

ESCALON MEDICAL CORP  
Form ARS  
May 17, 2013

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ESCALON  
2012 Annual Report

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May 17,2013

Dear Shareholder:

The board of directors and management cordially invite you to attend the annual meeting of the shareholders to be held on June 28, 2013 at 9:00 am at the corporate headquarters located at 435 Devon Park Drive, Building 100, Wayne, PA 19087. The annual report is attached. Please read it carefully.

Escalon Medical Corp has chosen to furnish its proxy statement and annual report to its shareholders over the Internet, as allowed by the rules of the Securities and Exchange Commission. Rather than mailing paper copies, we believe that this e-proxy process will expedite shareholder receipt of the materials, lower the Company's expenses associated with this process, and eliminate unnecessary printing and paper usage. As a shareholder of Escalon Medical Corp., you are receiving by mail (or electronic mail) a Notice of Internet Availability of Proxy Materials (the "Notice") which will instruct you on how to access and review the proxy statement and annual report on the Internet. The Notice will also instruct you how to vote your shares over the Internet. Shareholders who would like to receive a paper copy of the Escalon Medical Corp.

proxy statement and annual report, free of charge, should follow the instructions on the Notice.

Shareholders who request paper copies will also receive a proxy card or voting instruction form to allow them to vote their shares by mail in addition to over the Internet or by telephone.

It is important that your shares be voted at the meeting in accordance with your preference. If you do not plan to attend, you may vote your shares by following the instructions in the Notice. If you are able to attend the meeting and wish to vote in person, you may withdraw your proxy at that time. See the response to the question "How do I vote?" in the proxy statement for a more detailed description of voting procedures.

Sincerely,

Richard J. DePiano  
Chairman & CEO

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-K  
ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended June 30, 2012  
Commission File Number 0-20127

Escalon Medical Corp.  
(Exact name of registrant as specified in its charter)

Pennsylvania	33-0272839
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
435 Devon Park Drive, Building 100, Wayne, PA 19087	
(Address of principal executive offices, including zip code)	
(610) 688-6830	
(Registrant's telephone number, including area code)	

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Securities Registered Pursuant to Section 12(b) of the Act:

Common Stock, par value \$0.001	NASDAQ Capital Market
(Title of class)	(Name of each exchange on which registered)

Securities Registered Pursuant to Section 12(g) of the Act: NONE

Indicate by check mark if the registrant is a well-known seasoned issuer as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Exchange Act. Yes  No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer, accelerated filer, and smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes  No

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant on December 31, 2011 was approximately \$7,526,430, computed by reference to the price at which the common equity was last sold on the NASDAQ Capital Market on such date.

As of September 26, 2012, the registrant had 7,526,430 shares of common stock outstanding.

Documents Incorporated by Reference:

Certain information required by Part III of this Annual Report on Form 10-K will be set forth in, and is incorporated by reference from, the registrant's Proxy Statement for the 2012 Annual Meeting of Shareholders.



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Escalon Medical Corp.

Annual Report on Form 10-K

For the Fiscal Year Ended June 30, 2012

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PART 1

ITEM 1. BUSINESS

Company Overview

Escalon Medical Corp. (“Escalon” or the “Company”) is a Pennsylvania corporation initially incorporated in California in 1987 and reincorporated in Pennsylvania in November 2001. Within this document, the “Company” collectively shall mean Escalon and its wholly owned subsidiaries: Sonomed, Inc. (“Sonomed”), Trek, Inc. (“Trek”), Escalon Vascular Access, Inc. (“Vascular”), Escalon Medical Europe GmbH (“EME”), Escalon Digital Vision, Inc. (“EMI”), Escalon Pharmaceutical, Inc. (“Pharmaceutical”), Escalon Holdings, Inc. (“EHI”), Escalon IP Holdings, Inc., Escalon Vascular IP Holdings, Inc., Sonomed IP Holdings, Inc., Drew Scientific Holdings, Inc. and Drew Scientific Group, Plc (“Drew”) and its subsidiaries. The Company’s Internet address is [www.escalonmed.com](http://www.escalonmed.com).

The Company operates in the healthcare market, specializing in the development, manufacture marketing and distribution of medical devices and pharmaceuticals in the areas of ophthalmology, diabetes and hematology. The Company and its products are subject to regulation and inspection by the United States Food and Drug Administration (the “FDA”). The FDA and other governmental authorities require extensive testing of new products prior to sale and have jurisdiction over the safety, efficacy and manufacture of products, as well as product labeling and marketing.

Management reviews financial information, allocates resources and manages the business as three segments. The Escalon Clinical Diagnostics (“ECD”) segment consists of Drew Scientific, Inc., and its wholly owned subsidiaries JAS Diagnostics, Inc. (“JAS”) and Biocode Hycel (“Biocode”). ECD develops and sells clinical diagnostic instruments, reagents and chemistries. The Sonomed-Escalon segment consists of Sonomed, EMI and Trek, all of which are engaged in the development and sale of Ophthalmic medical devices. The Escalon Medical Corp. segment includes the administrative corporate operations of the consolidated group.

Business Segment No. 1: ECD

Drew Business

Drew is a diagnostics company specializing in the design, manufacture and distribution of instruments for blood cell counting and blood analysis. Drew is focused on providing instrumentation and consumables for the physician office and veterinary office laboratories. Drew also supplies the reagent and other consumable materials needed to operate the instruments. Drew acquired JAS on May 29, 2008. JAS was established in 2000 and specializes in the manufacture of a broad range of liquid stable, diagnostics chemistry reagents used in IVD tests. Many of these reagents are single vial stable, which offer ease of use, increased speed of results and extended on-board stability. Drew's wholly owned subsidiary, BH Holdings, S.A.S. (“BHH”) acquired certain assets of Biocode Hycell (“Biocode”) on December 31, 2008. Biocode specialized in hematology consumables for the physician office and veterinary office laboratories. On January 12, 2012 BHH initiated the filing of an insolvency declaration with the Tribunal de Commerce de Rennes, France (“Commercial Court”). The Commercial Court on January 18, 2012 opened the liquidation proceedings with continuation of BHH’s activity for three months and named an administrator to manage BHH. Since BHH is no longer controlled by Drew, it was deconsolidated in the December 31, 2011 quarterly consolidated financial statements and prior period amounts are presented as discontinued operations (see footnote 11 to the Notes to Consolidated Financial Statements for additional information). The operating results of Drew and JAS are included as part of the ECD business segment.

Diabetes Testing

Drew sells two diabetic testing products: the DS5 and the Hb-Gold. The DS5 instrument, dispenser and associated reagent kit measure long-term glucose control in diabetic patients. The system’s small size and ease of use make it

ideal for main laboratory, clinic or satellite laboratory settings. The Hb- Gold instrument and associated reagent kit provides for the in vitro measurement of certain genetic diseases of the blood. In the United States, this instrument is available for research only.

#### Hematology

Drew offers a broad array of equipment for use in the field of human and veterinary hematology. Drew's Excell product lines are for use in the field of human hematology, and its Hemavet product line is for use in the veterinary field.



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### Business Segment No. 2: Sonomed-Escalon

The Sonomed-Escalon segment consists of Sonomed, Inc., EMI and Trek, all of which are engaged in the development and sale of ophthalmic medical devices.

The systems are of four types: A-Scans, B-Scans, High Frequency B-Scans (“UBMs”) and pachymeters.

#### A-Scans

The A-Scan provides information about the internal structure of the eye by sending a beam of ultrasound along a fixed axis through the eye and displaying the various echoes reflected from the surfaces intersected by the beam. The principal echoes occur at the cornea, both surfaces of the lens and the retina. The system displays the position and magnitudes of the echoes on an electronic display. The A-Scan also includes software for measuring distances within the eye. This information is primarily used to calculate lens power for implants.

#### B-Scans

The B-Scan is primarily a diagnostic tool that supplies information to physicians where the media within the eye are cloudy or opaque. Whereas physicians normally use light, which cannot pass through such media, the ultrasound beam is capable of passing through the opacity and displaying an image of the internal structures of the eye. Unlike the A-Scan, the B-Scan transducer is not in a fixed position; it swings through a 60 degree sector to provide a two-dimensional image of the eye.

#### UBM

The UBM is a high frequency/high resolution ultrasound device, designed to provide highly detailed information about the anterior segment of the eye. The UBM is used for glaucoma evaluation, tumor evaluation and differentiation, pre- and post-intraocular lens implantation and corneal refractive surgery. The device allows the surgeons to perform precise measurements within the anterior chamber of the eye.

#### Pachymeters

The pachymeter uses the same principles as the A-Scan, but the system is tailored to measure the thickness of the cornea. With the advent of refractive surgery (where the cornea is actually cut and reshaped) this measurement has become critical. Surgeons must know the precise thickness of the cornea so as to set the blade to make a cut of approximately 20% of the thickness of the cornea.

#### Color/Fluorescein Angiography (“CFA”) Digital Imaging Systems

CFA (Color/Fluorescein Angiography) digital imaging system, designed specifically for ophthalmology. This diagnostic tool, ideal for use in detecting retinal problems in diabetic and elderly patients, provides a high-resolution image, far superior to conventional film in image quality, processing and capture. The instant image display provides users with the necessary clinical information that allows treatment to be performed while the patient is still in the physician’s office.

#### Ispan Intraocular Gases

The Company distributes two intraocular gas products C3F8 and SF6, which are used by vitreoretinal surgeons as a temporary tamponade in detached retina surgery. Under a non-exclusive distribution agreement with Scott Medical Products (“Scott”), the Company distributes packages of Scott gases in canisters containing up to 25 grams of gas. Along with the intraocular gases, the Company manufactures and distributes a patented disposable universal gas kit, which delivers the gas from the canister to the patient.

#### Viscous Fluid Transfer Systems

The Company markets viscous fluid transfer systems and related disposable syringe products, which aid surgeons in the process of injecting and extracting silicone oil. Adjustable pressures and vacuums provided by the equipment allow surgeons to manipulate the flow of silicone oil during surgery.

### Fiber Optic Light Sources

Light source and fiber optic products are widely used by vitreoretinal surgeons during surgery. The Company offers surgeons a complete line of light sources along with a variety of fiber optic probes and illuminated tissue manipulators.

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### Business Segment No. 3: Escalon Medical Corp.

The Escalon Medical Corp. business segment includes the administrative corporate operations of the consolidated group.

### Research and Development

The Company conducts development of medical devices for the diagnosis and monitoring of medical disorders in the areas of diabetes, cardiovascular diseases and hematology at the Company's Miami, Florida facility. The Company conducted medical device and vascular access product development at its New Berlin, Wisconsin facility through August 2010. Certain assets of Vascular Access were sold in April 2010, and Vascular continued to manufacture under a supply agreement until August 2010. The development of ultrasound ophthalmic equipment is performed at the Company's Lake Success, New York facility on Long Island. Company-sponsored research and development expenditures from continuing operations for the fiscal years ended June 30, 2012 and 2011 were approximately \$1,481,000 and \$1,603,000, respectively.

### Manufacturing and Distribution

The Company leases an aggregate of 81,379 square feet of space at its facilities in Texas, Connecticut, Florida and the United Kingdom. These sites are currently used for engineering, product design and development and product assembly. All of the Company's medical devices and consumables for the diagnosis and monitoring of medical disorders in the areas of diabetes, cardiovascular diseases and hematology are distributed from the Company's Dallas, Texas, Oxford, Connecticut, Miami, Florida and Barrow-in-Furness, United Kingdom facilities. See "Business Conditions" in "Management's Discussion and Analysis of Financial Condition of Results of Operations" for additional information.

The Company leases 11,250 square feet of space in Wisconsin, for its surgical products and vascular access operations prior to its sale on April 30, 2010. The facility is currently used for product assembly related to Trek. The Company also leases 3,452 square feet in Lawrence, Massachusetts used primarily for product design and development in the EMI business unit. The Company subcontracts component manufacture, assembly and sterilization to various vendors. The Company's ophthalmic surgical products are distributed from the Company's Wisconsin facility.

The Company designs, develops and services its ultrasound ophthalmic products at its 12,173 square foot facility in Lake Success, New York. The Company has achieved ISO 13485 certification at its manufacturing facilities for all medical devices the Company produces. ISO 13485 requires an implemented quality system that applies to product design, manufacture, installation and servicing. These certifications can be obtained only after a complete audit of a company's quality system by an independent outside auditor. These certifications require that facilities undergo periodic reexamination. The Company has obtained European Community certification ("CE") for many of its in vitro diagnostic devices for hematology, HbA1c, and clinical chemistry, ophthalmic surgical instruments, ophthalmic ultrasound systems, and image management systems.

The manufacture, testing and marketing of each of the Company's products entails risk of product liability. The Company carries product liability insurance to cover primary risk.

### Governmental Regulations

The Company's products are subject to stringent ongoing regulation by the FDA and similar health authorities, and if these governmental approvals or clearances of the Company's products are restricted or revoked, the Company could face delays that would impair the Company's ability to generate funds from operations.

The Company has received the necessary FDA and other necessary regulations clearances and approvals for all products that the Company currently markets. The FDA and comparable agencies in state and local jurisdictions and in foreign countries impose substantial requirements upon the manufacturing and marketing of pharmaceutical and medical device equipment and related disposables, including the obligation to adhere to the FDA's Good Manufacturing Practice regulations. Compliance with these regulations requires time-consuming detailed validation of

manufacturing and quality control practices, FDA periodic inspections and other procedures. If the FDA finds any deficiencies in the validation processes, for example, the FDA may impose restrictions on marketing the specific products until such deficiencies are corrected.

The FDA and similar health authorities in foreign countries extensively regulate the Company's activities. The Company must obtain either 510(K) clearances or pre-market approvals and new drug application approvals prior to marketing a product in the United States. Foreign regulation also requires that the Company obtain other approvals from foreign government agencies prior to the sale of products in those countries. Also, the Company may be required to obtain FDA clearance or approval before exporting a product or device that has not received FDA marketing clearance or approval.

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The Company has received CE approval on several of the Company's products that allows the Company to sell the products in the countries comprising the European Community. In addition to the CE mark, some foreign countries require separate individual foreign regulatory clearances.

### Marketing and Sales

The ECD business segment sells its products through internal sales and marketing employees located in the United States and in the United Kingdom, as well as through a large network of distributors, both domestic and international.

The Sonomed product line is sold through internal sales employees as well as independent sales representatives located in the United States and Europe, to a large network of distributors and directly to medical institutions.

Trek and EMI sell their ophthalmic devices and instruments directly to end users through internal sales and marketing employees located at the Company's Wisconsin and Massachusetts facilities. Sales are primarily made to teaching institutions, key hospitals and eye surgery centers, focusing primarily on physicians and operating room personnel performing vitreoretinal surgery. The EMI product line is sold through internal sales employees and independent sales representatives in the United States.

### Service and Support

The Company maintains a full-service program for all products sold. The Company provides limited warranties on all products against defects and performance. Product repairs are made at the Wisconsin facility for surgical devices and EMI devices. Sonomed's products are serviced at the Company's New York facility. Drew's products are serviced at its Dallas, Texas and Barrow-in-Furness, UK facilities.

### Patents, Trademarks and Licenses

The pharmaceutical and medical device communities place considerable importance on obtaining patent and trade secret protection for new technologies, products and processes for the purpose of strengthening the Company's position in the market place and protecting the Company's economic interests. The Company's policy is to protect its technology by aggressively obtaining patent protection for substantially all of its developments and products, both in the United States and in selected countries outside the United States. It is the Company's policy to file for patent protection in those foreign countries in which the Company believes such protection is necessary to protect its economic interests. The duration of the Company's patents, trademarks and licenses vary through 2020. The Company has 13 United States patents and 19 patents issued abroad that cover the Company's surgical products and pharmaceutical technology. Drew has approximately 63 patents related to its technology.

The Company intends to vigorously defend its patents if the need arises.

### Competition

There are numerous direct and indirect competitors of the Company in the United States and abroad. These competitors include ophthalmic-oriented companies that market a broad portfolio of products, including:

- prescription ophthalmic pharmaceuticals, ophthalmic devices, consumer products and other eye care products;
- large integrated pharmaceutical companies that market a limited number of ophthalmic pharmaceuticals in addition to many other pharmaceuticals;
- and smaller specialty pharmaceutical and biotechnology companies that are engaged in the development and commercialization of prescription ophthalmic pharmaceuticals and products and, to some extent, drug delivery systems. The Company's competitors for medical devices and ophthalmic pharmaceuticals include, but are not limited to, Bausch & Lomb, Inc., Alcon Laboratories, Inc., Paradigm Medical, Inc., Quantel, Inc. and Accutome, Inc.

Several large companies dominate the ophthalmic market, with the balance of the industry being highly fragmented. The Company believes that these large companies capture approximately 85% of the overall ophthalmic market. The balance of the market is comprised of smaller companies ranging from start-up entities to established market players. The ophthalmic market in general is intensely competitive, with each company eager to expand its market share. The Company's strategy is to compete primarily on the basis of technological innovation to which it has proprietary rights. The Company believes, therefore, that its business will depend in large part on protecting its intellectual property through patents and other governmental regulations.

Sonomed's principal competitors are Alcon Laboratories, Inc, Quantel, Inc. and Accutome, Inc. Sonomed has had a leading presence in the ophthalmic ultrasound industry for over 30 years. Management believes that this has helped Sonomed build a reputation as a long-standing operation that provides a quality product, which has enabled the Company to establish

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effective distribution coverage within the United States market. Various competitors offering similar products at a lower price could threaten Sonomed's market position. The development of laser technologies for ophthalmic biometrics and imaging may also diminish the Company's market position. This equipment can be used instead of ultrasound equipment in most, but not all, patients. Such equipment, however, is more expensive.

Trek and EMI sell a broad range of ophthalmic surgical and diagnostic products. The more significant products are ISPAN® gases and delivery systems. Trek and EMI also manufacture various ophthalmic surgical products for major ophthalmic companies to be sold under their names. To remain competitive, the Company needs to maintain a low-cost operation. There are numerous other companies that can provide this manufacturing service. There are a variety of other devices that directly compete with the camera back marketed by EMI.

Drew is a diagnostics company specializing in the design, manufacture and distribution of instruments for blood cell counting and blood analysis. Drew is focused on the market for the physician office and veterinary office laboratories. Drew's principal competition is Beckman Coulter and Bayer Diagnostics in the human market and IDDEX in the veterinary market. Currently Drew has only a nominal share of these markets, and the Company will seek to increase Drew's market share. The Company's strategy is to market instruments and consumables that are competitive for the low volume users in the domestic and overseas markets. Drew's business depends on its ability to enhance its current product range and control its production costs. Drew recognizes that other companies may adopt similar strategies which could hinder Drew's ability to increase market share.

### Human Resources

As of June 30, 2012, the Company employed 118 employees. Of these employees, 41 of the Company's employees are employed in manufacturing, 54 are employed in general and administrative positions, 12 are employed in sales and marketing and 11 are employed in research and development. The Company's employees are not covered by a collective bargaining agreement, and the Company considers its relationship with its employees to be good.

## ITEM 1A. RISK FACTORS

### Cautionary Factors That May Affect Future Results

Certain statements contained in, or incorporated by reference in, this report are forward-looking statements made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995, which provide current expectations or forecasts of future events. Such statements can be identified by the use of terminology such as "anticipate," "believe," "could," "estimate," "expect," "forecast," "intend," "may," "plan," "possible," "project," "should," "will," and similar words or expressions. The Company's forward-looking statements include certain information relating to general business strategy, growth strategies, financial results, liquidity, product development, the introduction of new products, the enhancement of existing products, the potential markets and uses for the Company's products, the Company's regulatory filings with the FDA, acquisitions, the development of joint venture opportunities, intellectual property and patent protection and infringement, the loss of revenue due to the expiration or termination of certain agreements, the effect of competition on the structure of the markets in which the Company competes, increased legal, accounting and Sarbanes-Oxley compliance costs, the Company's ability to continue to list its common stock on the Nasdaq Stock Market, defending the Company in litigation matters and the Company's cost-saving initiatives. The reader must carefully consider forward-looking statements and understand that such statements involve a variety of risks and uncertainties, known and unknown, and may be affected by assumptions that fail to materialize as anticipated. Consequently, no forward-looking statement can be guaranteed, and actual results may vary materially. It is not possible to foresee or identify all factors affecting the Company's forward-looking statements, and the reader therefore should not consider the following list of risk factors to be an exhaustive statement of all risks, uncertainties or potentially inaccurate assumptions.

