ESCALON MEDICAL CORP
Form 10-K
September 26, 2014

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, 2014
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.) |

100 Church Road, Suite 200, Ardmore, PA 19004
(Address of principal executive offices, including zip code)
(610) 688-6830
(Registrant's telephone number, including area code)

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 o No x
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 o No x

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 x No o

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 x No o

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 x No o

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 | o | Accelerated filer | o |
| Non-accelerated filer | o (Do not check if a smaller reporting company) | Smaller reporting company | x |

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant on December 31, 2013 was approximately $14,827,067, 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 25, 2014, 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 2014 Annual Meeting of Shareholders.

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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 Medical Europe GmbH (inactive), Escalon Digital Solutions, Inc. (“EMI”), Escalon Pharmaceutical, Inc. (“Pharmaceutical” inactive), Escalon Holdings, Inc. (“EHI”), Escalon IP Holdings, Inc., Sonomed IP Holdings, Inc., Drew Scientific Holdings, Inc. (discontinued), Drew Scientific Inc. (discontinued), and Drew Scientific Group, Plc (“Drew”) and its subsidiaries (discontinued). All intercompany accounts and transactions have been eliminated.

On October 3, 2012 the Company sold its Clinical Diagnostics Business to ERBA Diagnostics, Inc. The Escalon Clinical Diagnostics Business ("ECD") consisted of Drew Scientific, Inc., and its wholly owned subsidiaries JAS Diagnostics, Inc. ("JAS") and Drew Scientific Limited Co. The sales price was $6,500,000 in cash. The sale of this business had a material effect on earnings in subsequent periods. ECD prior period amounts are presented as discontinued operations (see footnote 10 to the Notes to Condensed Consolidated Financial Statements for additional information).

On October 18, 2012, the Company and its debt holder reached an agreement whereby the Company paid the balance of the seller-provided financing plus accrued interest related to the purchase of certain assets of BH Holdings, S.A.S ("Biocode" or "BHH") of $4,367,604 with a one-time payment of $2,487,480 resulting in a gain on extinguishment of debt of $1,880,124 which was included in discontinued operations. The repayment of the debt has reduced the Company's debt related to Biocode to zero.

As a result of these transactions the Company realized total gains of approximately $4,019,000. The total gain brought the Company back into compliance 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 operates in the healthcare market, specializing in the development, manufacture, marketing and distribution of medical devices and pharmaceuticals in the area of ophthalmology. 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 now reviews financial information, allocates resources and manages the business as two segments. 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: 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
The CFA (Color/Fluorescein Angiography) digital imaging system is 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.

AXIS Image Management

The AXIS Image management system easily manages images via the web from any device regardless of modality, manufacturer or location.

Business Segment No. 2: Escalon Medical Corp.
The Escalon Medical Corp. business segment includes the administrative corporate operations of the consolidated group.

Research and Development
The development of ultrasound ophthalmic equipment is performed at the Company's Lake Success, New York and Stoneham, Massachusetts facilities. Company-sponsored research and development expenditures from continuing operations for the fiscal years ended June 30, 2014 and 2013 were approximately $1,306,000 and $1,105,000,

respectively.

Manufacturing and Distribution

The Company leases 11,250 square feet of space in Wisconsin, for its surgical products. The facility is currently used for product assembly related to Trek. The Company also leases 3,452 square feet in Stoneham, 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.

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 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.

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.

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 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.

Human Resources

As of June 30, 2014, the Company employed 58 employees. Of these employees, 22 of the Company's employees are employed in manufacturing, 24 are employed in general and administrative positions, 4 are employed in sales and marketing and 8 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,” “wi 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 on 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 include, without limitation, the following:

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, 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:

- 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;
- 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.

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
- 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;
- 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 those 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.

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
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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.

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 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 and implementation of the Affordable Healthcare Act, 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, establishes new regulations on health plans, and creates 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.

Dilution

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 favorable. 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.

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

## ITEM 1B. UNRESOLVED STAFF COMMENTS

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

## ITEM 2. PROPERTIES

As of June 30, 2014 the Company leased an aggregate of 32,729 square feet of space for its (i) corporate offices in Wayne, Pennsylvania, (ii) Sonomed has a manufacturing facility in Lake Success, New York, (iii) Trek's distribution facility in New Berlin, Wisconsin, and (iv) EMI's product design and development facility in Stoneham, Massachusetts. The Company moved its corporate offices to 2,500 square feet located in Ardmore, Pennsylvania August 1, 2013 under a month to month lease. 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 BHH liquidation through the end of the remaining lease term, net of contractual or estimated sublease rental income. The Company has recognized accrued lease termination cost of $592,837 and $493,435 as of June 30, 2014 and 2013,

respectively. 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 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 $506,000 from continuing operations for the year ended June 30, 2014.

