3030 of the same name. This new section provides new guidance on the recognition, measurement and disclosure of inventories which include the requirement of inventory to be measured on a "first-in, first out" or weighted average basis. The adoption of this standard did not have a material impact on the Company's consolidated financial statements.

#### *Future Changes in Accounting Policies*

In February 2008, the CICA issued Section 3064, "Goodwill and Intangible Assets", replacing Section 3062, "Goodwill and Other Intangible Assets" and Section 3450, "Research and Development Costs". Various changes have been made to other sections of the CICA Handbook for consistency purposes. The new sections will be applicable to financial statements relating to fiscal years beginning on or after October 1, 2008. Accordingly, the company will adopt the new standards for the recognition, measurement,

# GALVANIC APPLIED SCIENCES INC.

## Notes to the Consolidated Financial Statements

### Three Months Ended July 31, 2008 (Unaudited)

presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets by profit-oriented enterprises. Standards concerning goodwill are unchanged from the standards included in the previous Section 3062. The company is currently evaluating the impact of the adoption of this new section.

Over the next few years the CICA will adopt its new strategic plan for the direction of accounting standards in Canada, which was ratified in January 2006. As part of the plan, Canadian GAAP for public companies will converge with International Financial Reporting Standards (“IFRS”) over the next few years. The company is currently assessing the impact of the convergence of Canadian GAPP with IFRS on its financial statements and expects to begin work on the conversion process later in 2008.

## 2. SHARE CAPITAL

### *Authorized*

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

### *Issued*

Common shares

	<b>Number of Shares</b>	<b>Amount \$</b>
Balance, April 30, 2008	15,841,072	5,032,023
Common shares purchased	(64,000)	(19,350)
Balance, July 31, 2008	<u>15,777,072</u>	<u>5,012,673</u>

### *Normal Course Issuer Bid*

To July 31, 2008, the company purchased 64,000 common shares for total consideration of \$19,350. The Company is entitled to purchase, for cancellation, up to 778,553 of its common shares under the Normal Course Issuer Bid, which commenced on April 8, 2008, and terminates on April 9, 2009.

### *Stock option Plan*

At July 31, 2008, 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. The options granted have the following expiry dates: August 28, 2008, September 16, 2010, and May 5, 2013.

# GALVANIC APPLIED SCIENCES INC.

## Notes to the Consolidated Financial Statements Three Months Ended July 31, 2008 (Unaudited)

	<b>Number of Shares Under Option</b>	<b>Weighted Average Exercise Price \$</b>
Options outstanding, beginning of period	370,000	0.50
Expired	(100,000)	0.51
Granted	600,000	0.30
Options outstanding, end of period	<u>870,000</u>	<u>0.36</u>

The following table summarizes outstanding and exercisable options at July 31, 2008:

<b>Exercise Price \$</b>	<b>Number Outstanding July 31, 2008</b>	<b>Weighted Average Remaining Contractual Life (Years)</b>	<b>Weighted Average Exercise Price \$</b>
0.50	270,000	1.75	0.50
0.30	<u>600,000</u>	4.75	0.30
	<u>870,000</u>		

Stock options issued have been accounted for using the fair-value method. The fair-value of each stock option granted is estimated on the date of grant using the Black-Scholes option-pricing model. Stock-based compensation expense with a corresponding amount credited to contributed surplus of \$18,956 (April 30, 2008 - \$16,971), has been recorded, using the following weighted average assumptions:

Risk-free interest rate (%)	3.95%
Expected option life (years)	5
Expected volatility (%)	6.9%
Estimated annual dividend	nil

## GALVANIC APPLIED SCIENCES INC.

### Notes to the Consolidated Financial Statements

#### Three Months Ended July 31, 2008 (Unaudited)

The following table presents a summary of activity related to the Company's contributed surplus for the periods ended July 31 and April 30, 2008:

	<u>July 31</u>	<u>April 30</u>
Balance, contributed surplus, beginning of period	854,042	917,563
Stock option expense	18,596	25,579
Options exercised	-	(89,100)
Balance, contributed surplus, end of period	<u>872,638</u>	<u>854,042</u>

### 3. 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 the processing and distribution market, Galvanic Canada; and the liquid analyzer 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.

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) sulfur and total sulfur, gas chromatographs and carbon dioxide (CO<sub>2</sub>) with infrared technology. 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.

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.