The Company cautions the reader to consider carefully these factors as well as the specific factors discussed with each specific forward-looking statement in this Form 10-K annual report and in the Company's other filings with the

Securities and Exchange Commission (the “SEC”). In some cases, these factors have impacted, and in the future (together with other unknown factors) could impact, the Company’s ability to implement the Company’s business strategy and may cause actual results to differ materially from those contemplated by such forward-looking statements. Any expectation, estimate or projection contained in a forward-looking statement may not be achieved. The Company also cautions the reader that forward-looking statements speak only as of the date made. The Company undertakes no obligation to update any forward-looking statement, but investors are advised to consult any further disclosures by the Company on this subject in the Company’s filings with the SEC. Although it is not possible to create a comprehensive list of all factors that may cause actual results to differ from the Company’s forward-looking statements, the material factors



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include, without limitation, the following:

The holder of debt incurred by the Company in connection with its acquisition of BHH intends to declare the entire amount in default.

On May 11, 2012, the holder of debt incurred by the Company in connection with its acquisition of BHH informed the Company that it intends to declare the entire amount in default, seek a judgment from a French Court and then enforce the Company's guarantee for payment. Consequently, the Company has recorded the entire debt of \$4,149,516 as a current liability. The Company will not be able to pay the debt in its current form from existing resources. The Company will need to explore all potential options including raising additional funds or selling certain assets in order to pay the debt; there is no guarantee that the Company will be able to successfully achieve these options. The Company's ability to continue as a going concern is dependent upon reaching a reasonable resolution with the debt holder or the ability to access funds to satisfy the debt obligation, as well as the other factors set forth under "Management's Discussion and Analysis—Debt History; – Continuing Operations" of this Form 10-K Report. Due to the Company's history of operating losses, the Company's auditors are uncertain that the Company will be able to continue as a going concern.

The financial statements included in this report have been prepared assuming that the Company will continue as a going concern. The independent auditors' report issued in conjunction with the financial statements for the year ended June 30, 2012 contains an explanatory paragraph indicating that certain matters (see footnote 1 to the Consolidated Financial Statements) raise substantial doubt about the Company's ability to continue as a going concern. The Company cannot guarantee that it can generate net income, increase revenues or successfully expand its operations in the future, and if it cannot do so, the Company may not be able to survive, and any investment in the Company may be lost.

The Company continues to operate under an austerity plan to stem the recurring losses at Drew (see footnote 15 of the June 30, 2012 consolidated financial statements for additional information on the austerity plan). If the Company is unable to achieve improvement in this area in the near term, it is not likely that the Company's existing cash and cash flow from operations will be sufficient to fund activities throughout the next 4 to 6 months without curtailing certain business activities. The Company's forecast of the period of time through which its financial resources will be adequate to support its operations is a forward-looking statement and involves risks and uncertainties, and actual results could vary as a result of a number of other factors, including the factors discussed in these risk factors, including the risk that the holder of debt the Company incurred in connection with its acquisition of BHH will be declared in default.

Because the Company's auditors have expressed a going concern qualification, the Company's ability to obtain additional financing could be adversely affected.

Because of continued losses, negative cash flows and debt payments, the Company has included going concern disclosure in Note 1 to its consolidated financial statements included in this report, addressing substantial doubt about the Company's ability to continue as a going concern. This going concern disclosure could adversely affect the Company's ability to obtain favorable financing terms in the future or to obtain any additional financing if needed. If the Company raises funds in the future, it may be required to raise those funds through public or private financings, strategic relationships or other arrangements at prices or other terms that may not be as favorable as they would absent such qualification. The sale of additional equity and debt securities may result in additional dilution to the Company's stockholders. Additional financing may not be available in amounts or on terms acceptable to the Company or at all. The Company continues to have recurring losses from prior acquisitions.

Since the acquisition of Drew the Company loaned approximately \$29.5 million to Drew. The funds were primarily used to procure components to build up inventory to support the manufacturing process, to pay off accounts payable and debt of Drew, and to expand the sales and marketing and research and development efforts, to fund new product development and underwrite operating losses since its acquisition. The Company cannot rule out that further working capital will be required by Drew. If the Company does not realize the expected benefits or synergies of such transactions, the Company's consolidated financial position, results of operations and stock price will be negatively

impacted.

Any acquisitions, strategic alliances, joint ventures and divestitures that the Company effects, if any, could result in financial results that differ from market expectations.

In the normal course of business, the Company engages in discussions with third parties regarding possible acquisitions,

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strategic alliances, joint ventures and divestitures. As a result of any such transactions, of which the Company cannot assure that any will occur, the Company's financial results may differ from the investment community's expectations in a given quarter. In addition, acquisitions and alliances may require the Company to integrate a different company culture, management team, business infrastructure, accounting systems and financial reporting systems. The Company may not be able to effect any such acquisitions or alliances. The Company may have difficulty developing, manufacturing and marketing the products of a newly acquired business in a way that enhances the performance of the Company's combined businesses or product lines to realize the value from any expected synergies. Depending on the size and complexity of an acquisition, the Company's successful integration of the entity depends on a variety of factors, including the retention of key employees and the management of facilities and employees in separate geographical areas. These efforts require varying levels of management resources, which may divert the Company's attention from other business operations. Also, the Company's results may be adversely impacted because of acquisition-related costs, amortization costs for certain intangible assets and impairment losses related to goodwill in connection with such transactions. Finally, acquisitions or alliances by the Company may not occur, which could impair the Company's growth.

The Company's results fluctuate from quarter to quarter.

The Company has experienced quarterly fluctuations in operating results and anticipates continued fluctuations in the future. A number of factors contribute to these fluctuations:

• Acquisitions, such as Drew and JAS and subsequent integration of the acquired business;

• The timing and expense of new product introductions by the Company or its competitors, although the Company might not successfully develop new products and any such new products may not gain market acceptance;

• The cancellation or delays in the purchase of the Company's products;

• Fluctuations in customer demand for the Company's products;

• Changes in domestic and foreign regulations;

• The gain or loss of significant customers;

• Changes in the mix of products sold by the Company;

• Competitive pressures on prices at which the Company can sell its products;

• Announcements of new strategic relationships by the Company or its competitors;

• Fluctuations in royalty income;

• Litigation costs and settlements; and

• General economic conditions and other external factors such as energy costs.

The Company sets its spending levels in advance of each quarter based, in part, on the Company's expectations of product orders and shipments during that quarter. A shortfall in revenue, therefore, in any particular quarter as compared to the Company's plan could have a material adverse impact on the Company's results of operations and cash flows. Also, the Company's quarterly results could fluctuate due to general market conditions in the healthcare industry or global economy generally, or market volatility unrelated to the Company's business and operating results. The Company's cost saving initiatives may not be effective, and the Company's ability to develop products could be adversely affected by reduced research and development.

The Company continues to undertake cost-saving initiatives that may not be effective in returning the Company to profitability. If these initiatives are insufficient, additional measures may be necessary. The cost savings initiatives include a reduction in research and development expenses, which could hinder the Company's ability to update or introduce new products.

Failure of the market to accept the Company's products could adversely impact the Company's business and financial condition.

The Company's business and financial condition will depend in part upon the market acceptance of the Company's products. The Company's products may not achieve market acceptance. Market acceptance depends on a number of factors including:

• The price of the products;

• The continued receipt of regulatory approvals for multiple indications;

- The establishment and demonstration of the clinical safety and efficacy of the Company's products;  
and

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¶The advantages of the Company's products over those marketed by the Company's competitors.

Any failure to achieve significant market acceptance of the Company's products will have a material adverse impact on the Company's business.

The Company's products are subject to stringent ongoing regulation by the FDA and similar domestic and foreign health care regulatory authorities, and if the regulatory approvals or clearances of the Company's products are restricted or revoked, the Company could face delays that would impair the Company's ability to generate funds from operations.

The FDA and similar health care regulatory authorities in foreign countries extensively regulate the Company's activities. The Company must obtain either 510(K) clearances or pre-market approvals and new drug application approvals prior to marketing any products in the United States. Foreign regulation also requires that the Company obtain other approvals from foreign government agencies prior to the sale of products in those countries. Also, the Company may be required to obtain FDA approval before exporting a product or device that has not received FDA marketing clearance or approval.

The Company has received the necessary FDA approvals for all products that the Company currently markets in the United States. Any restrictions on or revocation of the FDA approvals and clearances that the Company has obtained, however, would prevent the continued marketing of the impacted products and other devices. The restrictions or revocations could result from the discovery of previously unknown problems with the product. Consequently, FDA revocation would impair the Company's ability to generate funds from operations.

The FDA and comparable agencies in state and local jurisdictions and in foreign countries impose substantial requirements upon the manufacturing and marketing of pharmaceutical and medical device equipment and related disposables, including the obligation to adhere to the FDA's Good Manufacturing Practice regulations. Compliance with these regulations requires time-consuming detailed validation of manufacturing and quality control processes, FDA periodic inspections and other procedures. If the FDA finds any deficiencies in the validation processes, for example, the FDA may impose restrictions on marketing the specific products until such deficiencies are corrected. The Company has received CE approval on several of the Company's products that allows the Company to sell the products in the countries comprising the European Community. In addition to the CE mark, however, some foreign countries may require separate individual foreign regulatory clearances. The Company may not be able to obtain regulatory clearances for other products in the United States or foreign markets.

The process for obtaining regulatory clearances and approvals underlying clinical studies for any new products or devices and for multiple indications for existing products is lengthy and will require substantial commitments of Company's financial resources and Company's management's time and effort. Any delay in obtaining clearances or approvals or any changes in existing regulatory requirements would materially adversely impact the Company's business.

The Company's failure to comply with the applicable regulations would subject the Company to fines, delays or suspensions of approvals or clearances, seizures or recalls of products, operating restrictions, injunctions or civil or criminal penalties, which would adversely impact the Company's business, financial condition and results of operations.

The success of products with which the Company's products compete could have an adverse impact on the Company's business.

The Company faces intense competition in the medical device and pharmaceutical markets, which are characterized by rapidly changing technology, short product life cycles, cyclical oversupply and rapid price erosion. Many of the Company's competitors have substantially greater financial, technical, marketing, distribution and other resources. The Company's strategy is to compete primarily on the basis of technological innovation, reliability, quality and price of the Company's products. Without timely introductions of new products and enhancements, the Company's products will become technologically obsolete over time, in which case the Company's revenues and operating results would suffer. The success of the Company's new product offerings will depend on several factors, including the Company's ability to:

- Properly identify customer needs;
- Innovate and develop new technologies, services and applications;
- Establish adequate product distribution coverage;
- Obtain and maintain required regulatory approvals from the FDA and other regulatory agencies;

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- Protect the Company's intellectual property;
- Successfully commercialize new technologies in a timely manner;
- Manufacture and deliver the Company's products in sufficient volumes on time;
- Differentiate the Company's offerings from the offerings of the Company's competitors;
- Price the Company's products competitively;
- Anticipate competitors' announcements of new products, services or technological innovations; and
- Anticipate general market and economic conditions.

The Company may not be able to compete effectively in the competitive environments in which the Company operates.

The Company's products employ proprietary technology, and this technology may infringe on the intellectual property rights of third parties.

The Company holds several United States and foreign patents for the Company's products. Other parties, however, hold patents relating to similar products and technologies. If patents held by others were adjudged valid and interpreted broadly in an adversarial proceeding, the court or agency could deem them to cover one or more aspects of the Company's products or procedures. Any claims for patent infringements or claims by the Company for patent enforcement would consume time, result in costly litigation, divert technical and management personnel or require the Company to develop non-infringing technology or enter into royalty or licensing agreements. The Company may become subject to one or more claims for patent infringement. The Company may not prevail in any such action, and the Company's patents may not afford protection against competitors with similar technology.

If a court determines that any of the Company's products infringes, directly or indirectly, on a patent in a particular market, the court may enjoin the Company from making, using or selling the product. Furthermore, the Company may be required to pay damages or obtain a royalty-bearing license, if available, on acceptable terms.

Lack of availability of key system components could result in delays, increased costs or costly redesign of the Company's products.

Although some of the parts and components used to manufacture the Company's products are available from multiple sources, the Company currently purchases most of the Company's components and outsourced finished goods from single sources in an effort to obtain volume discounts. Lack of availability of any of these parts, components and finished goods could result in production delays, increased costs or costly redesign of the Company's products. Any loss of availability of an essential component or finished good could result in a material adverse change to the Company's business, financial condition and results of operations. Some of the Company's suppliers are subject to the FDA's Good Manufacturing Practice regulations. Failure of these suppliers to comply with these regulations could result in the delay or limitation of the supply of parts or components to the Company, which would adversely impact the Company's financial condition and results of operations.

The Company's ability to market or sell the Company's products may be adversely impacted by limitations on reimbursements by government programs, private insurance plans and other third party payers.

The Company's customers bill various third party payers, including government programs and private insurance plans, for the health care services provided to their patients. Third party payers may reimburse the customer, usually at a fixed rate based on the procedure performed, or may deny reimbursement if they determine that the use of the Company's products was elective, unnecessary, inappropriate, not cost-effective, experimental or used for a non-approved indication. Third party payers may deny reimbursement notwithstanding FDA approval or clearance of a product and may challenge the prices charged for the medical products and services. The Company's ability to sell the Company's products on a profitable basis may be adversely impacted by denials of reimbursement or limitations on reimbursement, compared with reimbursement available for competitive products and procedures. New legislation that further reduces reimbursements under the capital cost pass-through system utilized in connection with the Medicare program could also adversely impact the marketing of the Company's products.

Future legislation or changes in government programs may adversely impact the market for the Company's products. From time to time, the federal government and Congress have made proposals to change aspects of the delivery and financing of health care services. The Company cannot predict what form any future legislation or regulation may take

or its impact on the Company's business. Legislation that sets price limits and utilization controls adversely impact the rate of growth of the markets in which the Company participates. If any future health care legislation or regulations were to adversely impact

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those markets, the Company's product marketing could also suffer, which would adversely impact the Company's business.

The Company may become involved in product liability litigation, which may subject the Company to liability and divert management attention.

The testing and marketing of the Company's products entails an inherent risk of product liability, resulting in claims based upon injuries or alleged injuries or a failure to diagnose associated with a product defect. Some of these injuries may not become evident for a number of years. Although the Company is not currently involved in any product liability litigation, the Company may be party to litigation in the future as a result of an alleged claim. Litigation, regardless of the merits of the claim or outcome, could consume a great deal of the Company's time and attention away from the Company's core businesses. The Company maintains limited product liability insurance coverage of \$1,000,000 per occurrence and \$2,000,000 in the aggregate, with umbrella policy coverage of \$5,000,000 in excess of such amounts. A successful product liability claim in excess of any insurance coverage may adversely impact the Company's financial condition and results of operations. The Company's product liability insurance coverage may not continue to be available to the Company in the future on reasonable terms or at all.

The Company's international operations could be adversely impacted by changes in laws or policies of foreign governmental agencies and social and economic conditions in the countries in which the Company operates.

The Company derives a portion of its revenue from sales outside the United States. Changes in the laws or policies of governmental agencies, as well as social and economic conditions, in the countries in which the Company operates could impact the Company's business in these countries and the Company's results of operations. Also, economic factors, including inflation and fluctuations in interest rates and foreign currency exchange rates, and competitive factors such as price competition, business combinations of competitors or a decline in industry sales from continued economic weakness, both in the United States and other countries in which the Company conducts business, could adversely impact the Company's results of operations.

The Company is dependent on its management and key personnel to succeed.

The Company's principal executive officers and technical personnel have extensive experience with the Company's products, the Company's research and development efforts, the development of marketing and sales programs and the necessary support services to be provided to the Company's customers. Also, the Company competes with other companies, universities, research entities and other organizations to attract and retain qualified personnel. The loss of the services of any of the Company's executive officers or other technical personnel, or the Company's failure to attract and retain other skilled and experienced personnel, could have a material adverse impact on the Company's ability to maintain or expand businesses.

The market price of the Company's stock has historically been volatile, and the Company has not paid cash dividends. The volatility of the Company's common stock imposes a greater risk of capital losses on shareholders as compared to less volatile stocks. In addition, such volatility makes it difficult to ascribe a stable valuation to a shareholder's holdings of the Company's common stock. The following factors have and may continue to have a significant impact on the market price of the Company's common stock:

• Acquisitions, strategic alliances, joint ventures and divestitures that the Company effects, if any;

• Announcements of technological innovations;

• Changes in marketing, product pricing and sales strategies or new products by the Company's competitors;

• Changes in domestic or foreign governmental regulations or regulatory requirements; and

• Developments or disputes relating to patent or proprietary rights and public concern as to the safety and efficacy of the procedures for which the Company's products are used.

Moreover, the possibility exists that the stock market, and in particular the securities of technology companies such as the Company, could experience extreme price and volume fluctuations unrelated to operating performance.

The Company has not paid cash dividends on its common stock and does not anticipate paying cash dividends in the foreseeable future.

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Company is not in compliance with Nasdaq listing requirements.

As of June 30, 2012, the Company was not in compliance with these continued listing requirements. On February 15, 2012, the Company received a letter from the Listing Qualifications Staff of the NASDAQ Stock Market (the "Staff") notifying the Company that it did not comply with the minimum \$2,500,000 stockholders' equity requirement for continued listing on the NASDAQ Capital Market as set forth in Listing Rule 5550(b). The Company submitted a plan to regain compliance within the 45 calendar days from February 15, 2012 as required by NASDAQ rules. The Staff accepted the Company's plan to regain compliance and granted the Company until August 13, 2012 to successfully implement it. The Company was unable to successfully implement its compliance plan by the August 13, 2012 deadline. The Company has scheduled a hearing before the Staff to explain its plan for regaining compliance with the listing requirements. The hearing is scheduled for October 4, 2012.

In addition, on June 29, 2012, the Company received a letter from the Listing Qualifications Staff indicating that the Company is not in compliance with the \$1.00 minimum closing bid price requirement under the NASDAQ Listing Rules (the "Listing Rules"). The Listing Rules require listed securities to maintain a minimum bid price of \$1.00 per share. If a NASDAQ-listed company trades below the minimum bid price requirement for 30 consecutive business days, it is notified of the deficiency. Based upon the Staff's review, the Company no longer meets this requirement. The Listing Rules provide the Company with a compliance period of 180 calendar days, or until December 26, 2012 in which to regain compliance with this requirement.

To regain compliance with the minimum bid price requirement, the Company must have a closing bid price of \$1.00 per share or more for a minimum of ten consecutive business days during this compliance period. In the event that the Company does not regain compliance within this period, it may be eligible for additional time to regain compliance by satisfying certain requirements. However, if it appears to the Staff that the Company will not be able to cure the deficiency, or if the Company is otherwise not eligible, the Staff will notify the Company that its securities will be delisted from the NASDAQ Capital Market. The Company may still appeal the Staff's determination to delist its securities to a Hearing Panel. During any appeal process, the Company's common stock would continue to trade on the NASDAQ Capital Market. The NASDAQ notification letter has no immediate effect on the listing or trading of the Company's common stock on the NASDAQ Capital Market. The Company is currently looking at all of the options available with respect to regaining such compliance.