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, 2014 | | |
| Quarter ended September 30, 2013 | $1.51 | $1.14 |
| Quarter ended December 31, 2013 | $2.18 | $1.20 |
| Quarter ended March 31, 2014 | $2.29 | $1.34 |
| Quarter ended June 30, 2014 | $1.70 | $1.42 |
| Fiscal year ended June 30, 2013 | | |
| Quarter ended September 30, 2012 | $0.93 | $0.31 |
| Quarter ended December 31, 2012 | $1.10 | $0.39 |
| Quarter ended March 31, 2013 | $1.18 | $1.01 |
| Quarter ended June 30, 2013 | $1.50 | $1.01 |

As of September 24, 2014, there were 1,304 holders of record of the Company's common stock. On September 24, 2014 the closing price of the Company's Common Stock as reported by the NASDAQ Capital Market was $1.69 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.

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 two business segments: Sonomed-Escalon and Escalon Medical Corp. On October 3, 2012 the Company sold its ECD business to ERBA Diagnostics, Inc. The ECD segment consisted of Drew Scientific, Inc., and its wholly owned subsidiaries JAS and Drew Scientific Limited Co. ECD was a diagnostics company specializing in the design, manufacture and distribution of instruments for blood cell counting and blood analysis. ECD was focused on providing instrumentation and consumables for the physician office and veterinary office laboratories. ECD also supplied 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 10 of the Company's June 30, 2014 annual consolidated financial statements for additional information). The sales price was $6,500,000 in cash. The sale of this business had a material effect on earnings in subsequent periods. ECD

prior period amounts are presented as discontinued operations (see footnote 10 to the Notes to Condensed Consolidated Financial Statements for additional information).

On October 18, 2012, the Company and its debt holder reached an agreement whereby the Company paid the balance of the seller-provided financing plus accrued interest related to the purchase of certain assets of BHH of $4,367,604 with a one-time payment of $2,487,480 resulting in a gain on extinguishment of debt of $1,880,124 which was included in discontinued operations. The repayment of the debt has reduced the Company's debt related to Biocode to zero.

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 and image management systems.

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—Business.

Executive Overview—Fiscal Years Ended June 30, 2014 and 2013

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 increased approximately $857,000 or 7.5% during the fiscal year ended June 30, 2014 as compared to the prior fiscal year. The increase in revenue is attributed to the increased sales in Sonomed’s ultrasound products of $433,000, in Digital products of $389,000 and in Trek products of $35,000.
- Cost of goods sold as a percentage of product revenue from continuing operations decreased to approximately 50.9% of product revenues during the fiscal year ended June 30, 2014, as compared to approximately 51.4% of product revenue for the prior fiscal year. The decrease of 0.5% in cost of goods sold as a percentage of revenue is due mainly to the product mix sold during the current period.
- Operating expenses decreased approximately 5.9% during the fiscal year ended June 30, 2014, as compared to the prior fiscal year. This was due to decreased marketing, general and administrative expenses of 10.6% and offset by an increase of 18.2% in research and development.
- The fourth quarter was hampered by the transition to new products which involved the discounting of our older product inventory as well as the distribution of demonstration devices to our distributors which pressured margins.

Results of Operations

Fiscal Years Ended June 30, 2014 and 2013

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, 2014 and 2013. Table amounts are in thousands:

| | Fiscal Years Ended June 30, | | | |
|---|---|---|---|---|
| | 2014 | 2013 | % Change | |
| Product Revenue: | | | | |
| Sonomed-Escalon | $12,354 | $11,497 | 7.5 | % |
| Total | $12,354 | $11,497 | 7.5 | % |

Consolidated product revenue from continuing operations increased approximately $857,000 or 7.5%, to $12,354,000 during the year ended June 30, 2014 as compared to the last fiscal year. The increase in revenue is attributed to the increased sales in Sonomed's ultrasound products of $433,000, increase in Digital products of $389,000 and in Trek products of $35,000.