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

# GALVANIC APPLIED SCIENCES INC.

## Notes to the Consolidated Financial Statements

Three Months Ended July 31, 2008 (Unaudited)

	July 31, 2008			July 31, 2007		
	Galvanic Canada \$	Galvanic Lowell \$	Enterprise Total \$	Galvanic Canada \$	Galvanic Lowell \$	Enterprise Total \$
Revenue						
Operating Expenses	2,072,458	1,105,386	<b>3,177,844</b>	1,952,517	880,052	<b>2,832,569</b>
Segment profit (loss)	2,040,352	1,077,383	<b>3,117,735</b>	1,175,100	310,311	<b>1,485,411</b>
	32,106	28,003	<b>60,109</b>	(354,371)	(59,982)	<b>(414,353)</b>
Amortization	166,843	18,098	<b>184,941</b>	197,056	10,698	<b>207,754</b>
Total assets of segments						
Goodwill allocated to segment	8,512,040	2,381,478	<b>10,893,518</b>	11,824,948	1,586,382	<b>13,411,330</b>
Total enterprise assets	608,983	2,833,710	<b>3,442,693</b>	608,983	2,833,710	<b>3,442,693</b>
	9,121,023	5,225,371	<b>14,336,211</b>	12,433,931	4,420,092	<b>16,854,023</b>
Expenditures for capital assets	(4,275)	(7,523)	<b>(11,798)</b>	(17,380)	(4,134)	<b>(21,514)</b>
Expenditures for development costs	(103,468)	-	<b>(103,468)</b>	(131,555)	-	<b>(131,555)</b>

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

	2008 \$	2007 \$
Canada	<b>693,079</b>	761,388
United States	<b>1,237,319</b>	956,952
Other International Sales	<b>1,247,444</b>	1,114,229
	<b>3,177,842</b>	2,832,569

#### 4. CAPITAL DISCLOSURES

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

# **GALVANIC APPLIED SCIENCES INC.**

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

**Three Months Ended July 31, 2008 (Unaudited)**

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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 the normal course issuer bid.

The Company is subject to certain financial covenants associated with its revolving operating lines of credit. As of July 31, 2008 the Company is in compliance with these requirements.

### **5. FINANCIAL INSTRUMENTS**

The Company is exposed to financial risks arising from its financial assets and liabilities. The Company's financial assets and liabilities are comprised of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities and its operating loan.

#### ***Fair Value***

The carrying value of cash and cash equivalents, accounts receivable, accounts payable, accrued liabilities, operating lines of credit approximate fair value due to the short-term nature of these instruments

#### ***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 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 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 present a credit risk. As of July 31, 2008, two international customers had accounts receivable balances of \$500,000 or 15% of the accounts receivable balance which were more than 90 days overdue. In the event that these two customers are unable to meet their financial obligations the Company would incur a financial loss.

#### ***Liquidity Risk***

Liquidity risk is the risk that the company will not be able to meet its financial obligations as they become due. The Company manages liquidity risk through cash management and maintains sufficient operating lines of credit to meet financing requirements that exceed anticipated internally generated funds. As at July 31, 2008, accounts payable and accrued liabilities, operating lines of credit are less than one year.

# GALVANIC APPLIED SCIENCES INC.

## Notes to the Consolidated Financial Statements

Three Months Ended July 31, 2008 (Unaudited)

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### *Market Risk*

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

### *Interest Rate Risk*

The Company is exposed to interest rate risk with respect to its revolving operating lines of credit that bear interest at floating market rates. Fluctuations in the interest rate may impact the company's borrowing costs. Based on the operating loan outstanding as of July 31, 2008 any change in the prime rate would have had an insignificant impact on income before income taxes for the period.

### *Currency Risk*

The Company's international business is primarily denominated in U.S. dollars and as a result has a foreign exchange risk relative to the U.S. dollar. The types of foreign exchange 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 fluctuates 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 three months ended July 31, 2008, 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:

	<b>Earnings</b>	<b>Other Comprehensive Income</b>
1% decrease in value of Canadian dollar	18,000	9,800
1% increase in value of Canadian dollar	(18,000)	(9,800)

## **GALVANIC APPLIED SCIENCES INC.**

### **Notes to the Consolidated Financial Statements Three Months Ended July 31, 2008 (Unaudited)**

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#### **6. EARNINGS PER SHARE**

The number of shares used in the weighted average diluted calculation was 15,777,072 (April 30, 2008 – 15,572,551).

#### **7. 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 (1) (2) (3) (4)  
Mississauga, Ontario

Gerald J. Hipple  
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**

S. Grant Reeves (2) (3) (4)  
Chief Executive Officer

### **REGISTRAR AND TRANSFER**

Computershare Trust Company of  
Calgary, Alberta

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



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