If the Company's Nasdaq listing is terminated the Company will be traded on the OTC Bulletin Board.

The impact of terrorism or acts of war could have a material adverse impact on the Company's business.

Terrorist acts or acts of war, whether in the United States or abroad, could cause damage or disruption to the Company's operations, its suppliers, channels to market or customers, or could cause costs to increase, or create political or economic instability, any of which could have a material adverse impact on the Company's business. The Company's charter documents and Pennsylvania law may inhibit a takeover.

Certain provisions of Pennsylvania law and the Company's Bylaws could delay or impede the removal of incumbent directors and could make it more difficult for a third party to acquire, or discourage a third party from attempting to acquire, control of the Company. These provisions could limit the share price that certain investors might be willing to pay in the future for shares of the Company's common stock. The Company's Board of Directors is divided into three classes, with directors in each class elected for three-year terms. The Bylaws impose various procedural and other requirements that could make it more difficult for shareholders to effect certain corporate actions. The Company's Board of Directors may issue shares of preferred stock without shareholder approval on such terms and conditions, and having such rights, privileges and preferences, as the Board may determine. The rights of the holders of common stock will be subject to, and may be adversely impacted by, the rights of the holders of any preferred stock that may be issued in the future. The Company has no current plans to issue any shares of preferred stock.

There are inherent uncertainties involved in estimates, judgments and assumptions used in the preparation of financial statements in accordance with United States GAAP. Any changes in estimates, judgments and assumptions used could have a material adverse effect on the Company's business, financial position and operating results.

The consolidated financial statements included in the periodic reports the Company files with the SEC are prepared in accordance with accounting principles generally accepted in the United States of America, or GAAP. The preparation of financial statements in accordance with GAAP involves making estimates, judgments and assumptions that affect

reported amounts of assets (including intangible assets), liabilities and inventories and related valuation allowances, revenues, expenses and income. This includes estimates, judgments and assumptions for assessing the recoverability of the Company's goodwill and other intangible assets, pursuant to Financial Accounting Standards Board ("FASB") issued authoritative guidance. If any estimates, judgments or assumptions change in the future, the Company may be required to record additional expenses or impairment charges. Any resulting expense or impairment loss would be recorded as a charge against our earnings and could

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have a material adverse impact on our financial condition and operating results. Estimates, judgments and assumptions are inherently subject to change in the future, and any such changes could result in corresponding changes to the amounts of assets (including goodwill and other intangible assets), liabilities, revenues, expenses and income. Any such changes could have a material adverse effect on the Company's financial position and operating results.

On an on-going basis, the Company evaluates its estimates, including, among others, those relating to:

- sales returns;
- allowances for doubtful accounts;
- inventories and related valuation allowances;
- intangible assets and goodwill;
- income and other tax accruals;
- deferred tax asset valuation allowances;
- sales discounts;
- warranty obligations; and
- accrued lease termination costs
- contingencies and litigation.

The Company bases its estimates on historical experience and on various other assumptions that the Company believes to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. The Company's assumptions and estimates may, however, prove to have been incorrect and the Company's actual results may differ from these estimates under different assumptions or conditions. While the Company believes the assumptions and estimates it makes are reasonable, any changes to the Company's assumptions or estimates, or any actual results which differ from the Company's assumptions or estimates, could have a material adverse effect on the Company's financial position and operating results.

Healthcare policy changes, including pending proposals to reform the U.S. healthcare system, may have a material adverse effect on the Company.

Healthcare costs have risen significantly over the past decade. There have been and continue to be proposals by legislators, regulators and third-party payors to keep these costs down. Certain proposals, if passed, would impose limitations on the prices the Company will be able to charge for the Company's products, or the amounts of reimbursement available for its products from governmental agencies or third-party payers. These limitations could have a material adverse effect on the Company's financial position and results of operations.

Changes in the healthcare industry in the U.S. and elsewhere could adversely affect the demand for the Company's products as well as the way in which the Company conducts the Company's business. On March 23, 2010, health reform legislation was approved by Congress and has been signed into law. The reform legislation provides that most individuals must have health insurance, will establish new regulations on health plans, and create insurance pooling mechanisms and other expanded public health care measures.

The Company anticipates that out of the reform legislation will come a reduction in Medicare spending on services provided by hospitals and other providers and a form of sales or excise tax on the medical device manufacturing sector. Various healthcare reform proposals have also emerged at the state level. The Company cannot predict what healthcare initiatives, if any, will be implemented at the federal or state level, or the effect any future legislation or regulation will have on the Company. However, an expansion in government's role in the U.S. healthcare industry may lower reimbursements for the Company's products, reduce medical procedure volumes and adversely affect the Company's business, possibly materially.

**ITEM 1B. UNRESOLVED STAFF COMMENTS**

The Company does not believe there are any unresolved SEC staff comments.

ITEM 2. PROPERTIES

The Company currently leases an aggregate of 112,594 square feet of space for its (i) corporate offices in Wayne,

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Pennsylvania, (ii) Drew's administrative offices and/or manufacturing facilities in Barrow-in-Furness, United Kingdom, Dallas, Texas, Miami, Florida and Waterford, Connecticut, (iii) Sonomed has a manufacturing facility in Lake Success, New York, and (iv) Trek's distribution facility in New Berlin, Wisconsin, and (v) EMI's product design and development facility in Lawrence, Massachusetts. The corporate office lease in Pennsylvania is comprised of 5,854 square feet and expires in July 2013. The facility in the United Kingdom is comprised of 2,508 square feet whose lease expired in January 2011 and is now a month to month lease. The facility in Texas is comprised of 22,992 square feet whose lease expires in March 2014. The Company also has a facility in Rennes, France that is comprised of 31,215 square feet and expires in December 2017. BHH was put in liquidation during 2012, the Company recognized a liability for the difference between our future lease payments obligation and related costs from the date of year end through the end of the remaining lease term, net of contractual or estimated sublease rental income. The Company recognized accrued lease termination cost of \$338,145 as of June 30, 2012. Inherent in the calculation of accrued lease termination costs are significant management judgments and estimates, including estimates of the amount and timing of future sublease revenues and the timing and duration of future vacancy periods. We will review these judgments and estimates on a quarterly basis and make appropriate revisions. The Miami facility lease is comprised of 20,000 square feet and expires in December 2013. The Connecticut facility lease is comprised of 3,150 square feet and expires in November 2012. The New York facility lease covering 12,173 square feet expires in August 2017. The Wisconsin lease, covering 11,250 square feet of space expires in December 2015. The Massachusetts lease, covering 3,452 square feet expires in August 2015. Annual rent under all of the Company's property lease arrangements was approximately \$890,000 from continuing operations for the year ended June 30, 2012.

## ITEM 3. LEGAL PROCEEDINGS

The Company, from time to time is involved in various legal proceedings and disputes that arise in the normal course of business. These matters have previously and could pertain to intellectual property disputes, commercial contract disputes, employment disputes, and other matters. The Company does not believe that the resolution of any of these matters has had or is likely to have a material adverse impact on the Company's business, financial condition or results of operations.

## ITEM 4. MINE SAFETY DISCLOSURES

Not applicable

## PART II.

## ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

The Company's common stock trades on the NASDAQ Capital Market under the symbol "ESMC." The table below sets forth, for the periods indicated, the high and low sales prices as quoted on the NASDAQ Capital Market.

	High	Low
Fiscal year ended June 30, 2012		
Quarter ended September 30, 2011	\$ 1.35	\$ 1.10
Quarter ended December 31, 2011	\$ 1.29	\$ 1.00
Quarter ended March 31, 2012	\$ 1.13	\$ 0.78
Quarter ended June 30, 2012	\$ 1.40	\$ 0.52
Fiscal year ended June 30, 2011		
Quarter ended September 30, 2010	\$ 1.85	\$ 1.45
Quarter ended December 31, 2010	\$ 1.59	\$ 1.25
Quarter ended March 31, 2011	\$ 1.78	\$ 0.68

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Quarter ended June 30, 2011

\$1.38

\$0.85

As of September 25, 2012, there were 1,715 holders of record of the Company's common stock. On September 25, 2012 the closing price of the Company's Common Stock as reported by the NASDAQ Capital Market was \$0.40 per share.

The Company has never declared or paid a cash dividend on its common stock and presently intends to retain any future earnings to finance future growth and working capital needs.

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ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis should be read together with the consolidated financial statements and notes thereto and other financial information contained elsewhere in this Form 10-K and the discussion under "Risk Factors" included in Item IA of this Form 10-K.

The Company's continuing operations is primarily in three business segments. ECD, Sonomed-Escalon, Escalon Medical Corp. Certain assets of the Vascular business were sold for \$5,750,000 on April 30, 2010 to Vascular Solutions, Inc. (see footnote 11 of the Company's June 30, 2012 annual consolidated financial statements for additional information).

ECD is a diagnostics company specializing in the design, manufacture and distribution of instruments for blood cell counting and blood analysis. ECD is focused on providing instrumentation and consumables for the physician office and veterinary office laboratories. ECD also supplies the reagent and other consumable materials needed to operate the instruments. ECD added to its reagent business with the May 29, 2008 purchase of JAS and on December 31, 2008 BHH acquired certain assets of BioCode. BHH was deconsolidated beginning in the December 31, 2011 quarterly consolidated financial statements after Drew lost control of BHH (see footnote 11 of the Company's June 30, 2012 annual consolidated financial statements for additional information).

Sonomed-Escalon segment consists of the operations of Sonomed, EMI, and Trek. Sonomed develops, manufactures and markets ultrasound systems used for diagnosis or biometric applications in ophthalmology. Trek develops, manufactures and distributes ophthalmic surgical products under the Trek Medical Products names. EMI manufactures and markets digital camera systems for ophthalmic fundus photography.

The Escalon Medical Corp. business segment includes the administrative corporate operations of the consolidated group.

For a more complete description of these businesses and their products, see Item 1—Description of Business.

Executive Overview—Fiscal Years Ended June 30, 2012 and 2011

The following highlights are discussed in further detail within this Form 10-K. The reader is encouraged to read this Form 10-K in its entirety to gain a more complete understanding of factors impacting Company performance and financial condition.

Product revenue from continuing operations decreased approximately \$1,128,000 or 4.4% during the fiscal year ended June 30, 2012 as compared to the prior fiscal year. The decrease is related to decreased sales in the Company's ECD segment, which decreased approximately 5.3%, and decreased sales in Sonomed-Escalon segment of 3.4%.

Cost of goods sold as a percentage of product revenue from continuing operations decreased to approximately 62.1% of product revenues during the fiscal year ended June 30, 2012, as compared to approximately 67.4% of product revenue for the prior fiscal year. This decrease is related to the continued outsourcing of instrument manufacturing, to higher inventory write-offs in the prior year at ECD's Dallas facility and a change in the product mix favoring higher margin products at Sonomed-Escalon.

Operating expenses decreased approximately 6.3% during the fiscal year ended June 30, 2012, as compared to the prior fiscal year. This was due to decreased marketing, general and administrative expenses of 6.1% and a decrease of 7.6% in research and development related to the completion of research and development projects in the prior year at both ECD and Sonomed-Escalon.

Results of Operations

Fiscal Years Ended June 30, 2012 and 2011

The following table shows consolidated product revenue by business segment, as well as identifying trends in business segment product revenues for the fiscal years ended June 30, 2012 and 2011. Table amounts are in thousands:



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	Fiscal Years Ended June 30,		% Change
	2012	2011	
Product Revenue:			
ECD	\$12,985	\$13,708	(5.3)%
Sonomed-Escalon	11,462	11,867	(3.4)%
Total	\$24,447	\$25,575	(4.4)%

Consolidated product revenue from continuing operations decreased approximately \$1,128,000 or 4.4%, to \$24,447,000 during the year ended June 30, 2012 as compared to the last fiscal year.

In the ECD segment, product revenue decreased \$723,000 or 5.3% to \$12,985,000 during the year ended June 30, 2012 as compared to last fiscal year. The decrease is related to the decreased availability of Drew's Excell 2280, DS360 and DS5 instruments during the year ended June 30, 2012. Drew has committed to a plan to outsource all of its instrument manufacturing and closing its manufacturing facility in Dallas. During the year ended June 30, 2012 the DS5 and the DS360 were successfully outsourced to an equipment manufacturer in Missouri, as such, Drew expects to see an increase in the availability of these instruments for sale in the coming year. Drew is continuing to seek out an outsource partner for the Excell 2280 and the Hemavet. The Hemavet remains in full production at our Dallas facility and Drew anticipates having Hemavets available for sale adequate to cover demand for these instruments until an outsource partner is identified. The availability of Excell 2280 instruments in quantities necessary to meet demand will be limited until Drew identifies an outsource partner.

In the Sonomed-Escalon segment, product revenue decreased \$405,000, or 3.4%, to \$11,462,000 during the year ended June 30, 2012, as compared to the last fiscal year. The decrease in revenue is attributed to the decreased sales in Sonomed's ultrasound products related to decreased demand in both domestic and international markets and a decrease in EMI's digital imaging camera's and AXIS image management systems.

The following table presents consolidated cost of goods sold by reportable business segment and as a percentage of related segment product revenues for the fiscal years ended June 30, 2012 and 2011. Table amounts are in thousands:

	Fiscal Years Ended June 30,			
	2012	%	2011	%
Cost of Goods Sold:				
ECD	\$9,416	72.5	% \$10,775	78.6
Sonomed-Escalon	5,760	50.3	% 6,475	54.6
Total	\$15,176	62.1	% \$17,250	67.4

Consolidated cost of goods sold from continuing operations totaled approximately \$15,176,000, or 62.1%, of product revenue from continuing operations, for the fiscal year ended June 30, 2012, as compared to \$17,250,000, or 67.4%, of product revenue from continuing operations, for the prior fiscal year.

Cost of goods sold in the ECD segment totaled \$9,416,000, or 72.5% of product revenue for the fiscal year ended June 30, 2012, as compared to \$10,775,000, or 78.6% of product revenue, for the prior fiscal year. The decrease in cost of goods sold as a percentage of product revenue is related to the continuing process of outsourcing manufacturing and closing the Dallas facility and to higher inventory write-offs in the prior year. Drew is continuing to seek out a viable outsourcing partner to manufacture the Hemavet and the Excell 2280. Drew anticipates outsourcing the remaining manufacturing activities at its Dallas facility by December 31, 2012.

Cost of goods sold in the Sonomed-Escalon business segment totaled \$5,760,000, or 50.3% of product revenue, for the fiscal year ended June 30, 2012, as compared to \$6,475,000, or 54.6% of product revenue, for the prior fiscal year. The decrease of 4.3% in cost of goods sold as a percentage of revenue is due mainly to the product mix sold during the current period with increased sales in the higher margin Axis image management system and PacScan Plus.

The following table presents consolidated marketing, general and administrative expenses as well as identifying trends in business segment marketing, general and administrative expenses for the fiscal years ended June 30, 2012 and 2011. Table amounts are in thousands:



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	Fiscal Years Ended June 30,		% Change	
	2012	2011		
Marketing, General and Administrative:				
ECD	\$3,983	\$4,779	(16.7	)%
Sonomed-Escalon	3,066	2,822	8.6	%
Escalon Medical	2,975	3,077	(3.3	)%
Total	\$10,024	\$10,678	(6.1	)%

Consolidated marketing, general and administrative expenses from continuing operations decreased \$654,000, or 6.1%, to \$10,024,000 during the fiscal year ended June 30, 2012, as compared to the prior fiscal year.

Marketing, general and administrative expenses in the ECD business segment decreased \$796,000, or 16.7% of product revenue for the fiscal year ended June 30, 2012 to \$3,983,000, as compared to the same period last fiscal year. The continued decrease is related to the ongoing implementation of an outsourcing plan concerning the manufacturing facility in Dallas. The Dallas facility has been downsized to Hemavet and spare parts production only. The marketing, general and administrative expenses required to maintain the facility declined significantly as production activities declined.

Marketing, general and administrative expenses in the Sonomed-Escalon business segment increased \$244,000, or 8.6%, to \$3,066,000, as compared to the same period last fiscal year. The increase is due to an increase in sales people and related sales and marketing expenses.

Marketing, general and administrative expenses in the corporate decreased \$102,000, or 3.3% to \$2,975,000, as compared to the same period last fiscal year. The decrease is due to decreased expense in accounting, investor relations, director fees related to stock options and depreciation.

The following table presents consolidated research and development expenses from continuing operations by reportable business segment and as a percentage of related segment product revenues for the fiscal years ended June 30, 2012 and 2011.

Table amounts are in thousands:

	Fiscal Years Ended June 30,		% Change	
	2012	2011		
Research and Development:				
ECD	\$476	\$726	(34.4	)%
Sonomed Escalon	1,005	877	14.6	%
Total	\$1,481	\$1,603	(7.6	)%

Consolidated research and development expenses from continuing operations decreased \$122,000, or 7.6% of product revenue, to \$1,481,000 during the fiscal year ended June 30, 2012, as compared to the prior fiscal year. Research and development expenses were primarily expenses associated with the planned introduction of new or enhanced products in the ECD and Sonomed-Escalon business units.

Research and development expenses in the ECD business segment decreased \$250,000, or 34.4%, to \$476,000. The reduction is related to the completion of Drew's research and development on its DS360 instrument. Current research and development activities are limited to enhancing Drew's current instrument and reagent products. All future instrument related research projects will be outsourced on an as needed basis.

Research and development expenses in the Sonomed-Escalon segment increased \$128,000, or 14.6%, to \$1,005,000, as compared to the last fiscal year. The increase is related to increased engineering staff and related expenses necessary as Sonomed-Escalon researches and develops its next generation of diagnostic ultra-sound instruments.

For the years ended June 30, 2012 and 2011 the Company had net loss from discontinued operations of \$3,287,000 and \$742,000, respectively. The current year amount for loss from discontinued operation is only related to

discontinued operation of BHH. The prior year amount for loss from discontinued operations includes a loss from discontinued operations of BHH of

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\$911,000 offset by income generated from a supply agreement with Vascular Solutions, Inc. of \$169,000.

The Company recognized a gain of \$7,000 and a loss of approximately \$70,000 related to its investment in Ocular Telehealth Management (“OTM”) during the fiscal years ended June 30, 2012 and 2011, respectively. OTM is an early stage privately held company. OTM began operations during the three-month period ended September 30, 2004. (See note 13 of the notes to the June 30, 2012 consolidated financial statements.)

Interest expense was \$344,000 and \$324,000 for the fiscal years ended June 30, 2012 and 2011, respectively. The increase is related to the accrued interest related to related-party note payable (see Note 13 of the notes to the June 30, 2012 consolidated financial statements).

During the year ended June 30, 2012 the Company incurred a loss on disposal of certain Drew assets of approximately \$87,000.

During the year ended June 30, 2011 the Company received an income tax benefit of approximately \$240,000.

**Goodwill Impairment-EMI**

At March 31, 2011 management became concerned about EMI’s performance year to date as compared to our projected budget. The projected budget included sales related to EMI’s new image management system, Axis, as well as traditional legacy digital imaging systems. A significant portion of the Axis product target market represents institutions requiring large-scale, multi-instrument solutions, which has resulted in a much longer sales cycle than the Company had originally envisioned. While the feedback from initial and potential customers of the Axis product has been positive, converting this interest into sales has not materialized to date at the levels the Company had originally projected.

EMI had also encountered unexpected lagging demand for its legacy digital imaging systems primarily due to institutions allocating a disproportionate level of their capital budgets toward purchasing Optical Coherence Tomography (“OCT”) devices. It was anticipated that the emerging OCT technology would erode legacy digital imaging product sales due to competition for budgetary resources; however, the level has been greater than originally expected and not reflected in the Company’s original projections. OCT and digital imaging technologies are complementary and it is not known whether or for how long the lower available capital budgets for digital imaging will continue. These events will negatively affect the evaluation of the future operating results and cash flows of EMI.