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, 2014 and 2013. Table amounts are in thousands:

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| | Fiscal Years Ended June 30, | | | | |
|---|---|---|---|---|---|
| | 2014 | % | | 2013 | % |
| Cost of Goods Sold: | | | | | |
| Sonomed-Escalon | $6,292 | 50.9 | % | $5,905 | 51.4 % |
| Total | $6,292 | 50.9 | % | $5,905 | 51.4 % |

Consolidated cost of goods sold from continuing operations totaled approximately $6,292,000, or 50.9%, of product revenue from continuing operations, for the fiscal year ended June 30, 2014 , as compared to $5,905,000, or 51.4%, of product revenue from continuing operations, for the prior fiscal year. The decrease of 0.5% in cost of goods sold as a percentage of revenue is due mainly to the product mix sold during the current period.

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, 2014 and 2013. Table amounts are in thousands:

| | Fiscal Years Ended June 30, | | | |
|---|---|---|---|---|
| | 2014 | 2013 | % Change | |
| Marketing, General and Administrative: | | | | |
| Sonomed-Escalon | $2,879 | $3,083 | (6.6 | )% |
| Escalon Medical | 2,234 | 2,635 | (15.2 | )% |
| Total | $5,113 | $5,718 | (10.6 | )% |

Consolidated marketing, general and administrative expenses from continuing operations decreased $605,000, or 10.6%, to $5,113,000 during the fiscal year ended June 30, 2014, as compared to the prior fiscal year.

Marketing, general and administrative expenses in the Sonomed-Escalon business segment decreased $204,000, or 6.6%, to $2,879,000, as compared to the same period last fiscal year. The decrease is due to reduction in payroll, consulting fees, meeting and travel expense.

Marketing, general and administrative expenses in the corporate segment decreased $401,000, or 15.2% to $2,234,000, as compared to the same period last fiscal year. The decrease is due to reduced payroll, health insurance, commercial insurance, accounting expense, rental fee and SEC filing expenses.

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, 2014 and 2013.

Table amounts are in thousands:

| | Fiscal Years Ended June 30, | | | |
|---|---|---|---|---|
| | 2014 | 2013 | % Change | |
| Research and Development: | | | | |
| Sonomed Escalon | $1,306 | $1,105 | 18.2 | % |
| Total | $1,306 | $1,105 | 18.2 | % |

Consolidated research and development expenses from continuing operations increased $201,000, or 18.2% of product revenue, to $1,306,000 during the fiscal year ended June 30, 2014, as compared to the prior fiscal year. Research and development expenses were primarily expenses associated with the introduction of new or enhanced products in the Sonomed-Escalon business unit.

No customer represented more than 10% of consolidated revenue from continuing operations for the years ended June 30, 2014 and 2013. Foreign sales in 2014 increased $706,192 or 15% to $5,420,401.

| | 2014 | 2013 | |
|---|---|---|---|
| Sonomed-Escalon | 5,420,401 | 4,714,209 | |
| Total | 5,420,401 | 4,714,209 | |
| Total Net Revenue | 12,353,796 | 11,496,834 | |
| | 43.9 | % 41.0 | % |

Discontinued Operations

For the years ended June 30, 2014 and 2013 the Company had net loss from discontinued operations of $32,000 and net income from discontinued operation of $3,857,000, respectively. The current year loss is mainly due to an increase in the accrued BHH lease contingency liability.
The prior year amount for income from discontinued operations is mainly due to a gain from the sale of Drew of $2,717,000, the gain related to the debt settlement of $1,880,000 offset by the cumulative translation adjustment related to Drew of $578,000.

Other Income (Expense)
The Company recognized other income of approximately $8,000 and $78,000 during the fiscal years ended June 30, 2014 and 2013, respectively.
Interest expense was $0 and $79,000 for the fiscal years ended June 30, 2014 and 2013, respectively. The decrease is related to the settlement of debt after the sale of Drew on October 3, 2012.
Liquidity and Capital Resources
The following table presents overall liquidity and capital resources as of June 30, 2014 and 2013. Table amounts are in thousands:

| | June 30, 2014 | 2013 | |
|---|---|---|---|
| Current Ratio: | | | |
| Current assets | $6,897 | $6,523 | |
| Less: Current liabilities | 3,351 | 2,520 | |
| Working capital | $3,546 | $4,003 | |
| Current ratio | 2.1 to 1 | 2.6 to 1 | |
| Debt to Total Capital Ratio: | | | |
| Notes payable and current portion of long-term debt | $— | $— | |
| Total debt | — | — | |
| Total equity | 3,464 | 3,829 | |
| Total capital | $3,464 | $3,829 | |
| Total debt to total capital | — | % — | % |