The Company typically tests goodwill for possible impairment on an annual basis at June 30, and at any other time events occur or circumstances indicate that the carrying amount of goodwill may be impaired. Management determined that the events discussed above warranted performing an interim test of goodwill for possible impairment during the quarter ended March 31, 2011.

The first step of the FASB ASC 350 impairment analysis consists of a comparison of the fair value of the reporting segment with its carrying amount, including the goodwill. The fair value was determined based on the income approach, which estimates the fair value based on the future discounted cash flows. Under the income approach, the Company assumed, with respect to EMI, a forecasted cash flow period of five years, long-term annual growth rates of 3% and a discount rate of 19%.

Based on the interim income approach analysis that was performed for EMI it was determined that the carrying amount of the goodwill was in excess of its respective fair value. As such, the Company was required to perform the second step analysis in order to determine the amount of the goodwill impairment. The second step analysis consisted of comparing the implied fair value of the goodwill with the carrying amount of the goodwill, with an impairment charge resulting from any excess of the carrying value of the goodwill over the implied fair value of the goodwill. Based on the second step analysis, the Company concluded that all \$905,810 of the goodwill recorded at EMI was impaired. As a result, the Company recorded a non-cash goodwill impairment charge to continuing operations totaling \$905,810 during the year ended June 30, 2011.

The determination as to whether a write-down of goodwill is necessary involves significant judgment based on short-term and long-term projections of the Company. The assumptions supporting the estimated future cash flows of the reporting segment, including profit margins, long-term forecasts, discount rates and terminal growth rates, reflect the Company’s best estimates.

Liquidity and Capital Resources

The following table presents overall liquidity and capital resources as of June 30, 2012 and 2011. Table amounts are in thousands:

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	June 30, 2012	2011		
Current Ratio:				
Current assets	\$7,880,743	\$13,262,113		
Less: Current liabilities	8,063,348	5,594,092		
Working capital	\$(182,605	) \$7,668,021		
Current ratio	1.0 to 1	2.4 to 1		
Debt to Total Capital Ratio:				
Notes payable and current maturities	\$4,449,516	\$278,278		
Long-term debt, net of current portion	—	4,506,018		
Total debt	4,449,516	4,784,296		
Total equity	644,865	6,190,132		
Total capital	\$5,094,381	\$10,974,428		
Total debt to total capital	87.3	% 43.6		%
Working Capital Position				

Working capital decreased \$7,851,000 as of June 30, 2012, and the current ratio decreased to 1.0 to 1 from 2.4 to 1 when compared to June 30, 2011. The decrease in working capital was caused primarily by the fact that the Company has recorded the entire debt of \$4,150,000 as a current liability during fiscal year 2012. Also the decrease was caused by a decrease in cash of \$624,000 to \$891,000 in 2012 from \$1,515,000 in 2011. Accounts receivable decreased by \$904,000 to \$2,898,000 in 2012 from \$3,802,000 in 2011. Net inventory decreased \$1,240,000 to \$3,783,000 in 2012 from \$5,023,000 in 2011. Assets from discontinued operation decreased \$2,775,000 from \$2,775,000 in 2011 related to the liquidation of BHH. Overall total current assets decreased \$5,381,000 to \$7,881,000 in 2012 from \$13,262,000 in 2011. Total current liabilities, which consist of all the long-term debt, related party note payable, accounts payable and accrued expenses and liabilities of discontinued operations, increased \$2,469,000 to \$8,063,000 in 2012 from \$5,594,000 in 2011.

Debt to Total Capital Ratio increased to 87.3% in 2012 from 43.6% in 2011 as a result of the reduction of the total equity of \$5,545,000 to \$645,000 in 2012 from \$6,190,000 in 2011 due mainly to the net loss of \$5,945,000.

Cash Used In or Provided By Operating Activities

During fiscal 2012, the Company used approximately \$701,000 of cash for operating activities as compared to using approximately \$515,000 for operating activities during the year ended June 30, 2011.

Cash used in operating activities during 2012 was primarily the result of the net loss of \$5,945,000 partially offset by non cash items of depreciation and amortization of \$476,000, loss of disposal of assets of \$87,000, compensation expense related to stock options of \$73,000, a decrease in accounts receivable of \$835,000, a decrease in inventory of \$1,240,000 and also were offset by the decrease in accounts payable and accrued expenses of \$369,000 and an increase in other current assets of \$161,000.

Cash used in operating activities during 2011 was primarily the result of the net loss of \$5,758,000 partially offset by non cash items of depreciation and amortization of \$571,000, goodwill impairment of \$906,000, and compensation expense related to stock options of \$111,000, loss of OTM of \$71,000, a decrease in inventory of \$605,000 and in other current and long-term assets of \$412,000, an increase in accounts payable and accrued expenses of \$709,000 and also were offset by an increase in accounts receivable of \$255,000.

Cash flow from operations also included \$273,000 used in operating activities from discontinued operations and \$1,414,000 provided by operating activities from discontinued operations for the years ended June 30, 2012 and 2011, respectively. These cash inflows will not recur in future periods.

Cash Flows Used In Investing and Financing Activities

Cash flows used in investing activities for 2012 were approximately \$79,000 related to the purchases of fixed assets. Cash flows used in investing activities for 2011 were approximately \$402,000. This amount is made up of purchases of fixed assets of \$252,000 and investment in OTM of \$45,000 from continuing operations and purchase of fixed

assets of \$105,000

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from discontinued operations.

Any necessary capital expenditures have generally been funded out of cash from operations, and the Company is not aware of any factors that would cause historical capital expenditure levels to not be indicative of capital expenditures in the future and, accordingly, does not believe that the Company will have to commit material resources to capital investment for the foreseeable future.

Cash flows provided by financing activities in the amount of \$144,000 during 2012 relate to proceeds from a related party note payable of \$300,000 and offset by the repayment of debt of \$156,000. Cash flows used in financing activities for 2011 were approximately \$122,000 related to repayment of debt.

The Company continues to operate under an austerity plan to stem the recurring losses at Drew (see footnote 15 of the statements to the consolidated financial statements for June 30, 2012). If the Company is unable to achieve improvement in this area in the near term, it is not likely that our existing cash and cash flow from operations will be sufficient to fund activities throughout the next 4 to 6 months without curtailing certain business activities. The Company's forecast of the period of time through which its financial resources will be adequate to support its operations is a forward-looking statement and involves risks and uncertainties, and actual results could vary as a result of a number of factors, including the factors discussed in "Risk Factors".

If the Company raises funds in the future, the Company may be required to raise those funds through public or private financings, strategic relationships or other arrangements at prices and other terms that may not be as favorable as they would be absent such qualification. The sale of additional equity and debt securities may result in additional dilution to the Company's shareholders. Additional financing may not be available in amounts or on terms acceptable to us or at all.

Debt History

On December 31, 2008, Drew acquired certain assets of Biocode for \$5,900,000 (4,200,000 Euros) plus acquisition costs of approximately \$300,000. The sales price was payable in cash of approximately \$324,000 (approximately 231,000 Euros) and \$5,865,000 in debt from Drew. The seller-provided financing is collateralized by certain assets of Biocode. Biocode assets were vertically integrated into the Company's clinical diagnostics business that includes Drew and JAS.

On April 29, 2011 the Company amended its seller financed debt in connection with the Biocode transaction. Under the terms of the debt refinancing, the Company agreed to pay the balance of the seller provided financing of 3,375,000 Euros by the sum per month in euros having an exchange value of \$50,000 United States Dollars as of the date of payment. Interest remained unchanged and will accrue on the outstanding amount of the purchase price at an interest rate of 7% per year on the basis of the actual days elapsed and a 365 day year. The first payment under the amended agreement was paid on May 31, 2011. Upon the 60th month after this Amendment, the Company agreed to pay the balance of the outstanding amount in euros in full in one payment. At the time of the refinancing, the current portion of our long-term debt was reduced from approximately \$2,600,000 to \$252,000.

On January 12, 2012 BH Holdings, S.A.S. ("BHH") a wholly owned subsidiary of Drew, initiated the filing of an insolvency declaration with the Tribunal de Commerce de Rennes, France ("Commercial Court"). The Commercial Court on January 18, 2012 opened the liquidation proceedings with continuation of BHH's activity for three months and named an administrator to manage BHH. Because BHH is no longer controlled by Drew it was deconsolidated in the December 31, 2011 quarterly consolidated financial statements and prior period amounts are presented as discontinued operations (see footnote 11 to the Notes to Consolidated Financial Statements for additional information). This debt was guaranteed by Escalon, and as a result of the insolvency declaration the debt has been transferred to Escalon.

On May 11, 2012, the holder of debt incurred by the Company in connection with its acquisition of BHH informed the Company that it intends to declare the entire amount in default, seek a judgment from a French Court and then enforce the Company's guarantee for payment. Consequently the Company has recorded the entire debt of \$4,149,516 as a current liability. The Company will not be able to pay the debt in its current form from existing resources. The Company will need to explore all potential options including raising additional funds or selling certain assets in order to pay the debt; there is no guarantee that the Company will be able to successfully achieve these options. The Company's ability to continue as a going concern is dependent upon reaching a reasonable resolution with the debt

holder or the ability to access funds to satisfy the debt obligation, as well as the other factors set forth under “Management’s Discussion and Analysis—Debt History; – Continuing Operations” of this Form 10-K Report.  
Forward-Looking Statement About Significant Items Likely To Impact Liquidity

The accompanying consolidated financial statements have been prepared on a going concern basis, which contemplates

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the realization of assets and the satisfaction of liabilities in the normal course of business. The Company has incurred recurring operating losses, debt payments and negative cash flows from operating activities. These conditions raise substantial doubt about the Company's ability to continue as a going concern. The consolidated financial statements for the fiscal year ended June 30, 2012 do not include any adjustments relating to the realization of the carrying value of assets or the amounts and classification of liabilities that might be necessary should we be unable to continue as a going concern. The Company's continuance as a going concern is dependent on the Company's future profitability and on the on-going support of the Company's shareholders, affiliates and creditors. In order to mitigate the going concern issues, the Company is actively pursuing business partnerships, managing the Company's continuing operations, selling certain assets and seeking capital funding on an ongoing basis via the issuance of securities and private placements. If the Company is unsuccessful in its efforts to raise additional capital in the near term, the Company may be required to significantly reduce its research, development, and administrative activities, including further reduction of its employee base.

In the normal course of business, the Company engages in discussions with third parties regarding possible acquisitions, strategic alliances, joint ventures and divestitures. As a result of any such transactions, the Company's financial results may differ from the investment community's expectations in a given quarter. In addition, acquisitions and alliances may require the Company to integrate a different company culture, management team, business infrastructure, accounting systems and financial reporting systems. The Company may not be able to effect any such acquisitions or alliances. The Company may have difficulty developing, manufacturing and marketing the products of a newly acquired business in a way that enhances the performance of the Company's combined businesses or product lines to realize the value from any expected synergies. Depending on the size and complexity of an acquisition, the Company's successful integration of the entity depends on a variety of factors, including the retention of key employees and the management of facilities and employees in separate geographical areas. These efforts require varying levels of management resources, which may divert the Company's attention from other business operations.

### Common Stock

The Company's common stock is currently listed on the NASDAQ Capital Market. In order to continue to be listed on the NASDAQ Capital Market, the following requirements must be met:

• Shareholders' equity of \$2,500,000 or market value of listed securities of \$35,000,000 or net income from continuing operations (in the latest fiscal year or two of the last three fiscal years) of \$500,000;

• 500,000 publicly held shares;

• \$1,000,000 market value of publicly held shares;

• A minimum bid price of \$1;

• 300 round lot shareholders;

• Two market makers; and

• Compliance with corporate governance standards.

As of June 30, 2012, the Company was not in compliance with these continued listing requirements. On February 15, 2012, the Company received a letter from the Listing Qualifications Staff of the NASDAQ Stock Market (the "Staff") notifying the Company that it did not comply with the minimum \$2,500,000 stockholders' equity requirement for continued listing on the NASDAQ Capital Market as set forth in Listing Rule 5550(b). The Company submitted a plan to regain compliance within the 45 calendar days from February 15, 2012 as required by NASDAQ rules. The Staff accepted the Company's plan to regain compliance and granted the Company until August 13, 2012 to successfully implement it. The Company was unable to successfully implement its compliance plan by the August 13, 2012 deadline. The Company has scheduled a hearing before the Staff to explain its plan for regaining compliance with the listing requirements. The hearing is scheduled for October 4, 2012.

In addition, on June 29, 2012, the Company received a letter from the Listing Qualifications Staff indicating that the Company is not in compliance with the \$1.00 minimum closing bid price requirement under the NASDAQ Listing Rules (the "Listing Rules"). The Listing Rules require listed securities to maintain a minimum bid price of \$1.00 per share. If a NASDAQ-listed company trades below the minimum bid price requirement for 30 consecutive business

days, it is notified of the deficiency. Based upon the Staff's review, the Company no longer meets this requirement. The Listing Rules provide the Company with a compliance period of 180 calendar days, or until December 26, 2012 in which to regain compliance with this requirement.

To regain compliance with the minimum bid price requirement, the Company must have a closing bid price of \$1.00 per share or more for a minimum of ten consecutive business days during this compliance period. In the event that the

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Company does not regain compliance within this period, it may be eligible for additional time to regain compliance by satisfying certain requirements. However, if it appears to the Staff that the Company will not be able to cure the deficiency, or if the Company is otherwise not eligible, the Staff will notify the Company that its securities will be delisted from the NASDAQ Capital Market. The Company may still appeal the Staff's determination to delist its securities to a Hearing Panel. During any appeal process, the Company's common stock would continue to trade on the NASDAQ Capital Market. The NASDAQ notification letter has no immediate effect on the listing or trading of the Company's common stock on the NASDAQ Capital Market. The Company is currently looking at all of the options available with respect to regaining such compliance.

If the Company's Nasdaq listing is terminated the Company will be traded on the OTC Bulletin Board.

### Critical Accounting Policies

The preparation of financial statements requires management to make estimates and assumptions that impact amounts reported therein. The most significant of those involve the application of FASB issued authoritative guidance concerning Revenue Recognition, Goodwill and Other Intangible Assets, discussed further in the notes to consolidated financial statements included in this Form 10-K. The financial statements are prepared in conformity with accounting principles generally accepted in the United States of America, and, as such, include amounts based on informed estimates and judgments of management. For example, estimates are used in determining valuation allowances for deferred income taxes, uncollectible receivables, obsolete inventory, sales returns and rebates warranty liabilities and purchased intangible assets. Actual results achieved in the future could differ from current estimates. The Company used what it believes are reasonable assumptions and, where applicable, established valuation techniques in making its estimates.

### Revenue Recognition

The Company recognizes revenue from the sale of its products at the time of shipment, when title and risk of loss transfer. The Company provides products to its distributors at agreed wholesale prices and to the balance of its customers at set retail prices. Distributors can receive discounts for accepting high volume shipments. The discounts are reflected immediately in the net invoice price, which is the basis for revenue recognition. No further material discounts are given.

The Company's considerations for recognizing revenue upon shipment of product to a distributor are based on the following:

- Persuasive evidence that an arrangement (purchase order and sales invoice) exists between a willing buyer (distributor) and the Company that outlines the terms of the sale (company information, quantity of goods, purchase price and payment terms). The buyer (distributor) does not have a right of return.
- Shipping terms are ex-factory shipping point. At this point the buyer (distributor) takes title to the goods and is responsible for all risks and rewards of ownership, including insuring the goods as necessary.
- The Company's price to the buyer (distributor) is fixed and determinable as specifically outlined on the sales invoice.
- The sales arrangement does not have customer cancellation or termination clauses.
- The buyer (distributor) places a purchase order with the Company; the terms of the sale are cash, COD or credit.
- Customer credit is determined based on the Company's policies and procedures related to the buyer's (distributor's) creditworthiness. Based on this determination, the Company believes that collectability is reasonably assured.

The Company assesses collectability based on creditworthiness of the customer and past transaction history. The Company performs ongoing credit evaluations of its customers and does not require collateral from its customers. For many of the Company's international customers, the Company requires an irrevocable letter of credit to be issued by the customer before the purchase order is accepted.

### Valuation of Intangible Assets

The Company annually evaluates for impairment its intangible assets and goodwill in accordance with SFAS 142, "Goodwill and Other Intangible Assets," or whenever events or changes in circumstances indicate that the carrying value may not be recoverable, see footnote 4 to consolidated financial statements included in this Form 10-K for details on a goodwill impairment charge related to the carrying amount of EMI's goodwill. These intangible assets

include goodwill, trademarks and trade names. Recoverability of these assets is measured by comparison of their carrying amounts to future discounted cash flows the assets are expected to generate. If identifiable intangibles are considered to be impaired, the impairment to be recognized equals the amount by which the carrying value of the assets exceeds its fair market value. The Company does not amortize intangible assets with indefinite useful lives, rather such assets are required to be tested for impairment at least annually or sooner whenever events or changes in circumstances indicate that the assets may be impaired. The Company



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performs its intangible asset impairment tests on or about June 30, of each year. Any such impairment charge could be significant and could have a material adverse impact on the Company's financial statements if and when an impairment charge is recorded.

### Income/(Loss) Per Share

The Company computes net income/(loss) per share under the provisions of FASB issued authoritative guidance. Under the provisions of FASB issued authoritative guidance, basic and diluted net income/(loss) per share is computed by dividing the net income/(loss) for the period by the weighted average number of shares of common stock outstanding during the period. The calculation of diluted net income/(loss) per share excludes potential common shares if the impact is anti-dilutive. Basic earnings per share are computed by dividing net income/(loss) by the weighted average number of shares of common stock outstanding during the period. Diluted earnings per share are determined in the same manner as basic earnings per share, except that the number of shares is increased by assuming exercise of dilutive stock options and warrants using the treasury stock method.

### Taxes

Estimates of taxable income of the various legal entities and jurisdictions are used in the tax rate calculation. Management uses judgment in estimating what the Company's income will be for the year. Since judgment is involved, there is a risk that the tax rate may significantly increase or decrease in any period.

In determining income/(loss) for financial statement purposes, management must make certain estimates and judgments. These estimates and judgments occur in the calculation of certain tax liabilities and in the determination of the recoverability of certain deferred tax assets, which arise from temporary differences between the tax and financial statement recognition of revenue and expense. FASB issued authoritative guidance concerning accounting for income taxes also requires that the deferred tax assets be reduced by a valuation allowance, if based on the available evidence, it is more likely that not that all or some portion of the recorded deferred tax assets will not be realized in future periods.

In evaluating the Company's ability to recover the Company's deferred tax assets, management considers all available positive and negative evidence including the Company's past operating results, the existence of cumulative losses and near-term forecasts of future taxable income that is consistent with the plans and estimates management is using to manage the underlying businesses.

Through June 30, 2012, the Company has recorded a valuation allowance against the Company's net operating losses for substantially all of the deferred tax asset due to uncertainty of their realization as a result of the Company's earnings history, the number of years the Company's net operating losses and tax credits can be carried forward, the existence of taxable temporary differences and near-term earnings expectations. The amount of the valuation allowance could decrease if facts and circumstances change that materially increase taxable income prior to the expiration of the loss carryforwards. Any reduction would reduce (increase) the income tax expense (benefit) in the period such determination is made by the Company.

The Company has adopted FASB issued guidance related to accounting for uncertainty in income taxes, which provides a comprehensive model for the recognition, measurement, and disclosure in financial statements of uncertain income tax positions that a company has taken or expects to take on a tax return. Under the FASB guidance a company can recognize the benefit of an income tax position only if it is more likely than not (greater than 50%) that the tax position will be sustained upon tax examination, based solely on the technical merits of the tax position. Otherwise, no benefit can be recognized. The tax benefits recognized are measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. Additionally, companies are required to accrue interest and related penalties, if applicable, on all tax exposures for which reserves have been established consistent with jurisdictional tax laws. The Company has elected to recognize interest expense and penalties related to uncertain tax positions as a component of its provision for income taxes.