Working Capital Position
Working capital decreased $457,000 as of June 30, 2014, and the current ratio decreased to 2.1 to 1 from 2.6 to 1 when compared to June 30, 2013.
Overall total current assets increased $374,000 to $6,897,000 in 2014 from $6,523,000 in 2013. Total current liabilities, which consists of current portion of post-retirement pension benefits, accounts payable, accrued expenses, and liabilities of discontinued operations, increased $831,000 to $3,351,000 in 2014 from $2,520,000 in 2013.

The Debt to Total Capital Ratio is 0% in 2014 and 2013 due to the settlement of debt after the sale of Drew.

Cash Used In or Provided By Operating Activities

During fiscal 2014, the Company used approximately $623,000 of cash for operating activities as compared to using approximately $1,934,000 for operating activities during the year ended June 30, 2013.

For the year ended June 30, 2014, the Company had a net loss of $382,000, which includes net loss from discontinued operations of $32,000, a decrease in accounts receivable of $36,000, an increase in inventory of $1,057,000, a decrease in other current assets of $2,000 and a decrease in accrued post retirement benefits of $82,000, and an increase in accounts payable and accrued expenses of $812,000, partially offset by non cash items of depreciation and amortization of $13,000 and compensation expense related to stock options of $17,000.

The increase in inventory is related to the new VuPad product recently introduced by Sonomed. The Company expects demand for its new VuPad product to increase during the first half of fiscal year 2015.

For the year period ended June 30, 2013, the Company had a net income of $2,624,000, which includes net income from discontinued operations of $3,857,000, an increase in accounts receivable of $382,000, an increase in inventory of $419,000, other income of $14,000, a increase in other current assets of $89,000, decrease in accrued post retirement benefits of $17,000, and a decrease in accounts payable and accrued expenses of $152,000, partially offset by non cash items of depreciation and amortization of $14,000 and compensation expense related to stock options of $44,000.

Cash flow from operations also included $13,000 and $314,000 used in and provided by operating activities from discontinued operations for the years ended June 30, 2014 and 2013, 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 2014 were approximately $23,000 related to the purchase of fixed assets from continuing operations.

Cash flows provided by investing activities for 2013 were approximately $6,486,000 primarily related to the proceeds from the sale of Drew of $6,500,000, offset by purchase of fixed assets from continuing operations of $6,000 and the purchase of fixed assets from discontinued operations of $8,000.

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.

During 2014 there was no cash flows used in or provided by financing activities.

Cash flows used in financing activities in the amount of $2,787,000 during 2013 relate to settlement of the debt related to the BHH purchase of $2,487,000 and repayment of a related party note payable of $300,000.

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 favorable. 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 was 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 accrued 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 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 was 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 10 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 was 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 intended 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 recorded the entire debt of $4,149,516 as a current liability.

On October 18, 2012, the Company and its debt holder reached an agreement whereby the Company paid off the balance of the seller-provided financing of $4,367,604 with a one-time payment of $2,487,480 resulting in a gain on extinguishment of debt of $1,880,124. The repayment of the debt reduced the Company's debt related to Biocode to zero.

During the year ended June 30, 2013 , 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 1.25% per month, which was 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. Related party interest expense for the year ended June 30, 2013 $11,250. The entire amount due of $332,216 including accrued interest of $32,216, was paid in full on October 5, 2012.

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 September 24, 2014 the Company is compliant with each of these requirements.

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 the provisions of FASB issued authoritative guidance for Goodwill and Other Intangible Assets, or whenever events or changes in circumstances indicate that the carrying value may not be recoverable. 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 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, 2014, the Company has recorded a valuation allowance against the Company's net operating losses for 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 yield curve in effect at the time of the grant.

Recently Issued Accounting Standards

In July 2013, the FASB issued ASU 2013-11, Income Taxes (Topic 740), which clarifies the presentation requirements of unrecognized tax benefits when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists at the reporting date. The amendments in this ASU are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013 and should be applied prospectively. The adoption of this ASU is not expected to have a material impact to the Company's consolidated financial statements.