### Stock-Based Compensation

Stock-based compensation expense for all stock-based compensation awards granted after July 1, 2006 is based on the grant-date fair value estimate in accordance with the provisions of the FASB issued guidance. The Company recognizes these compensation costs on a straight-line basis over the requisite service period of the award.

Valuations are based on highly subjective assumptions about the future, including stock price volatility and exercise patterns. The fair value of share-based payment awards was estimated using the Black-Scholes option pricing model. Expected volatilities are based on the historical volatility of the Company's stock. The Company uses historical data to estimate option exercise and employee terminations. The expected term of options granted represents the period of time that options granted are expected to be outstanding. The risk-free rate for periods within the expected life of the option is based on the U.S. Treasury

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yield curve in effect at the time of the grant.

Recently Issued Accounting Standards

In January 2010, FASB issued ASU No. 2010-06, Improving Disclosures about Fair Value Measurements. This update provides amendments to Subtopic 820-10 that requires new disclosure to include transfers in and out of Levels 1 and 2 and activity in Level 3 fair value measurements. Further, this update clarifies existing disclosures on level of disaggregation and disclosures about inputs and valuation techniques. A reporting entity should provide fair value measurement disclosures for each class of assets and liabilities and should provide disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements. Those disclosures are required for fair value measurements that fall in either Level 2 or Level 3. The new disclosures and clarifications of existing disclosures became effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. The adoption of this ASU did not have a material impact on the Company's consolidated financial statements

In April 2010, the FASB issued ASU 2010-13, "Compensation—Stock Compensation (Topic 718): Effect of Denominating the Exercise Price of a Share-Based Payment Award in the Currency of the Market in Which the Underlying Equity Security Trades," or ASU 2010-13. ASU 2010-13 provides amendments to Topic 718 to clarify that an employee share-based payment award with an exercise price denominated in currency of a market in which a substantial portion of the entity's equity securities trades should not be considered to contain a condition that is not a market, performance, or service condition. Therefore, an entity would not classify such an award as a liability if it otherwise qualifies as equity. The amendments in this Update are effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2010. The adoption of ASU 2010-13 did not have a material impact on the Company's consolidated financial statements.

In May 2011, the FASB issued ASU No. 2011-04 which provides a consistent definition of fair value in GAAP and International Financial Reporting Standards and ensures that their respective fair value measurement and disclosure requirements are the same (except for minor differences in wording and style). The amendments change certain fair value measurement principles and enhance the disclosure requirements particularly for level 3 fair value measurements. The standard will become effective for the Company during interim and annual periods beginning after December 15, 2011 and should be applied prospectively. The Company does not believe that the implementation of this standard will have a material impact on its financial position, results of operation and cash flows.

In June 2011, the FASB issued ASU No. 2011-05 which requires an entity to present all non-owner changes in stockholders' equity either in a single continuous statement of comprehensive income or in two separate but consecutive statements. ASU 2011-05 eliminates the option to present the components of other comprehensive income as part of the statement of changes in stockholders' equity. This standard will become effective for the Company in fiscal years, and interim periods within those years, beginning after December 15, 2011 and should be applied retrospectively. The Company does not believe that the implementation of this standard will have a material impact on its financial position, results of operation and cash flows.

In September 2011, the FASB issued ASU No. 2011-08, Intangibles—Goodwill and Other (Topic 350): Testing Goodwill for Impairment, which simplifies how an entity tests goodwill for impairment. Under that option, an entity no longer would be required to calculate the fair value of a reporting unit unless the entity determines, based on that qualitative assessment, that it is more likely than not that its fair value is less than its carrying amount. The amendments will be effective for the company for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011 and should be applied prospectively. The Company does not believe that the implementation of this standard will have a material impact on its financial position, results of operation and cash flows.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Escalon Medical Corp.  
Index to Consolidated Financial Statements

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and  
Shareholders of Escalon Medical Corp.

We have audited the accompanying consolidated balance sheets of Escalon Medical Corp. and Subsidiaries as of June 30, 2012 and 2011, and the related consolidated statements of operations, comprehensive loss, shareholders' equity, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Escalon Medical Corp. and Subsidiaries as of June 30, 2012 and 2011, and the consolidated results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The accompanying consolidated financial statements for the year ended June 30, 2012 have been prepared assuming that the Company will continue as a going concern. As discussed in Note 1 to the consolidated financial statements, the Company's inability to repay the debt, the related default on the debt incurred on the Biocode Hycel acquisition, continued losses from operations and negative cash flows from operating activities raise substantial doubt about the Company's ability to continue as a going concern. Management's plans concerning these matters are also described in Note 1 to the consolidated financial statements. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/ Mayer Hoffman McCann P.C.

Plymouth Meeting, Pennsylvania

September 26, 2012

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ESCALON MEDICAL CORP. AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS

	June 30, 2012	June 30, 2011
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 890,623	\$ 1,514,514
Accounts receivable, net	2,898,367	3,802,316
Inventory, net	3,782,618	5,022,499
Other current assets	309,135	148,161
Assets of discontinued operations	—	2,774,623
Total current assets	7,880,743	13,262,113
Property and equipment, net	335,607	518,880
Long-term accounts receivable	68,707	—
Goodwill	218,208	218,208
Trademarks and trade names	694,006	694,006
Patents, net	22,220	52,931
Covenant not to compete and customer lists, net	530,974	808,640
Non-current assets from discontinued operations	—	1,721,566
Total assets	\$ 9,750,465	\$ 17,276,344
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Current portion of long-term debt	\$ 4,149,516	\$ 278,278
Related party note payable	300,000	—
Accounts payable	1,350,997	1,746,951
Accrued expenses	1,924,690	1,897,441
Liabilities of discontinued operations	338,145	1,671,422
Total current liabilities	8,063,348	5,594,092
Long-term debt, net of current portion	—	4,506,018
Accrued post-retirement benefits	1,042,252	986,102
Total long-term liabilities	1,042,252	5,492,120
Total liabilities	9,105,600	11,086,212
Shareholders equity:		
Preferred stock, \$0.001 par value; 2,000,000 shares authorized; no shares issued	—	—
Common stock, \$0.001 par value; 35,000,000 shares authorized; 7,526,430 issued and outstanding	7,526	7,526
Common stock warrants	132,114	1,733,460
Additional paid-in capital	69,369,658	67,694,959
Accumulated deficit	(68,348,811	) (62,404,014
Accumulated other comprehensive loss	(515,622	) (841,799
Total shareholders' equity	644,865	6,190,132
Total liabilities and shareholders' equity	\$ 9,750,465	\$ 17,276,344
See notes to consolidated financial statements		

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ESCALON MEDICAL CORP. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF OPERATIONS

For the Years Ended June 30,	2012	2011	
Net revenues:			
Product revenue	\$24,446,525	\$25,575,276	
Revenues, net	24,446,525	25,575,276	
Costs and expenses:			
Cost of goods sold	15,175,706	17,250,273	
Marketing, general and administrative	10,024,089	10,678,655	
Research and development	1,480,769	1,602,616	
Goodwill impairment	—	905,810	
Total costs and expenses	26,680,564	30,437,354	
Loss from operations	(2,234,039	) (4,862,078	)
Other (expense) income			
Loss on disposal of assets	(86,885	) —	
Equity in Ocular Telehealth Management, LLC	7,491	(70,393	)
Interest income	137	240	
Interest expense	(344,243	) (323,611	)
Total other (expense) income	(423,500	) (393,764	)
Net loss from continuing operations before taxes	(2,657,539	) (5,255,842	)
Benefit of income taxes	—	(239,879	)
Net loss from continuing operations	(2,657,539	) (5,015,963	)
Net loss from discontinued operations	(3,287,258	) (741,685	)
Net loss	\$(5,944,797	) \$(5,757,648	)
Net loss per share			
Basic:			
Continuing operations	\$(0.35	) \$(0.67	)
Discontinued operations	(0.44	) (0.10	)
Net (loss)	\$(0.79	) \$(0.77	)
Diluted:			
Continuing operations	\$(0.35	) \$(0.67	)
Discontinued operations	(0.44	) (0.10	)
Net (loss)	\$(0.79	) \$(0.77	)
Weighted average shares—basic	7,526,430	7,526,430	
Weighted average shares—diluted	7,526,430	7,526,430	
See notes to the consolidated financial statements			



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ESCALON MEDICAL CORP. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

For the years ended June 30,

	2012	2011	
Net loss	\$(5,944,797	) \$(5,757,648	)
Foreign currency translation	326,177	(228,278	)
Total comprehensive loss	\$(5,618,620	) \$(5,985,926	)

See notes to the consolidated financial statements

ESCALON MEDICAL CORP. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY  
FOR THE YEARS ENDED JUNE 30, 2012 and 2011

	Common Stock		Common Stock Warrants	Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
	Shares	Amount					
Balance at June 30, 2010	7,526,430	\$7,526	\$1,733,460	\$67,583,905	\$(56,646,366)	\$(613,521 )	\$12,065,004
Net loss	—	—	—	—	(5,757,648 )	—	(5,757,648 )
Foreign currency translation	—	—	—	—	—	(228,278 )	(228,278 )
Compensation expense	—	—	—	111,054	—	—	111,054
Balance at June 30, 2011	7,526,430	7,526	1,733,460	67,694,959	(62,404,014 )	(841,799 )	6,190,132
Net loss	—	—	—	—	(5,944,797 )	—	(5,944,797 )
Foreign currency translation	—	—	—	—	—	326,177	326,177
Expired warrants	—	—	(1,601,346 )	1,601,346	—	—	—
Compensation expense	—	—	—	73,353	—	—	73,353
Balance at June 30, 2012	7,526,430	\$7,526	\$132,114	\$69,369,658	\$(68,348,811)	\$(515,622 )	\$644,865

See notes to consolidated financial statements

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ESCALON MEDICAL CORP. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS

Years Ended June 30,	2012	2011	
Cash Flows from Operating Activities:			
Net loss	\$ (5,944,797	) \$ (5,757,648	)
Adjustments to reconcile net loss to cash provided by operating activities of continuing operations:			
Loss from discontinued operations	3,287,258	741,685	
Depreciation and amortization	475,857	570,650	
Goodwill Impairment	—	905,810	
Loss on disposal of assets	86,885	—	
Compensation expense related to stock options	73,353	111,054	
Change in accrued post-retirement benefits	56,150	(41,719	)
(Income) loss of Ocular Telehealth Management, LLC	(7,491	) 70,393	
Change in operating assets and liabilities:			
Accounts receivable, net	835,242	(254,870	)
Inventory, net	1,239,881	604,892	
Other current and long term-assets	(160,974	) 411,514	
Accounts payable and accrued expenses	(368,700	) 709,158	
Net cash (used in) operating activities from continuing operations	(427,336	) (1,929,081	)
Net cash (used in) provided by operating activities from discontinued operations	(273,234	) 1,414,145	
Net cash (used in) operating activities	(700,570	) (514,936	)
Cash Flows from Investing Activities:			
Investment in Ocular Telehealth Management, LLC	—	(45,000	)
Purchase of fixed assets	(79,155	) (252,340	)
Net cash (used in) investing activities from continuing operations	(79,155	) (297,340	)
Net cash (used in) investing activities from discontinued operations	—	(104,949	)
Net cash (used in) investing activities	(79,155	) (402,289	)
Cash Flows from Financing Activities:			
Proceeds from related party note payable	300,000	—	
Principal payments on long-term debt	(155,795	) (122,732	)
Net cash provided by (used in) financing activities from continuing operations	144,205	(122,732	)
Effect of exchange rate changes on cash and cash equivalents	11,629	(269,732	)
Net (decrease) in cash and cash equivalents	(623,891	) (1,309,689	)
Cash and cash equivalents, beginning of year	1,514,514	2,824,203	
Cash and cash equivalents, end of year	\$ 890,623	\$ 1,514,514	
Supplemental Schedule of Cash Flow Information:			
Interest paid	\$ 170,550	\$ 323,611	
See notes to consolidated financial statements			

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Escalon Medical Corp. and Subsidiaries  
Notes to Consolidated Financial Statements

1. Going Concern

The accompanying consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. Escalon Medical Corp. (“Escalon” or the “Company”) has incurred recurring operating losses and negative cash flows from operating activities and is in default on the debt related to the December 31, 2008 purchase of certain assets of Biocode. These conditions raise substantial doubt about the Company’s ability to continue as a going concern. If the Company is unsuccessful in its efforts to raise additional capital in the near term, the Company may be required to significantly reduce its research, development, and administrative activities, including further reduction of its employee base. The 2012 consolidated financial statements do not include any adjustments relating to the realization of the carrying value of assets or the amounts and classification of liabilities that might be necessary should the Company be unable to continue as a going concern. The Company’s continuance as a going concern is dependent on its future profitability and on the on-going support of its shareholders, affiliates and creditors. In order to mitigate the going concern issues, the Company is actively pursuing business partnerships, managing our continuing operations, seeking to sell certain assets and seeking capital funding on an ongoing basis via private placements. The Company may not be successful in any of these efforts.

The Company continues to operate under an austerity plan to stem the recurring losses at Drew (see note 15 of these consolidated financial statements for additional information on the austerity plan). If the Company is unable to achieve improvement in this area in the near term, it is not likely that our existing cash and cash flow from operations will be sufficient to fund activities throughout the next 4 to 6 months without curtailing certain business activities. The Company’s forecast of the period of time through which its financial resources will be adequate to support its operations is a forward-looking statement and involves risks and uncertainties, and actual results could vary as a result of a number of factors, including the factors discussed in “Risk Factors”.

If the Company raises funds in the future, the Company may be required to raise those funds through public or private financings, strategic relationships or other arrangements at prices and other terms that may not be as favorable as they would without such qualification. The sale of additional equity and debt securities may result in additional dilution to the Company’s shareholders. Additional financing may not be available in amounts or on terms acceptable to the Company or at all.

2. Organization and Description of Business and Business Conditions

The Company is a Pennsylvania corporation initially incorporated in California in 1987, and reincorporated in Pennsylvania in November 2001. Within this document, the “Company” collectively shall mean Escalon and its wholly owned subsidiaries: Sonomed, Inc. (“Sonomed”), Trek, Inc. (“Trek”), Escalon Vascular Access, Inc. (“Vascular”), Escalon Medical Europe GmbH (“EME”), Escalon Digital Vision, Inc. (“EMI”), Escalon Pharmaceutical, Inc. (“Pharmaceutical”), Escalon Holdings, Inc. (“EHI”), Escalon IP Holdings, Inc., Escalon Vascular IP Holdings, Inc., Sonomed IP Holdings, Inc., Drew Scientific Holdings, Inc., and Drew Scientific Group, Plc (“Drew”) and its subsidiaries. All intercompany accounts and transactions have been eliminated. The Company’s Internet address is [www.escalonmed.com](http://www.escalonmed.com).

The Company operates in the healthcare market, specializing in the development, manufacture, marketing and distribution of medical devices and pharmaceuticals in the areas of ophthalmology, diabetes, hematology and vascular access. The Company and its products are subject to regulation and inspection by the United States Food and Drug Administration (the “FDA”). The FDA requires extensive testing of new products prior to sale and has jurisdiction over the safety, efficacy and manufacture of products, as well as product labeling and marketing.

Management reviews financial information, allocates resources and manages the business as three segments, ECD, Sonomed-Escalon, and Escalon Medical Corp. The ECD segment consists of Drew, and its wholly owned subsidiaries JAS Diagnostics, Inc. (“JAS”). ECD develops and sells clinical diagnostic instruments, reagents and chemistries. The Sonomed-Escalon segment consists of Sonomed, EMI and Trek, all of which are engaged in the development and sale of Ophthalmic medical devices. The Escalon Medical Corp. segment includes the administrative corporate operations

of the consolidated group.

### 3. Significant Accounting Policies

#### Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All

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intercompany accounts and transactions have been eliminated.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that impact the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents

For the purposes of reporting cash flows, the Company considers all cash accounts, which are not subject to withdrawal restrictions or penalties, and highly liquid investments with original maturities of 90 days or less to be cash and cash equivalents. From time to time cash balances exceed FDIC insurance limits.

Fair Value of Financial Instruments

On July 1, 2008, the Company adopted Financial Accounting Standards Board ("FASB") issued authoritative guidance related to fair value measurement for financial assets and liabilities. The carrying amounts for cash and cash equivalents, accounts receivable, line of credit, accounts payable and accrued liabilities approximate their fair value because of their short-term maturity. The carrying amounts of long-term debt approximate fair value since the Company's interest rates approximate current market interest rates. While we believe the carrying value of the assets and liabilities is reasonable, considerable judgment is used to develop estimates of fair value; thus the estimates are not necessarily indicative of the amounts that could be realized in a current market exchange.

Revenue Recognition

The Company recognizes revenue from the sale of its products at the time of shipment, when title and risk of loss transfer. The Company provides products to its distributors at agreed wholesale prices and to the balance of its customers at set retail prices. Distributors can receive discounts for accepting high volume shipments. The discounts are reflected immediately in the net invoice price, which is the basis for revenue recognition. No further material discounts or sales incentives are given.

The Company's considerations for recognizing revenue upon shipment of product to a distributor are based on the following:

- Persuasive evidence that an arrangement (purchase order and sales invoice) exists between a willing buyer (distributor) and the Company that outlines the terms of the sale (company information, quantity of goods, purchase price and payment terms). The buyer (distributor) does not have a right of return. Shipping terms are ex-factory shipping point. At this point the buyer (distributor) takes title to the goods and is responsible for all risks and rewards of ownership, including insuring the goods as necessary.
- The Company's price to the buyer (distributor) is fixed and determinable as specifically outlined on the sales invoice. The sales arrangement does not have customer cancellation or termination clauses.
- The buyer (distributor) places a purchase order with the Company; the terms of the sale are cash, COD or credit. Customer credit is determined based on the Company's policy and procedures related to the buyer's (distributor's) creditworthiness. Based on this determination, the Company believes that collectibility is reasonably assured. Provision has been made for estimated sales returns based on historical experience.

Shipping and Handling Revenues and Costs

Shipping and handling revenues are included in product revenue and the related costs are included in cost of goods sold.

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## Inventory

Raw materials, work in process and finished goods are recorded at lower of cost (first-in, first-out) or market. The composition of inventory is as follows:

	June 30, 2012	2011
Raw materials	\$2,112,001	\$1,567,082
Work in process	238,586	880,313
Finished goods	1,432,031	2,575,104
Total inventory	\$3,782,618	\$5,022,499

Valuation allowance activity for the years ended June 30, 2012 and 2011 was as follows:

	June 30, 2012	2011
Balance, July 1	\$1,952,560	\$1,180,755
Provision for valuation allowance	68,390	772,307
Write-off's	(1,469,981	) (502
Balance, June 30	\$550,969	\$1,952,560

## Accounts Receivable

Accounts receivable are recorded at net realizable value. The Company performs ongoing credit evaluations of customers' financial condition and does not require collateral for accounts receivable arising in the normal course of business. The Company maintains allowances for potential credit losses based on the Company's historical trends, specific customer issues and current economic trends. Accounts are written off when they are determined to be uncollectible based on management's assessment of individual accounts. Allowance for doubtful accounts activity for the years ended June 30, 2012 and 2011 was as follows:

	June 30, 2012	2011
Balance, July 1	\$743,864	\$895,838
Provision for bad debts	139,694	61,823
Write-off's	(201,178	) (213,797
Balance, June 30	\$682,380	\$743,864

## Property and Equipment

Property and equipment is recorded at cost. Leasehold improvements are amortized on a straight-line basis over the lesser of the estimated useful life of the asset or lease term. Depreciation on property and equipment is recorded using the straight-line method over the estimated economic useful life of the related assets. Estimated useful lives are generally 3 to 5 years for computer equipment and software, 5 to 7 years for furniture and fixtures, 5 years for leasehold improvements, and 5 to 10 years for production and test equipment. Depreciation and amortization expense for the years ended June 30, 2012 and 2011 was \$167,000 and \$260,000, respectively.

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Property and equipment consist of the following at:

	June 30,	
	2012	2011
Equipment	\$1,612,728	\$2,344,591
Furniture and Fixtures	82,888	74,504
Leasehold Improvements	114,914	114,914
	1,810,530	2,534,009
Less: Accumulated depreciation and amortization	(1,474,923	) (2,015,129
	\$335,607	\$518,880

During the fiscal year ended June 30, 2012 approximately \$770,000 of fully depreciated assets were removed from Drew books. During the fiscal year ended June 30, 2012 assets with a historical cost of approximately \$150,000 and accumulated depreciation of approximately \$63,000 were disposed of resulting in a loss of approximately \$87,000.

Long-lived Assets

Long-lived assets and certain identifiable intangibles to be held and used are reviewed for impairment whenever events or changes in circumstances indicate that the carrying value may not be recoverable. An asset's value is impaired if management's estimate of the aggregate future cash flows, undiscounted and without interest charges, to be generated by the asset are less than the carrying value of the asset. Such cash flows consider factors such as expected future operating income and historical trends, as well as the effects of demand and competition. To the extent impairment has occurred, the loss will be measured as the excess of the carrying amount of the asset over the fair value of the asset. Such estimates require the use of judgment and numerous subjective assumptions, which if actual experience varies, could result in material differences in the requirements for impairment charges.

Intangible Assets

The Company follows FASB issued authoritative guidance for recording goodwill and other intangible assets, which discontinues the amortization of goodwill and identifiable intangible assets that have indefinite lives. In accordance with FASB issued authoritative guidance, these goodwill and identifiable intangible assets that have indefinite lives are tested for impairment on an annual basis. The company recognized a goodwill impairment loss of \$905,810 during fiscal year 2011 for EMI. See footnote 4 for details on the goodwill impairment charge.

Accrued Warranties

The Company provides a limited one year warranty against manufacturer's defects on its products sold to customers. The Company's standard warranties require the Company to repair or replace, at the Company's discretion, defective parts during such warranty period. The Company accrues for its product warranty liabilities based on estimates of costs to be incurred during the warranty period, based on historical repair information for warranty costs.

Business Combinations

The Company allocates the purchase price of acquired companies to the tangible and intangible assets acquired and liabilities assumed based on their estimated fair values. When acquisitions are deemed material by management, the Company engages independent third-party appraisal firms to assist in determining the fair values of assets acquired and liabilities assumed. Such a valuation requires management to make significant estimates and assumptions, especially with respect to intangible assets.

Stock-Based Compensation

Stock-based compensation expense for all share-based payment awards granted after July 1, 2006 is based on the grant date fair value estimate in accordance with the provisions of FASB issued authoritative guidance. As of June 30, 2012 and 2011 there was \$54,756 and \$128,109 respectively, of total unrecognized compensation cost related to non-vested share-based compensation arrangements under the plans. The remaining cost is expected to be recognized over a weighted average period of 1.34 years. For the years ended June 30, 2012 and 2011, \$73,353 and \$111,054, respectively, was recorded as compensation expense, respectively.





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Valuations are based upon highly subjective assumptions about the future, including stock price volatility and exercise patterns. The fair value of share-based payment awards was estimated using the Black-Scholes option pricing model. Expected volatilities are based on the historical volatility of the Company's stock. The Company uses historical data to estimate option exercise and employee terminations. The expected term of options granted represents the period of time that options granted are expected to be outstanding. The risk-free rate for periods within the expected life of the option is based on the U.S. Treasury yield curve in effect at the time of the grant.

The Company has historically granted options under the Company's option plans with an option exercise price equal to the closing market value of the stock on the date of the grant and with vesting, primarily for Company employees, either in equal annual amounts over a two to five year period or immediately, and, primarily for non-employee directors, immediately.

The Company did not receive any cash from share option exercises under stock-based payment plans for the years ended June 30, 2012 and 2011. The Company did not realize any tax effect, which would be a reduction in its tax rate, on options due to the full valuation allowances established on its deferred tax assets.

The Company measures compensation expense for non-employee stock-based awards based on the fair value of the options issued, as this measurement is used to measure the transaction, and is more reliable than the fair value of the services received. Fair value is measured as the value of the Company's common stock on the date that the commitment for performance by the counterparty has been reached or the counterparty's performance is complete. The fair value of the equity instrument is charged directly to compensation expense and additional paid-in capital. For the years ended June 30, 2012 and 2011, no compensation expense was recorded, respectively.

**Research and Development**

All research and development costs are charged to operations as incurred.

**Advertising Costs**

Advertising costs are charged to operations as incurred. Advertising expense for the years ended June 30, 2012 and 2011 was \$96,000 and \$32,000, respectively.

**Net Income (loss) Per Share**

Earnings (loss) per share is computed by dividing net income (loss) by the weighted average number of shares of common stock outstanding during the year. All outstanding stock options and warrants are considered potential common stock. The dilutive effect, if any, of stock options and warrants is calculated using the treasury stock method. A reconciliation of the denominator of the basic and diluted earnings per share for the years ended June 30, 2012 and 2011 is as follows:

	2012	2011
Basic Weighted average shares outstanding	7,526,430	7,526,430
Effect of dilutive securities—Stock options and warrants	—	—
Diluted weighted average shares outstanding	7,526,430	7,526,430

For the years ended June 30, 2012 and 2011 the impact of all dilutive securities were omitted from the diluted earnings per share calculation as they reduce the loss per share (anti-dilutive). No warrants or options were issued in fiscal year 2012. As of June 30, 2012 and 2011 there were 150,000 warrants issued to purchase shares of Escalon common stock were outstanding. These warrants were excluded from the calculation of diluted earnings per share as the exercise price of the warrants exceeded the average share price of the Company's common stock making the warrants anti-dilutive.

**Income Taxes**

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis and operating loss and tax credit carry forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Valuation

allowances are recorded to reduce deferred tax assets when it is more likely than not that a tax benefit will not be realized.

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The Company follows the FASB issued authoritative guidance for accounting for income taxes which provides a comprehensive model for the recognition, measurement, and disclosure in financial statements of uncertain income tax positions that a company has taken or expects to take on a tax return. Under ASC 740-10, a company can recognize the benefit of an income tax position only if it is more likely than not (greater than 50%) that the tax position will be sustained upon tax examination, based solely on the technical merits of the tax position. Otherwise, no benefit can be recognized. The tax benefits recognized are measured based on the largest benefit that has a greater than fifty percent likelihood of being realized upon ultimate settlement. Additionally, companies are required to accrue interest and related penalties, if applicable, on all tax exposures for which reserves have been established consistent with jurisdictional tax laws. The Company has elected to recognize interest expense and penalties related to uncertain tax positions as a component of its provision for income taxes.

### Comprehensive Income (Loss)

The Company reports comprehensive income in accordance with the FASB issued authoritative guidance which establishes standards for reporting comprehensive income and its component in financial statements. Comprehensive income, as defined, includes all changes in equity during a period from non-owner sources.

### Foreign Currency Translation

The Company translates the assets and liabilities of international subsidiaries into U.S. dollars at the current rates of exchange in effect as of each balance sheet date. Revenues and expenses are translated using average rates in effect during the period. Gains and losses from translation adjustments are included in accumulated other comprehensive income on the consolidated balance sheet. Foreign currency transaction gains or losses are recognized in current operations and have not been significant to the Company's operating results in any period. In addition, the effect of foreign currency rate changes on cash and cash equivalents has not been significant in any period.

### Subsequent Events

The Company has evaluated subsequent events through September 26, 2012, which is the date the consolidated financial statements were available to be issued.

### Reclassification

Certain amounts were reclassified from the June 30, 2011 presentations to conform with the current year presentation.

### New Accounting Pronouncements

#### Recently Issued Accounting Standards

In January 2010, FASB issued ASU No. 2010-06, Improving Disclosures about Fair Value Measurements. This update provides amendments to Subtopic 820-10 that requires new disclosure to include transfers in and out of Levels 1 and 2 and activity in Level 3 fair value measurements. Further, this update clarifies existing disclosures on level of disaggregation and disclosures about inputs and valuation techniques. A reporting entity should provide fair value measurement disclosures for each class of assets and liabilities and should provide disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements. Those disclosures are required for fair value measurements that fall in either Level 2 or Level 3. The new disclosures and clarifications of existing disclosures became effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. The adoption of this ASU did not have a material impact on the Company's consolidated financial statements.

In April 2010, the FASB issued ASU 2010-13, "Compensation—Stock Compensation (Topic 718): Effect of Denominating the Exercise Price of a Share-Based Payment Award in the Currency of the Market in Which the Underlying Equity Security Trades," or ASU 2010-13. ASU 2010-13 provides amendments to Topic 718 to clarify that an employee share-based payment award with an exercise price denominated in currency of a market in which a substantial portion of the entity's equity securities trades should not be considered to contain a condition that is not a market, performance, or service condition. Therefore, an entity would not classify such an award as a liability if it otherwise qualifies as equity. The amendments in this Update are effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2010. The adoption of this ASU did not have a material impact on the Company's consolidated financial statements.

In May 2011, the FASB issued ASU No. 2011-04 which provides a consistent definition of fair value in GAAP and International Financial Reporting Standards and ensures that their respective fair value measurement and disclosure requirements are the same (except for minor differences in wording and style). The amendments change certain fair value measurement principles and enhance the disclosure requirements particularly for level 3 fair value measurements. The standard

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will become effective for the Company during interim and annual periods beginning after December 15, 2011 and should be applied prospectively. The Company does not believe that the implementation of this standard will have a material impact on its financial position, results of operation and cash flows.

In June 2011, the FASB issued ASU No. 2011-05 which requires an entity to present all non-owner changes in stockholders' equity either in a single continuous statement of comprehensive income or in two separate but consecutive statements. ASU 2011-05 eliminates the option to present the components of other comprehensive income as part of the statement of changes in stockholders' equity. This standard will become effective for the Company in fiscal years, and interim periods within those years, beginning after December 15, 2011 and should be applied retrospectively. The Company does not believe that the implementation of this standard will have a material impact on its financial position, results of operation and cash flows.

In September 2011, the FASB issued ASU No. 2011-08, Intangibles—Goodwill and Other (Topic 350): Testing Goodwill for Impairment, which simplifies how an entity tests goodwill for impairment. Under that option, an entity no longer would be required to calculate the fair value of a reporting unit unless the entity determines, based on that qualitative assessment, that it is more likely than not that its fair value is less than its carrying amount. The amendments will be effective for the company for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011 and should be applied prospectively. The Company does not believe that the implementation of this standard will have a material impact on its financial position, results of operation and cash flows.

### 4. Intangible Assets

#### Goodwill, Trademarks and Trade Names

Goodwill, trademarks and trade names represent intangible assets obtained from EOI, Endologix, Sonomed and Drew acquisitions. Goodwill represents the excess of purchase price over the fair value of net assets acquired.

The Company adopted FASB authoritative guidance effective July 1, 2001 for goodwill and identified intangible assets that have indefinite lives. These assets are no longer amortized but reviewed for impairment annually or more frequently if certain indicators arise.

In accordance with authoritative guidance effective July 1, 2001, the Company discontinued the amortization of goodwill and identifiable intangible assets that have indefinite lives. Intangible assets that have finite lives continue to be amortized over their estimated useful lives. Management has evaluated the carrying value of goodwill and its identifiable intangible assets that have indefinite lives during each of the fiscal years subsequent to July 1, 2001, utilizing discounted cash flows of the respective business units. In accordance with FASB Accounting Standards Codification ("ASC") 350-20, these intangible assets will continue to be assessed on an annual basis, and impairment, if any, would be recorded as a charge against income from operations. After evaluating the discounted cash flow of each of its respective business units, management concluded that the carrying value of goodwill and identifiable intangible assets at EMI exceeded their fair values during the year ended June 30, 2011 and therefore were impaired. The authoritative guidance makes use of the concept of reporting units. All acquisitions must be assigned to a reporting segment or unit. Reporting units have been defined under the standards to be the same as or one level below an operating segment, as defined by FASB issued authoritative guidance related to disclosures about segments of an enterprise and related information.

The Company tests goodwill for possible impairment on an annual basis and at any other time events occur or circumstances indicate that the carrying amount of goodwill may be impaired. There was \$905,810 impairment of goodwill for EMI during the year ended June 30, 2011. As a result of the Company's testing during the year ended June 30, 2012, no additional impairments were recorded.

#### Goodwill Impairment-EMI

At March 31, 2011 management became concerned about EMI's performance year to date as compared to our projected budget. The projected budget included sales related to EMI's new image management system, Axis, as well as traditional legacy digital imaging systems. A significant portion of the Axis product target market represents institutions requiring large-scale, multi-instrument solutions, which has resulted in a much longer sales cycle than we had originally envisioned. While the feedback from initial and potential customers of the Axis product has been

positive, converting this interest into sales has not materialized to date at the levels we had originally projected. EMI also encountered unexpected lagging demand for its legacy digital imaging systems primarily due to institutions

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allocating a disproportionate level of their capital budgets toward purchasing Optical Coherence Tomography (“OCT”) devices. It was anticipated that the emerging OCT technology would erode legacy digital imaging product sales due to competition for budgetary resources; however, the level has been greater than originally expected and not reflected in our original projections. OCT and digital imaging technologies are complementary and it is not known whether or for how long the lower available capital budgets for digital imaging will continue. These events will negatively affect the evaluation of the future operating results and cash flows of EMI.

The Company typically tests goodwill for possible impairment on an annual basis at June 30, and at any other time events occur or circumstances indicate that the carrying amount of goodwill may be impaired. Management determined that the events discussed above warranted performing an interim test of goodwill for possible impairment during the quarter ended March 31, 2011.

The first step of the FASB ASC 350 impairment analysis consists of a comparison of the fair value of the reporting segment with its carrying amount, including the goodwill. The fair value was determined based on the income approach, which estimates the fair value based on the future discounted cash flows. Under the income approach, the Company assumed, with respect to EMI, a forecasted cash flow period of 5 years, long-term annual growth rates of 3% and a discount rate of 19%.

Based on the interim income approach analysis that was performed for EMI it was determined that the carrying amount of the goodwill was in excess of its respective fair value. As such, the Company was required to perform the second step analysis in order to determine the amount of the goodwill impairment. The second step analysis consisted of comparing the implied fair value of the goodwill with the carrying amount of the goodwill, with an impairment charge resulting from any excess of the carrying value of the goodwill over the implied fair value of the goodwill. Based on the second step analysis, the Company concluded that all \$905,810 of the goodwill recorded at EMI was impaired. As a result, the Company recorded a non-cash goodwill impairment charge to continuing operations totaling \$905,810 during the year ended June 30, 2011 representing all of EMI's recorded goodwill.

The determination as to whether a write-down of goodwill is necessary involves significant judgment based on short-term and long-term projections of the Company. The assumptions supporting the estimated future cash flows of the reporting segment, including profit margins, long-term forecasts, discount rates and terminal growth rates, reflect the Company's best estimates.

The following tables present unamortized intangible assets by business segment as of June 30, 2012 and 2011:

	2012 Net Carrying Amount	2011 Net Carrying Amount
Goodwill		
ECD	\$93,181	\$93,181
Sonomed-Escalon	125,027	125,027
Total	\$218,208	\$218,208

	2012 Net Carrying Amount	2011 Net Carrying Amount
Trademarks and tradenames		
ECD	\$89,000	\$89,000
Sonomed-Escalon	605,006	605,006
Total	\$694,006	\$694,006

## Patents

It is the Company's practice to seek patent protection on processes and products in various countries. Patent application costs are capitalized and amortized over their estimated useful lives, not exceeding 17 years, on a straight-line basis from the date the related patents are issued. Costs associated with patents no longer being pursued are expensed. Accumulated patent amortization on patents from continuing operations was approximately \$229,000 and \$198,000 at June 30, 2012 and 2011, respectively. Amortization expense from continuing operations for the years

ended June 30, 2012 and 2011 was approximately \$31,000 and \$33,000, respectively.

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Amortization expense, relating entirely to patents, is estimated to be approximately \$14,000 in 2013 and there will be amortization expense of \$2,000 related to patents in each year 2014, 2015, 2016 and 2017.

**Covenant Not to Compete and Customer Lists**

The Company recorded the value of covenants not to compete and customer lists as intangible assets as part of the acquisitions of MRP and JAS. The valuation was based on the fair market value of these assets at the time of acquisition. These assets are amortized over their estimated useful lives, between 5 and 10 years, on a straight-line basis from the date of acquisition. Accumulated amortization was approximately \$930,000 and \$653,000 at June 30, 2012 and 2011, respectively. Amortization expense for each of the years ended June 30, 2012 and 2011 was approximately \$278,000 and \$241,000, respectively.

Amortization expense, relating entirely to covenant not to compete and the customer list is estimated to be approximately \$278,000 and \$253,000 in year 2013 and 2014 and there will be no amortization expense in year 2015, 2016 and 2017.

The following table presents amortized intangible assets by business segment as of June 30, 2012:

	Gross Carrying Amount	Impairment	Adjusted Gross Carrying Amount	Accumulated Amortization	Net Carrying Value
<b>Amortized Intangible Assets Patents</b>					
Sonomed-Escalon	\$251,361	\$—	\$251,361	\$(229,141 )	\$22,220
Total	\$251,361	\$—	\$251,361	\$(229,141 )	\$22,220
<b>Covenant Not To Compete/ Customer Lists</b>					
ECD	\$1,461,397	\$—	\$1,461,397	\$(930,423 )	\$530,974
Total	\$1,461,397	\$—	\$1,461,397	\$(930,423 )	\$530,974

During the year ended June 30, 2011, the Company wrote off the fully amortized covenant not to compete and customer lists in the amount of approximately \$443,000.

The following table presents amortized intangible assets by business segment as of June 30, 2011:

	Gross Carrying Amount	Impairment	Adjusted Gross Carrying Amount	Accumulated Amortization	Net Carrying Value
<b>Amortized Intangible Assets Patents</b>					
Sonomed-Escalon	\$251,361	—	\$251,361	\$(198,430 )	\$52,931
Total	\$251,361	\$—	\$251,361	\$(198,430 )	\$52,931
<b>Covenant Not To Compete/ Customer Lists</b>					
ECD	\$1,461,397	\$—	\$1,461,397	\$(652,757 )	\$808,640
Total	\$1,461,397	\$—	\$1,461,397	\$(652,757 )	\$808,640

**5. Accrued Expenses**

The following table presents accrued expenses:

	June 30, 2012	June 30, 2011
Accrued compensation	\$644,907	\$735,958
Warranty accruals	74,273	170,409
Interest accrual	170,829	—
Other accruals	1,034,681	991,074

Total accrued expenses	\$1,924,690	\$1,897,441
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Accrued compensation as of June 30, 2012 and 2011 primarily relates to payroll, bonus and vacation accruals, and payroll tax liabilities. Included in accrued compensation as of June 30, 2011 are severance costs incurred in Drew Dallas of \$120,000 (see note 15 to consolidated financial statements).

### 6. Long-Term Debt

On December 31, 2008, Drew acquired certain assets of Biocode for \$5,900,000 (4,200,000 Euros) plus acquisition costs of approximately \$300,000. The sales price was payable in cash of approximately \$324,000 (approximately 231,000 Euros) and \$5,865,000 in debt from Drew. The seller-provided financing was collateralized by certain assets of Biocode and guaranteed by Drew. Biocode assets were vertically integrated into the Company's clinical diagnostics business that includes Drew and JAS.