In February 2013, FASB issued Accounting Standards Update 2013-02, Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income to improve the transparency of reporting these reclassifications. Other comprehensive income (loss) includes gains and losses that are initially excluded from net income for an accounting period. Those gains and losses are later reclassified out of accumulated other comprehensive income into net income. The amendments in this ASU do not change the current requirements for reporting net income or other comprehensive income in financial statements. All of the information that this ASU

requires already is required to be disclosed elsewhere in the financial statements under U.S. GAAP. The new amendments will require an organization to (i) present the effects on the line items of net income of significant amounts reclassified out of accumulated other comprehensive income, but only if the item reclassified is required under U.S. GAAP to be reclassified to net income in its entirety in the same reporting period; and (ii) cross-reference to other disclosures currently required under U.S. GAAP for other reclassification items to be reclassified directly to net income in their entirety in the same reporting period. The amendments are effective for interim and annual

reporting periods beginning after December 15, 2012. The adoption of this standard did not have a material impact to the Company's consolidated financial statements.

In July 2013, FASB issued Accounting Standards Update 2014-02 Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists to reduce diversity in practice by providing guidance on the presentation of unrecognized tax benefits. Under the new provision an unrecognized tax benefit, or a portion of an unrecognized tax benefit, should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward with some exceptions. The amendments in this Update are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. The adoption of this standard is not expected to have a material impact to the Company's consolidated financial statements.

In March 2014, FASB issued Accounting Standards Update 2014-07 Consolidation (Topic 810) Applying Variable Interest Entities Guidance to Common Control Leasing Arrangements. The amendments permit a private company lessee (the reporting entity) to elect an alternative not to apply VIE guidance to a lessor entity if (a) the private company lessee and the lessor entity are under common control, (b) the private company lessee has a lease arrangement with the lessor entity, (c) substantially all of the activities between the private company lessee and the lessor entity are related to leasing activities (including supporting leasing activities) between those two entities, and (d) if the private company lessee explicitly guarantees or provides collateral for any obligation of the lessor entity related to the asset leased by the private company, then the principal amount of the obligation at inception of such guarantee or collateral arrangement does not exceed the value of the asset leased by the private company from the lessor entity. The alternative will be effective for annual periods beginning after December 15, 2014, and interim periods within annual periods beginning after December 15, 2015. The adoption of this standard is not expected to have a material impact to the Company's consolidated financial statements.

In April 2014 FASB issued Accounting Standards Update 2014-08 Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360) Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity. Under the new provision only those disposals of components of an entity that represent a strategic shift that has (or will have) a major effect on an entity's operations and financial results will be reported as discontinued operations in the financial statements; a business or nonprofit activity that, on acquisition, meets the criteria to be classified as held for sale is reported in discontinued operations; and a disposal of an equity method investment that meets the definition of discontinued operation is reported in discontinued operations. The adoption of this standard is not expected to have a material impact to the Company's consolidated financial statements.

In May 2014 FASB issued Accounting Standards Update 2014-09 Revenue from Contracts with Customers (Topic 606). Under the new provision, an entity should apply five steps for revenue recognition to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. For a public entity, the amendments in this Update are effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. Early application is not permitted. The adoption of this standard is not expected to have a material impact to the Company's consolidated financial statements.

In June 2014 FASB issued Accounting Standards Update 2014-11 Compensation-Stock Compensation (Topic 718). Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period. The amendments require that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. The adoption of this standard is not expected to have a material impact to the Company's consolidated financial statements.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Escalon Medical Corp.
Index to Consolidated Financial Statements

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, 2014 and 2013, and the related consolidated statements of operations, comprehensive income (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, 2014 and 2013, and the consolidated results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

/s/ Mayer Hoffman McCann P.C.
Plymouth Meeting, Pennsylvania
September 26, 2014

ESCALON MEDICAL CORP. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

| | June 30, 2014 | June 30, 2013 |
|---|---|---|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | $2,009,554 | $2,654,701 |
| Accounts receivable, net | 1,690,156 | 1,725,841 |
| Inventory, net | 2,910,727 | 1,853,686 |
| Other current assets | 286,548 | 288,598 |
| Total current assets | 6,896,985 | 6,522,826 |
| Property and equipment, net | 24,456 | 12,594 |
| Goodwill | 125,027 | 125,027 |
| Trademarks and trade names | 605,006 | 605,006 |
| Patents, net | 4,800 | 6,712 |
| Total assets | $7,656,274 | $7,272,165 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Current portion of post-retirement benefits | $101,891 | $101,891 |
| Accounts payable | 1,486,081 | 672,926 |
| Accrued expenses | 1,169,943 | 1,171,281 |
| Liabilities of discontinued operations | 592,837 | 573,435 |
| Total current liabilities | 3,350,752 | 2,519,533 |
| Accrued post-retirement benefits, net of current portion | 841,699 | 923,706 |
| Total long-term liabilities | 841,699 | 923,706 |
| Total liabilities | 4,192,451 | 3,443,239 |
| 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 |
| Additional paid-in capital | 69,562,522 | 69,413,628 |
| Accumulated deficit | (66,106,225) | (65,724,342) |
| Total shareholders' equity | 3,463,823 | 3,828,926 |
| Total liabilities and shareholders' equity | $7,656,274 | $7,272,165 |