On April 29, 2011 the Company amended its seller financed debt in connection with the Biocode transaction. Under the terms of the debt refinancing, the Company agreed to pay the balance of the seller provided financing of 3,375,000 Euros by the sum per month in euros having an exchange value of \$50,000 United States Dollars as of the date of payment. Interest rate remained unchanged and interest accrues on the outstanding amount of the purchase price at an interest rate of 7% per year on the basis of the actual days elapsed and a 365 day year. The first payment under the amended agreement was paid on May 31, 2011. Upon the 60th month after this Amendment, the Company has agreed to pay the balance of the outstanding amount in euros in full in one payment.

On January 12, 2012 BH Holdings, S.A.S. ("BHH") a wholly owned subsidiary of Drew, initiated the filing of an insolvency declaration with the Tribunal de Commerce de Rennes, France ("Commercial Court"). The Commercial Court on January 18, 2012 opened the liquidation proceedings with continuation of BHH's activity for three months and named an administrator to manage BHH. Because BHH is no longer controlled by Drew it was deconsolidated in the December 31, 2011 quarterly financial statements and prior period amounts are presented as discontinued operations (see footnote 11 to the Notes to Consolidated Financial Statements for additional information). This debt was guaranteed by Drew, and as a result of the insolvency declaration the debt has been transferred to Escalon. The debt holder is pursuing BHH under applicable French law prior to invoking Drew's guarantee. In addition the Company is in negotiations with the debt holder to restructure the debt if the guarantee is invoked.

### 7. Capital Stock Transactions

#### Stock Option Plans

As of June 30, 2012, the Company had in effect five employee stock option plans that provide for incentive and non-qualified stock options. After accounting for shares issued upon exercise of options, a total of 1,281,152 shares of the Company's common stock remain available for issuance as of June 30, 2012. Under the terms of the plans, options may not be granted for less than the fair market value of the Common Stock at the date of grant. Vesting generally occurs ratably over five years and the options are exercisable over a period no longer than 10 years after the grant date. As of June 30, 2012, options to purchase 1,021,688 shares of the Company's common stock were outstanding, of which 975,905 were exercisable, and 45,783 shares were reserved for future grants.

The following is a summary of Escalon's stock option activity and related information for the fiscal years ended June 30, 2012 and 2011:

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	2012		2011	
	Common Stock Options	Weighted Average Exercise Price		Weighted Average Exercise Price
Outstanding at the beginning of the year	1,021,688	\$4.58		\$4.58
Granted	—	\$0		\$—
Exercised	—	\$0		\$—
Forfeited	—	\$0		\$—
Outstanding at the end of the year	1,021,688	\$4.58		\$4.58
Exercisable at the end of the year	975,905			
Weighted average fair value of options granted during the year		\$—		\$—

The following table summarizes information about stock options outstanding as of June 30, 2012:

	Number Outstanding at June 30, 2012	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Number Exercisable at June 30, 2012	Weighted Average Exercise Price
Range of Exercise Prices					
\$1.45 to \$2.12	102,367	1.33	\$1.53	86,017	\$1.53
\$2.37 to \$2.77	419,942	0.57	\$2.62	390,509	\$2.63
\$4.97 to \$5.59	73,000	3.28	\$5.05	73,000	\$5.05
\$6.19 to \$6.19	168,250	2.17	\$6.19	168,250	\$6.19
\$6.94 to \$8.06	258,129	2.39	\$7.41	258,129	\$7.41
Total	1,021,688			975,905	

Compensation expense related to stock options for the years ended June 30, 2012 and 2011 was \$73,353 and \$111,054, respectively.

#### Sale of Common Stock and Warrants

On November 20, 2008, the Company completed a \$1,100,000 private placement of common stock and common stock purchase warrants to accredited investors. The Company sold 1,000,000 shares of common stock at \$1.10 per share. The investors also received warrants to purchase an additional 150,000 shares of common stock at an exercise price of \$1.21 per share, which expire in 5 years. The warrants have a fair value of \$132,114. The fair value of the warrants was estimated at the date of agreement using the Black-Scholes pricing method. The net proceeds to the Company from the offering, after fees and expenses of \$1,029,000 have been allocated among common stock and warrants based on their relative fair values. As the result of the private placement, the Company had 7,526,430 shares of common stock outstanding, not including the shares issuable upon the exercise of the warrants.

The shares were offered in reliance on an exemption from the registration requirements of the Securities Act of 1933 (the "Securities Act"). The shares may not be offered or sold in the United States absent an effective registration statement or an applicable exemption from the registration requirements of the Securities Act and applicable state securities laws.

On March 17, 2004, the Company completed a \$10,400,000 private placement of common stock and common stock purchase warrants to accredited and institutional investors. The Company sold 800,000 shares of its common stock at \$13.00 per share. The investors also received warrants to purchase an additional 120,000 shares of common stock at an exercise price of \$15.60 per share. The warrants expired on September 13, 2009. The securities were sold pursuant to the exemptions from registration of Rule 506 of Regulation D and Section 4(2) under the Securities Act of 1933. The Company has subsequently filed a registration statement with the Securities and Exchange Commission, declared effective on April 20, 2004, to register for resale by the holders all of the common stock issued in conjunction with

this private placement and common stock purchasable upon exercise of the warrants.

The net proceeds to the Company from the offering, after costs associated with the offering, of \$9,787,918, have been allocated among common stock and warrants based on their relative fair values. The Company used the Black-Sholes pricing

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model to determine the fair value of the warrants to be \$1,601,346. These warrants have expired and the entire amount has been reclassified to additional paid in capital.

Per FASB ASC 815, in some cases, an instrument may be indexed to the issuer's stock and one or more other defined contingencies. For the purpose of evaluating whether such an instrument, should be considered indexed to an entity's own stock for accounting purposes, the following two-step approach must be applied. An instrument that fails either step is not considered indexed to the company's own stock, and therefore, would be reported as a liability as opposed to equity.

Step 1. Evaluate any contingent exercise provisions—an instrument is not considered indexed to a company's own stock if its exercisability is affected by changes in an underlying event or the occurrence of an event based on (a) an observable market (other than the market for the issuer's own stock) or (b) an observable index (other than an index calculated or measured solely by reference to the issuer's own operations, such as sales revenue of the issuer). Exercise contingencies based on other underlyings or events do not preclude the instrument from being considered indexed to a company's own stock.

The warrant's exercisability is not affected by changes in an observable market or an observable index; therefore the warrants pass step one.

Step 2. Evaluate settlement provisions—an instrument would be considered indexed to an entity's own stock if (a) its settlement consideration would equal the difference between the fair value of a fixed number of the entity's equity shares and a fixed strike price/settlement amount (but if not fixed, this condition is still met if the only variables that affect the settlement amount are inputs to the fair value of a fixed-for-fixed forward or option on equity shares) and (b) the strike price or embedded conversion option is denominated in the issuer's functional currency.

There are no provisions in the Common Stock Purchase Warrant Agreements that change the fact that the settlement consideration would equal the difference between the fair value of a fixed number of the entity's equity shares and a fixed strike price/settlement amount. As such, the warrants also pass step two.

Since the warrants passed both step 1 and 2 under FASB ASC 815, the warrants are indexed solely to shares in the reporting entities stock and are therefore not recorded as a liability but as equity.

## 8. Income Taxes

The provision for income taxes for the years ended June 30, 2012 and 2011 consists of the following:

	2012	2011	
Current income tax (benefit) provision			
Federal, (alternative minimum tax refund)	\$—	\$(239,879	)
State	—	—	
	—	(239,879	)
Deferred income tax provision			
Federal	(419,527	) 868,724	
State	(98,407	) 203,774	
Change in valuation allowance	517,934	(1,072,498	)
	—	—	
Income tax (benefit) expense	\$—	\$(239,879	)

During the year ended June 30, 2011, the alternative minimum tax refund was applied for by the Company in connection with the change in certain federal tax laws.

Income taxes (benefit) as a percentage of income (loss) for the years ended June 30, 2012 and 2011 differ from statutory federal income tax rate due to the following:

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	2012		2011	
Statutory federal income tax rate	(34.00	)%	(34.00	)%
Increase in deductible timing differences	11.70	%	0.00	%
Net operating loss carryforward	22.30	%	27.20	%
Nondeductible permanent difference (Goodwill)	0.00	%	6.80	%
Alternative minimum tax refund	0.00	%	(4.20	)%
Effective income tax rate	0.00	%	(4.20	)%

As of June 30, 2012, the Company had deferred income tax assets of \$12,393,721. The deferred income tax assets have a valuation allowance of \$12,363,776. The valuation allowance is based on uncertainty with respect to the ultimate realization of net operating loss carryforwards.

The components of the net deferred income tax assets and liabilities as of June 30, 2012 and 2011 are as follows:

	2012		2011	
Deferred income tax assets:				
Net operating loss carryforward	\$10,105,598		\$9,098,323	
Executive post retirement costs	354,366		335,275	
General business credit	207,698		207,698	
Allowance for doubtful accounts	232,009		252,914	
Accrued vacation	155,012		154,114	
Inventory reserve	187,330		663,871	
Accrued lease termination costs	114,969		—	
Accrued interest and other current liabilities	118,942		—	
Accelerated amortization on goodwill and other intangible assets	892,544		1,101,794	
Warranty reserve	25,253		57,363	
Total deferred income tax assets	12,393,721		11,871,352	
Valuation allowance	(12,363,776	)	(11,845,843	)
	29,945		25,509	
Deferred income tax liabilities:				
Accelerated depreciation	(29,945	)	(25,509	)
Total deferred income tax liabilities	(29,945	)	(25,509	)
	\$—		\$—	

As of June 30, 2012, the Company has a valuation allowance of \$12,363,776, which primarily relates to the federal net operating loss carryforwards. The valuation allowance is a result of management evaluating its estimates of the net operating losses available to the Company as they relate to the results of operations of acquired businesses subsequent to their being acquired by the Company. The Company evaluates a variety of factors in determining the amount of the valuation allowance, including the Company's earnings history, the number of years the Company's operating loss and tax credits can be carried forward, the existence of taxable temporary differences, and near-term earnings expectations. Future reversal of the valuation allowance will be recognized either when the benefit is realized or when it has been determined that it is more likely than not that the benefit will be realized through future earnings. Any tax benefits related to stock options that may be recognized in the future through reduction of the associated valuation allowance will be recorded as additional paid-in capital. The Company has available federal and state net operating loss carry forwards of approximately \$28,957,000 and \$3,376,000, respectively, of which \$1,547,000 and \$253,000, respectively, will expire over the next 10 years, and \$27,410,000 and \$3,123,000, respectively, will expire in years 11 through twenty-four. Approximately \$1,521,000 of federal net operating losses expired June 30, 2012. Not included in the \$28,957,000 federal net operating loss is approximately \$8.2 million federal NOL carry forward at June 30, 2012 which represents amounts that were transferred to the Company as a result of the acquisition of Drew. Use of this transferred NOL could be limited under Section 382 and can only be used against future Drew taxable income. Any tax benefit realized from such use would first reduce acquired goodwill.

The Company continues to monitor the realization of its deferred tax assets based on changes in circumstances, for





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example, recurring periods of income for tax purposes following historical periods of cumulative losses or changes in tax laws or regulations. The Company's income tax provision and management's assessment of the realizability of the Company's deferred tax assets involve significant judgments and estimates. If taxable income expectations change, in the near term the Company may be required to reduce the valuation allowance which would result in a material benefit to the Company's results of operations in the period in which the benefit is determined by the Company.

Effective July 1, 2007, the Company adopted the FASB authoritative guidance which prescribes a model for the recognition and measurement of a tax position taken or expected to be taken in a tax return, and provides guidance on derecognition, classification, interest, penalties, disclosure and transition. Implementation of the FASB authoritative guidance did not result in a cumulative effect adjustment to retained earnings. With few exceptions, the Company is no longer subject to audits by tax authorities for tax years prior to 2008. However, to the extent allowed by law, the tax authorities may have the right to examine prior periods where net operating losses were generated and carried forward, and make adjustments up to the amount of the net operating loss amount. At June 30, 2012, the Company did not have any significant unrecognized tax positions.

The Company has provided what it believes to be an appropriate amount of tax for items that involve interpretation to the tax law. However, events may occur in the future that will cause the Company to reevaluate the current provision and may result in an adjustment to the liability for taxes.

## 9. Commitments and Contingencies

### Commitments

The Company leases its manufacturing, research and corporate office facilities and certain equipment under non-cancelable operating lease arrangements. The future annual amounts to be paid under these arrangements as of June 30, 2012 are as follows:

Year Ending June 30,	Lease Obligations
2013	\$889,887
2014	693,757
2015	572,778
2016	495,457
2017	461,232
Thereafter	71,246
Total	\$3,184,357

Rent expense charged to continuing operations during the years ended June 30, 2012 and 2011 was approximately \$909,000 and \$907,000, respectively including equipment rent and property rent.

The Company guaranteed the lease payment for BHH. The lease is expected to be expired in June 30, 2018 and annual lease payment is estimated at \$135,300. Because BHH was put in liquidation during 2012, the Company recognized a liability for the difference between our future lease payments obligation and related costs from June 30, 2012 through the end of the remaining lease term, net of contractual or estimated sublease rental income. The Company accrued lease termination costs of \$338,145 as of June 30, 2012. Inherent in the calculation of accrued lease termination costs are significant management judgments and estimates, including estimates of the amount and timing of future sublease revenues and the timing and duration of future vacancy periods. We will review these judgments and estimates on a quarterly basis and make appropriate revisions.

### Legal Proceedings

The Company, from time to time is involved in various legal proceedings and disputes that arise in the normal course of business. These matters have included intellectual property disputes, contract disputes, employment disputes and other matters. The Company does not believe that the resolution of any of these matters has had or is likely to have a material adverse impact on the Company's business, financial condition or results of operations.

## 10. Retirement and Post-Retirement Plans

The Company adopted a 401(k) retirement plan effective January 1, 1994. The Company's employees become eligible for

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the plan commencing on the date of employment. Company contributions are discretionary, and no Company contributions have been made since the plan's inception.

On January 14, 2000, the Company acquired Sonomed. Sonomed adopted a 401(k) retirement plan effective on January 1, 1993. This plan has continued subsequent to the acquisition and is available only to Sonomed employees. There were no discretionary contributions for the fiscal years ended June 30, 2012 and 2011.

On July 23, 2004, the Company acquired Drew. Drew adopted a 401(k) retirement plan effective on July 1, 1995. This plan has continued subsequent to the acquisition and is available only to Drew's United States employees. Company contributions are discretionary, and no contributions have been made since Drew was acquired by the Company. Drew also has two defined contribution retirement plans which became effective November 24, 2002 and February 1, 1992. These plans have continued subsequent to the acquisition and are available only to Drew's United Kingdom Employees. There were no Drew contributions for the fiscal years ended June 30, 2012 and 2011.

On June 23, 2005, the Company entered into a Supplemental Executive Retirement Benefit Agreement with its Chairman and Chief Executive Officer. The agreement provides for the payment of supplemental retirement benefits to the covered executive in the event of the covered executive's termination of services with the Company under the following circumstances:

If the covered executive retires, the Company would be obligated to pay the executive \$8,000 per month for life, with payments commencing the month after retirement. If the covered executive were to die within a period of three years after such retirement, the Company would be obligated to continue making such payments until a minimum of 36 months payments have been made to the covered executive and his beneficiaries in the aggregate.

If the covered executive dies before his retirement while employed by the Company, the Company would be obligated to make 36 months payments to his beneficiaries of \$8,000 per month commencing in the month after his death.

If the covered executive were to become disabled while employed by the Company, the Company would be obligated to pay the executive \$8,000 per month for life, with payments commencing the month after he suffers such disability.

If the covered executive were to die within three years after suffering such disability, the Company would be obligated to continue making such payments until a minimum of 36 months payments have been made to the covered executive and his beneficiaries in the aggregate.

If the covered executive's employment with the Company is terminated by the Company, or if the executive terminates his employment with the Company for good reason, as defined in the agreement, the Company would be obligated to pay the executive \$8,000 per month for life. If the covered executive were to die within a period of three years after such termination, the Company would be obligated to continue making such payments until a minimum of 36 months payments have been made to the covered executive and his beneficiaries in the aggregate.

As of June 30, 2012 and 2011 approximately \$1,042,000 and \$986,000 was accrued retirement benefits, respectively.

These amounts represent the approximate present value of the supplemental retirement benefits awarded. The increase in accrued retirement benefits is because a lower discount rate was used to calculate the present value of obligation.

As of June 30, 2012, the Company applied an annual interest rate of 2%, the average return for the 10-year treasury note during 2012.

## 11. Discontinued Operations

### BH Holdings, S.A.S

On January 12, 2012 BHH initiated the filing of an insolvency declaration with the Tribunal de Commerce de Rennes, France ("Commercial Court"). The Commercial Court on January 18, 2012 opened the liquidation proceedings with continuation of BHH's activity for 3 months and named an administrator to manage BHH. Since Drew no longer has a controlling financial interest in BHH it was deconsolidated in the December 31, 2011 quarterly consolidated financial statements and prior period amounts are presented as discontinued operations.

The Company incurred a loss of \$2,738,000 related to the deconsolidation of BHH. The desconsolidated loss was calculated by measuring the difference between:

a. The aggregate of:

(1) The fair value of any consideration received, (there was no consideration received);

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- (2) The fair value of any retained noncontrolling investment in the former subsidiary at the date the subsidiary is deconsolidated; and
- (3) The carrying amount of any noncontrolling interest in the former subsidiary (including any accumulated other comprehensive income attributable to the noncontrolling interest) at the date the subsidiary is deconsolidated (there was no noncontrolling interest in the former subsidiary).
- b. The carrying amount of the former subsidiary's assets and liabilities.

The following table summarizes the results of discontinued operations of BHH for the years ended June 30, 2012 and 2011 (in thousands):

For the years ended June 30,	2012	2011	
Revenue, net	\$ 1,970	\$ 4,369	
Cost of goods	574	623	
Market, general and administrative	1,945	4,657	
Research & development	—	—	
Total Costs and expenses	2,519	5,280	
Loss (income) from discontinued operations	(549	) (911	)
Other income and expenses:			
Loss on liquidation of net assets from discontinued operations	(2,738	) —	
Loss (income) before income taxes	(3,287	) (911	)
Income tax	—	—	
Net loss	\$(3,287	) \$(911	)

Assets and liabilities of discontinued operations of BHH included in the consolidated balance sheets are summarized as follows at June 30, 2012 and 2011 (in thousands):

	June 30, 2012	June 30, 2011	
Assets			
Cash	\$—	\$400	
Accounts receivable	—	965	
Inventory	—	1,238	
Other current assets	—	171	
Fixed assets	—	132	
Covenant not to compete and customer list, net	—	1,481	
Other assets	—	109	
Total assets	—	4,496	
Liabilities			
Accounts payable	—	370	
Accrued expenses	—	1,147	
Accrued lease termination costs	338	155	
Total liabilities	338	1,672	
Net assets of discontinued operations	\$(338	) \$2,824	

Discontinued Operation of Vascular

In an effort to enhance stockholder value, improve working capital and enable us to focus on the Company's core in-vitro

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diagnostics and ophthalmology manufacturing businesses, on April 30, 2010 the Company divested certain Vascular Access assets held by its Vascular Access subsidiaries to Vascular Solutions, Inc. The total sales price was \$5,750,000, consisting of cash of \$5,000,000 at closing and \$750,000 payable in cash upon the successful completion of the transfer of the manufacturing to Vascular Solutions, Inc. plus a one-time earn-out payment in an amount equal to 25% of the net sales of the VasuView TAP products sold by Vascular Solutions, Inc. between July 1, 2010 and June 30, 2011. The manufacturing transfer was completed on August 31, 2010. During this four-month transition, the Company continued to manufacture product in its Wisconsin facility under a supply agreement concurrently entered into with Vascular Solutions, Inc. The supply agreement ended on August 30, 2010. Vascular Access generated approximately \$565,000 in gross profit related to the supply agreement.