See notes to consolidated financial statements

ESCALON MEDICAL CORP. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS

| For the Years Ended June 30, | 2014 | 2013 |
|---|---|---|
| Net revenues: | | |
| Product revenue | $12,353,796 | $11,496,834 |
| Revenues, net | 12,353,796 | 11,496,834 |
| Costs and expenses: | | |
| Cost of goods sold | 6,291,611 | 5,905,112 |
| Marketing, general and administrative | 5,113,312 | 5,718,267 |
| Research and development | 1,306,387 | 1,105,255 |
| Total costs and expenses | 12,711,310 | 12,728,634 |
| Loss from continuing operations | (357,514) | (1,231,800) |
| Other (expense) income | | |
| Other income | 7,776 | 78,004 |
| Interest income | 206 | 246 |
| Interest expense | — | (79,479) |
| Total other (expense) income | 7,982 | (1,229) |
| Net loss from continuing operations | (349,532) | (1,233,029) |
| (Loss) income from discontinued operations before taxes | (106,351) | 3,937,498 |
| Benefit (provision) for income taxes | 74,000 | (80,000) |
| Net (loss) income from discontinued operations | (32,351) | 3,857,498 |
| Net (loss) income | $(381,883) | $2,624,469 |
| Net (loss) income per share | | |
| Basic: | | |
| Continuing operations | $(0.05) | $(0.16) |
| Discontinued operations | — | 0.51 |
| Net (loss) income | $(0.05) | $0.35 |
| Diluted: | | |
| Continuing operations | $(0.05) | $(0.16) |
| Discontinued operations | — | 0.51 |
| Net loss (income) | $(0.05) | $0.35 |
| Weighted average shares—basic | 7,526,430 | 7,526,430 |
| Weighted average shares—diluted | 7,526,430 | 7,526,430 |

See notes to consolidated financial statements

ESCALON MEDICAL CORP. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

| For the years ended June 30, | 2014 | 2013 |
|---|---|---|
| Net (loss) income | $(381,883) | $2,624,469 |
| Foreign currency translation | — | (62,814) |
| Add: Reclassification adjustment for foreign currency losses included in net income (loss) | — | 578,436 |
| Total comprehensive (loss) income | $(381,883) | $3,140,091 |

See notes to consolidated financial statements

ESCALON MEDICAL CORP. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
FOR THE YEARS ENDED JUNE 30, 2014 and 2013

| | 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, 2012 | 7,526,430 | $7,526 | $132,114 | $69,369,658 | $(68,348,811) | $ (515,622) | $644,865 |
| Net income | — | — | — | — | 2,624,469 | — | 2,624,469 |
| Foreign currency translation | — | — | — | — | — | 515,622 | 515,622 |
| Compensation expense | — | — | — | 43,970 | — | — | 43,970 |
| Balance at June 30, 2013 | 7,526,430 | 7,526 | 132,114 | 69,413,628 | (65,724,342) | — | 3,828,926 |
| Net loss | — | — | — | — | (381,883) | — | (381,883) |
| Expired warrants | — | — | (132,114) | 132,114 | — | — | — |
| Compensation expense | — | — | — | 16,780 | — | — | 16,780 |
| Balance at June 30, 2014 | 7,526,430 | $7,526 | $— | $69,562,522 | $(66,106,225) | $ — | $3,463,823 |

See notes to consolidated financial statements

ESCALON MEDICAL CORP. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

| Years Ended June 30, | 2014 | 2013 |
|---|---|---|
| Cash Flows from Operating Activities: | | |
| Net (loss) income | $(381,883) | $2,624,469 |
| Adjustments to reconcile net income (loss) to cash used in operating activities of continuing operations: | | |
| Net loss (income) from discontinued operations | 32,351 | (3,857,498) |
| Depreciation and amortization | 12,591 | 14,281 |
| Compensation expense related to stock options | 16,780 | 43,970 |
| Other income | — | (14,415) |
| Change in operating assets and liabilities: | | |
| Accounts receivable, net | 35,684 | (382,018) |
| Inventory, net | (1,057,041) | (419,426) |
| Other current assets | 2,051 | (89,286) |
| Accounts payable and accrued expenses | 811,817 | (151,812) |
| Change in accrued post-retirement benefits | (82,007) | (16,655) |
| Net cash (used in) operating activities from continuing operations | (609,657) | (2,248,390) |
| Net cash (used in) provided by operating activities from discontinued operations | (12,949) | 314,346 |
| Net cash (used in) operating activities | (622,606) | (1,934,044) |
| Cash Flows from Investing Activities: | | |
| Purchase of fixed assets | (22,541) | (5,780) |
| Net cash (used in) investing activities from continuing operations | (22,541) | (5,780) |
| Proceeds from sale of Drew | — | 6,500,000 |
| Purchase of fixed assets, discontinued operations | — | (8,618) |
| Net cash provided by investing activities from discontinued operations | — | 6,491,382 |
| Net cash (used in) provided by investing activities | (22,541) | 6,485,602 |
| Cash Flows from Financing Activities: | | |
| Repayments of related party note payable | — | (300,000) |
| Principal payments on long-term debt | — | (2,487,480) |
| Net cash (used in) financing activities from continuing operations | — | (2,787,480) |
| Net (decrease) increase in cash and cash equivalents | (645,147) | 1,764,078 |
| Cash and cash equivalents, beginning of year | 2,654,701 | 890,623 |
| Cash and cash equivalents, end of year | $2,009,554 | $2,654,701 |
| Supplemental Schedule of Cash Flow Information: | | |
| Interest paid | $— | $32,216 |
| Tax paid | $6,000 | $— |

See notes to consolidated financial statements

Escalon Medical Corp. and Subsidiaries
Notes to Consolidated Financial Statements

1. Organization and Description of Business and Business Conditions

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 Medical Europe GmbH (inactive), Escalon Digital Solutions, Inc. (“EMI”), Escalon Pharmaceutical, Inc. (“Pharmaceutical” inactive), Escalon Holdings, Inc. (“EHI”), Escalon IP Holdings, Inc., Sonomed IP Holdings, Inc., Drew Scientific Holdings, Inc. (discontinued), Drew Scientific Inc. (discontinued), and Drew Scientific Group, Plc (“Drew”) and its subsidiaries (discontinued). All intercompany accounts and transactions have been eliminated.

The Company operates in the healthcare market, specializing in the development, manufacture, marketing and distribution of medical devices and pharmaceuticals in the area of ophthalmology. 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.

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. had incurred recurring operating losses and negative cash flows from operating activities. These conditions raised substantial doubt in prior periods about the Company’s ability to continue as a going concern.

We believe that our existing cash and cash flow from operations will be sufficient to fund our activities throughout fiscal 2015. However, we have based this estimate on assumptions that may prove to be wrong, and we may use our available capital resources sooner than we currently expect. Further, our operating plan may change, and we may need additional funds to meet operational needs and capital requirements for product development and commercialization sooner than planned. Our forecast of the period of time through which our financial resources will be adequate to support our 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.”

With the sale of Escalon Clinical Diagnostics Business ("ECD") in October 2012 the Company is directing all of its research and development efforts towards Sonomed-Escalon and plans on introducing new and enhanced products the next 12 to 18 months.

Management reviews financial information, allocates resources and manages the business as two segments, Sonomed-Escalon, and Escalon Medical Corp. 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.

2. Significant Accounting Policies
Principles of Consolidation
The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All 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 federal 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, post-retirement benefits, accounts payable and accrued liabilities approximate their fair value because of their short-term maturity. The carrying amounts of long-term post retirement benefits approximate fair value since the Company utilizes approximate current market interest rates to calculate the liability. 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.