The following table summarizes the results of discontinued operations for the years ended June 30, 2012 and 2011 (in thousands):

For the years ended June 30,	2012	2011
Revenue, net	\$—	\$638
Cost of goods	—	283
Market, general and administrative	—	157
Research & development	—	29
Total Costs and expenses	—	469
Net income (loss) from discontinued operations	—	169
Gain on sale of assets	—	—
Net income	\$—	\$169

There are no assets and liabilities of discontinued operations included in the consolidated balance sheets at June 30, 2012 and June 30, 2011 related to Vascular Access.

## 12. Segment Reporting

Management reviews financial information, allocates resources and manages the business as three segments, Sonomed-Escalon, ECD and Escalon Medical Corp. The Sonomed-Escalon segment consists of Sonomed, Escalon Digital Imaging and Trek, all of which are engaged in the development and sale of Ophthalmic medical devices. The ECD segment consists of Drew Scientific, Inc., and its wholly owned subsidiaries JAS Diagnostics and Biocode-Hycell. ECD develops and sells clinical diagnostic instruments, reagents and chemistries. The Escalon Medical Corp. segment presents the administrative corporate operations of the consolidated group.

The table below sets forth loss from continuing operations for the years ended June 30, 2012 and 2011.

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Segment Statements of Operations — Years ended June 30, (in thousands)								
	Escalon	Clinical Diagnostics	Sonomed	Escalon	Corporate		Total	
	2012	2011	2012	2011	2012	2011	2012	2011
Revenues, net:								
Product revenue	\$12,985	\$13,709	\$11,462	\$11,867	\$—	\$—	\$24,447	\$25,575
Total revenue, net	12,985	13,709	11,462	11,867	—	—	24,447	25,575
Costs and expenses:								
Cost of goods sold	9,416	10,775	5,760	6,475	—	—	15,176	17,250
Marketing, general & admin	5,297	6,124	4,226	3,702	501	853	10,024	10,679
Research & development	476	725	1,005	877	—	—	1,481	1,603
Goodwill impairment	—	—	—	906	—	—	—	906
Total costs and expenses	15,189	17,625	10,991	11,960	501	853	26,681	30,438
(Loss) income from operations	(2,204 )	(3,916 )	471	(93 )	(501 )	(853 )	(2,234 )	(4,863 )
Other (expense) and income:								
Loss on disposal of assets	(87 )	—	—	—	—	—	(87 )	—
Equity in OTM	—	—	—	—	7	(70 )	7	(70 )
Interest income	—	—	—	—	—	—	—	—
Interest expense	(166 )	(324 )	—	—	(178 )	—	(344 )	(324 )
Total other (expense) and income	(253 )	(324 )	—	—	(171 )	(70 )	(424 )	(394 )
(Loss) and income before taxes	(2,457 )	(4,240 )	471	(93 )	(672 )	(923 )	(2,658 )	(5,256 )
Income taxes benefit from continuing operations	—	—	—	—	—	(240 )	—	(240 )
Net (loss) income from continuing operations	\$(2,457 )	\$(4,240 )	\$471	\$(93 )	\$(672 )	\$(683 )	\$(2,658 )	\$(5,016 )

The Company operates in the healthcare market, specializing in the development, manufacture and marketing of (1) ophthalmic medical devices and pharmaceuticals; (2) in-vitro diagnostic (“IVD”) instrumentation and consumables for use in human and veterinary hematology. The business segments reported above are the segments for which separate financial information is available and for which operating results are evaluated regularly by executive management in deciding how to allocate resources and assessing performance. The accounting policies of the business segments are the same as those described in the summary of significant accounting policies. For the purposes of this illustration, corporate expenses, which consist primarily of executive management and administrative support functions, are allocated across the business segments based upon a methodology that has been established by the Company, which includes a number of factors and estimates and that has been consistently applied across the business segments. These expenses are otherwise included in the corporate segment.

During the fiscal years ended June 30, 2012 and 2011, ECD derived its revenue from the sale of instrumentation and consumables for blood cell counting and blood analysis in the areas of diabetes, cardiovascular diseases and human and veterinary hematology. Sonomed-Escalon derived its revenue from the sale of A-Scans, B-Scans and pachymeters. These products are used for diagnostic or biometric applications in ophthalmology. Revenue from the sale of ISPAN gas products and various disposable ophthalmic surgical products are from CFA digital imaging systems and related products.

No customer represented more than 10% of consolidated revenue from continuing operations for the years ended June 30, 2012 and 2011. Foreign sales in 2012 decreased \$14,000 or 0.2% to \$5,929,000.

	2012	2011
ECD	\$211,234	\$84,056



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Sonomed-Escalon	5,717,769	5,859,438		
Total	\$5,929,003	\$5,943,494		
Total Net Revenue	\$24,446,525	\$25,575,276		
	24.3	% 23.2		%

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## 13. Related Party Transactions

Escalon and a member of the Company's Board of Directors are founding and equal members of Ocular Telehealth Management, LLC ("OTM"). OTM is a diagnostic telemedicine company providing remote examination, diagnosis and management of disorders affecting the human eye. OTM's initial solution focuses on the diagnosis of diabetic retinopathy by creating access and providing annual dilated retinal examinations for the diabetic population. OTM was founded to harness the latest advances in telecommunications, software and digital imaging in order to create greater access and a more successful disease management for populations that are susceptible to ocular disease. Through June 30, 2012, Escalon had invested \$444,000 in OTM and owned 45% of OTM. No additional investments were made during the year ended June 30, 2012. The Company provides administrative support functions to OTM. For the years ended 2012 and 2011 the Company recorded a gain of \$7,000 and a loss of \$70,000, respectively. At June 30, 2012 OTM had total assets, liabilities and equity of \$9,000, \$80,000 and (\$71,000), respectively. During the year ended June 30, 2012, Richard J. DePiano, Sr., the Company's Chief Executive Officer, participated in an accounts receivable factoring program that was implemented by the Company. Under the program, Mr. DePiano advanced the Company \$300,000 which represented 80% of an amount due from certain Drew customers. The receivables were not eligible to be sold to the Company's usual factoring agent. Interest on the transaction is 1.75% per month, which is equal to the best price offered by the Company's usual factoring agent. The transaction excluded fees typically charged by the factoring agent and provided much needed liquidity to the Company. As of June 30, 2012 interest expense of \$24,715 was accrued.

## 14. Fair Value Measurements

On July 1, 2008, the Company adopted the FASB-issued authoritative guidance for the fair value of financial assets and liabilities. This standard defines fair value and establishes a hierarchy for reporting the reliability of input measurements used to assess fair value for all assets and liabilities. The FASB issued authoritative guidance defines fair value as the selling price that would be received for an asset, or paid to transfer a liability, in the principal or most advantageous market on the measurement date. The hierarchy established prioritizes fair value measurements based on the types of inputs used in the valuation technique. The inputs are categorized into the following levels:

Level 1—Observable inputs such as quoted prices in active markets for identical assets or liabilities.

Level 2—Directly or indirectly observable inputs for quoted and other than quoted prices for identical or similar assets and liabilities in active or non-active markets.

Level 3—Unobservable inputs not corroborated by market data, therefore requiring the entity to use the best available information available in the circumstances, including the entity's own data.

Certain financial instruments are carried at cost on the consolidated balance sheets, which approximates fair value due to their short-term, highly liquid nature. These instruments include cash and cash equivalents, accounts receivable, accounts payable, accrued expenses and related party note payable.

The Company determined that the fair value of the outstanding debt approximates the outstanding balances based on the remaining maturity of the note for the Biocode debt and other Level 3 measurements. By "other level 3 measurements" the Company is referring to "unobservable inputs not corroborated by market data, therefore requiring the entity to use the best available information available in the circumstances, including the entity's own data". The Company included this reference because in determining the estimated fair value of our debt we first attempted to use a "commonly accepted valuation methodology" of applying rates currently available to the Company for debt with similar terms and remaining maturities. The debt currently on the Company's balance sheet is related to the acquisition of Biocode Hycell on December 31, 2008. The acquisition was 100% financed by the seller. Management concluded that given the financial state of the Company and the overall state of the credit markets there is no financial institution that would make available funds to the Company for the 100% financing of a foreign entity with similar terms and remaining maturities, or in fact, on any terms. The Company then considered whether there was any "level 3" considerations, as defined above, which might aid the Company in determining the fair market value of this unique form of debt. The Company determined that there was not and came to the conclusion that given the weakened state of the Company and overall market conditions there was no other source of financing available to the Company, from

any source on any terms, other than the willing seller of the Biocode assets. Therefore, the Company concluded that the fair market value of the debt remains equal to its book value at June 30, 2012 and 2011.

15. Drew Dallas Austerity Plan Update

Drew has committed to a plan to outsource all of its instrument manufacturing and closing its manufacturing facility in

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Dallas. During the year ended June 30, 2012, the DS5 and the DS360 were successfully outsourced to an equipment manufacturer in Missouri, as such, Drew will see an increase in the availability of these instruments for sale in the coming year. Drew is continuing to seek out an outsource partner for the Excell 2280 and the Hemavet. The Hemavet remains in full production at our Dallas facility and Drew anticipates having Hemavets available for sale adequate to cover demand for these instruments until an outsource partner is identified. The availability of Excell 2280 instruments in quantities necessary to meet demand will be limited until Drew identifies an outsource partner. Drew is currently projecting a Dallas facility closing date of December 31, 2012. Approximately \$120,000 was accrued at June 30, 2011 to cover severance expenses related to the closing of this facility.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None

ITEM 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

As of the end of the period covered by this Annual Report on Form 10-K, the Company's management evaluated, with the participation of the Company's principal executive officer and principal financial officer, the effectiveness of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934). Based upon that evaluation, the Company's principal executive officer and principal financial officer concluded that the Company's disclosure controls and procedures are effective in ensuring that information required to be disclosed by the company in the reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and is accumulated and communicated to our management, including the Company's principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure. Management's Report on Internal Control over Financial Reporting

The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934). The Company's internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP and includes those policies and procedures that:

• Pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the Company's assets;

• Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with GAAP, and that the Company's receipts and expenditures are being made only in accordance with authorizations of the Company's management and directors; and

• Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on our financial statements.

As of the end of the period covered by this Annual Report on Form 10-K, the Company's management evaluated, with the participation of its principal executive officer and principal financial officer, the effectiveness of the Company's internal control over financial reporting. This evaluation was conducted using the framework in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based upon that evaluation, the Company's management concluded that its internal control over financial reporting was effective as of June 30, 2012.

Pursuant to the rules of the SEC, the Company's management's report on internal control over financial reporting is furnished with this Annual Report on Form 10-K and shall not be deemed to be "filed" for purposes of Section 18 of the Securities Exchange Act of 1934 or otherwise subject to the liabilities of that section, nor shall it be deemed to be incorporated by reference in any filing under the Securities Act of 1933 or Securities Exchange Act of 1934.

This Annual Report on Form 10-K does not include an attestation report of the Company's independent registered public accounting firm regarding our internal control over financial reporting. The Company's management's report on internal control over financial reporting was not subject to attestation by the Company's independent registered public accounting firm

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pursuant to temporary rules of the Securities and Exchange Commission that permit us to provide only the Company's management's report on internal control over financial reporting in this Annual Report on Form 10-K.

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting that occurred during our fourth fiscal quarter of 2012 that would have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

ITEM 9B OTHER INFORMATION

None

PART III

ITEM 10 DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

Item 10 will be provided by incorporating the information required under such item by reference to the Company's Proxy Statement to be filed with the SEC no later than 120 days after the end of the fiscal year covered by this Form 10-K annual report, or, alternatively, by amendment to this Form 10-K annual report under cover of Form 10-K/A no later than the end of such 120-day period.

ITEM 11. EXECUTIVE COMPENSATION

Item 11 will be provided by incorporating the information required under such item by reference to the Company's Proxy Statement to be filed with the SEC no later than 120 days after the end of the fiscal year covered by this Form 10-K annual report, or, alternatively, by amendment to this Form 10-K annual report under cover of Form 10-K/A no later than the end of such 120-day period.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

Item 12 will be provided by incorporating the information required under such item by reference to the Company's Proxy Statement to be filed with the SEC no later than 120 days after the end of the fiscal year covered by this Form 10-K annual report, or, alternatively, by amendment to this Form 10-K annual report under cover of Form 10-K/A no later than the end of such 120-day period.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

Item 13 will be provided by incorporating the information required under such item by reference to the Company's Proxy Statement to be filed with the SEC no later than 120 days after the end of the fiscal year covered by this Form 10-K annual report, or, alternatively, by amendment to this Form 10-K annual report under cover of Form 10-K/A no later than the end of such 120-day period.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

Item 14 will be provided by incorporating the information required under such item by reference to the Company's Proxy Statement to be filed with the SEC no later than 120 days after the end of the fiscal year covered by this Form 10-K annual report, or, alternatively, by amendment to this Form 10-K annual report under cover of Form 10-K/A no later than the end of such 120-day period.

PART IV

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ITEM 15. EXHIBITS FINANCIAL STATEMENT SCHEDULES

1. Documents Filed as Part of This Annual Report on Form 10-K:

a. Financial Statements

The following consolidated financial statements of the Company and its subsidiaries are included in Part II, Item 8 of this Annual Report on Form 10-K:

Report of Independent Registered Public Accounting Firm

Consolidated Balance Sheets as of June 30, 2012 and 2011

Consolidated Statements of Operations for the years ended June 30, 2012 and 2011

Consolidated Statements of Comprehensive Loss for the years ended June 2012 and 2011

Consolidated Statements of Shareholders' Equity for the years ended June 30, 2012 and 2011

Consolidated Statements of Cash Flows for the years ended June 30, 2012 and 2011

Notes to Consolidated Financial Statements

2. Financial Statement Schedules

All other schedules have been omitted because the required information is not applicable or the information is included in the Company's Consolidated Financial Statements or the related Notes to Consolidated Financial Statements.

3. EXHIBITS

The following is a list of exhibits filed as part of this Annual Report on Form 10-K, where so indicated by footnote, exhibits that were previously filed, are incorporated by reference. For exhibits incorporated by reference, the location of the exhibit in the previous filing is indicated parenthetically, followed by the footnote reference to the previous filing.

- 3.1 (a) Restated Articles of Incorporation of the Company. (8)
- (b) Agreement and Plan of Merger dated as of September 28, 2001 between Escalon Pennsylvania, Inc. and Escalon Medical Corp. (8)
- 3.2 Bylaws of Registrant. (8)
- 4.5 (a) Warrant Agreement between Registrant and U.S. Stock Transfer Corporation. (1)
- (b) Amendment to Warrant Agreement between the Company and U.S. Stock Transfer Corporation. (2)
- (c) Amendment to Warrant Agreement between the Company and American Stock Transfer Corporation. (3)
- 10.6 Employment Agreement between the Company and Richard J. DePiano dated May 12, 1998. (6)\*\*
- 10.7 Non-Exclusive Distributorship Agreement between Company and Scott Medical Products dated October 12, 2000. (9)
- 10.13 Supply Agreement between the Company and Bausch & Lomb Surgical, Inc. dated August 13, 1999. (5)
- 10.29 Company's amended and restated 1999 Equity Incentive Plan. (13) \*\*





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- 10.30 Securities Purchase Agreement dated as of March 16, 2004 (the “Securities Purchase Agreement”) between the Company and the Purchasers signatory thereto. (14)
- 10.31 Registration Rights Agreement dated as of March 16, 2004 between the Company and the Purchasers signatory thereto. (14)
- 10.32 Form of Warrant to Purchase Common Stock issued to each Purchaser under the Securities Purchase Agreement. (14)
- 10.33 Manufacturing Supply and Distribution Agreement between Sonomed, Inc. and Ophthalmic Technologies, Inc. dated as of March 11, 2004. (15)
- 10.34 Supplemental Executive Retirement Benefit Agreement for Richard DePiano dated June 23, 2005. (16)\*\*
- 10.35 Settlement Agreement with Intralase Corp, dated February 27, 2008 (4).
- 10.36 Vascular Access Sales Agreement with Vascular Solutions, Inc. dated April 28, 2010 (17)
- 21 Subsidiaries. (11)
- 23.1 Consent of Independent Registered Public Accounting Firm (\*).
- 31.1 Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes Oxley Act of 2002 (\*).
- 31.2 Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes Oxley Act of 2002 (\*).
- 32.1 Certification of the Chief Executive Officer pursuant to Section 906 of the Sarbanes Oxley Act of 2002 (\*).
- 32.2 Certification of the Chief Financial Officer pursuant to Section 906 of the Sarbanes Oxley Act of 2002 (\*).

\* Filed herewith

\*\* Management contract of compensatory plan

- (1) Filed as an exhibit to Pre-Effective Amendment No. 2 to the Company’s Registration Statement on Form S-1 dated November 9, 1993 (Registration No. 33-69360).
- (2) Filed as an exhibit to the Company’s Form 10-KSB for the year ended June 30, 1994.
- (3) Filed as an exhibit to the Company’s Form 10-KSB for the year ended June 30, 1995.
- (4) Filed as an exhibit to the Company’s Form 8-K dated February 27, 2008.
- (5) Filed as an exhibit to the Company’s Form 10-KSB for the year ended June 30, 1999.
- (6) Filed as an exhibit to the Company’s Form 8-K/A, dated March 31, 2000
- (7) Filed as an exhibit to the Company’s Registration Statement on Form s-\* dated February 25, 2000 (Registration No. 333-31138).
- (8) Filed as an exhibit to the Company’s Proxy Statement on Schedule 14A, as filed by the Company with the SEC on September 21, 2001.
- (9) Filed as an exhibit to the Company’s Form 10-KSB for the year ended June 30, 2001.
- (10) Filed as an exhibit to the Company’s Form 10-Q for the quarter ended March 31, 2001.
- (11) Filed as an exhibit to the Company’s Form 10-KSB/A for the year ended June 30, 2002.
- (12) Filed as an exhibit to the Company’s Form 10-Q for the quarter ended December 31, 2002.
- (13) Filed as an exhibit to the Company’s Form 10-Q for the quarter ended December 31, 2003.

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- (14) Filed as an exhibit to the Company's Registration Statement on Form s\_3 dated April 8, 2004 (Registration No. 333-114332).
- (15) Filed as an exhibit to the Company's Form 10-Q for the quarter ended March 31, 2004.
- (16) Filed as an exhibit to the Company's Form 8-K, dated June 23, 2005.
- (17) Filed as an exhibit to the Company's Form 8-K, dated May 6, 2010.

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Signatures

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Escalon Medical  
Corp.  
(Registrant)

By: /s/ Richard J. DePiano  
Richard J. DePiano  
Chairman and Chief Executive Officer

Dated: September 26, 2012

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

By: /s/ Richard J. DePiano Richard J. DePiano	Chairman and Chief Executive Officer (Principal Executive Officer) and Director	September 26, 2012
By: /s/ Robert M. O'Connor Robert M. O'Connor	Chief Financial Officer (Principal Financial and Accounting Officer)	September 26, 2012
By: /s/ Anthony Coppola Anthony Coppola	Director	September 26, 2012
By: /s/ Jay L. Federman Jay L. Federman	Director	September 26, 2012
By: /s/ William L.G. Kwan William L.G. Kwan	Director	September 26, 2012
By: /s/ Lisa Napolitano Lisa Napolitano	Director	September 26, 2012
By: /s/ Fred Choate Fred Choate	Director	September 26, 2012