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, 2014 | 2013 |
|---|---|---|
| Raw materials | $1,278,929 | $742,012 |
| Work in process | 598,877 | 413,584 |
| Finished goods | 1,032,921 | 698,090 |
| Total inventory | $2,910,727 | $1,853,686 |

Valuation allowance activity for the years ended June 30, 2014 and 2013 was as follows:

| | June 30, 2014 | 2013 |
|---|---|---|
| Balance, July 1 | $198,120 | $370,266 |
| Provision for valuation allowance | — | — |
| Write-off's | — | (172,146) |
| Balance, June 30 | $198,120 | $198,120 |

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, 2014 and 2013 was as follows:

| | June 30, 2014 | 2013 |
|---|---|---|
| Balance, July 1 | $409,562 | $316,337 |
| Provision for bad debts | 53,755 | 156,319 |
| Write-off's | (151,604) | (63,094) |
| Balance, June 30 | $311,713 | $409,562 |

Property and Equipment

Property and equipment are 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 and 5 to 10 years for production and test equipment. Depreciation and amortization expense for the years ended June 30, 2014 and 2013 was approximately $11,000 and $6,000, respectively.

Property and equipment consist of the following at:

| | June 30, 2014 | 2013 |
|---|---|---|
| Equipment | $863,517 | $861,569 |
| Furniture and Fixtures | 96,404 | 75,810 |
| | 959,921 | 937,379 |
| Less: Accumulated depreciation and amortization | (935,465) | (924,785) |
| | $24,456 | $12,594 |

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.

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, 2014 and 2013 there was $106,979 and $10,786, 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 1.84 years. For the years ended June 30, 2014 and 2013, $12,417 and $43,970, respectively, was recorded as compensation expense.

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, 2014 and 2013. 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, 2014 and 2013, non-employee compensation expense was $4,363 and $0, 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, 2014 and 2013 was $131,000 and $129,000, 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, 2014 and 2013 is as follows:

| | 2014 | 2013 |
|---|---|---|
| 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 year ended June 30, 2014 the impact of all dilutive securities was omitted from the diluted earnings per share calculation as they reduce the loss per share (anti-dilutive). For the year ended June 30, 2013 the impact of all dilutive securities was omitted from the diluted earnings per share calculation as the average market price of the Company's stock is less than the exercise price of the stock options. As of June 30, 2013 there were 150,000 warrants issued to purchase shares of Escalon common stock outstanding. These warrants expired unexercised during the year ended June 30, 2014. All of the outstanding options and warrants were excluded from the calculation of diluted earnings per share as the exercise price of the options and warrants exceeded the average share price of the Company’s common stock making the options and 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.

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 FASB Accounting Standards Codification ("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, if necessary.

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, 2014 , which is the date the consolidated financial statements were available to be issued.

New Accounting Pronouncements

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Recently Issued Accounting Standards

In July 2013, the FASB issued ASU 2013-11, Income Taxes (Topic 740), which clarifies the presentation requirements of unrecognized tax benefits when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists at the reporting date. The amendments in this ASU are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013 and should be applied prospectively. The adoption of this ASU is not expected to have a material impact to the Company's consolidated financial statements.

In February 2013, FASB issued Accounting Standards Update 2013-02, Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income to improve the transparency of reporting these reclassifications. Other comprehensive income (loss) includes gains and losses that are initially excluded from net income for an accounting period. Those gains and losses are later reclassified out of accumulated other comprehensive income into net income. The amendments in this ASU do not change the current requirements for reporting net income or other comprehensive income in financial statements. All of the information that this ASU requires already is required to be disclosed elsewhere in the financial statements under U.S. GAAP. The new amendments will require an organization to (i) present the effects on the line items of net income of significant amounts reclassified out of accumulated other comprehensive income, but only if the item reclassified is required under U.S. GAAP to be reclassified to net income in its entirety in the same reporting period; and (ii) cross-reference to other disclosures currently required under U.S. GAAP for other reclassification items to be reclassified directly to net income in their entirety in the same reporting period. The amendments are effective for interim and annual reporting periods beginning after December 15, 2012. The adoption of this standard did not have a material impact to the Company's consolidated financial statements.

In July 2013, FASB issued Accounting Standards Update 2014-02 Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists to reduce diversity in practice by providing guidance on the presentation of unrecognized tax benefits. Under the new provision an unrecognized tax benefit, or a portion of an unrecognized tax benefit, should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward with some exceptions. The amendments in this Update are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. The adoption of this standard is not expected to have a material impact to the Company's consolidated financial statements.

In March 2014, FASB issued Accounting Standards Update 2014-07 Consolidation (Topic 810) Applying Variable Interest Entities Guidance to Common Control Leasing Arrangements. The amendments permit a private company lessee (the reporting entity) to elect an alternative not to apply VIE guidance to a lessor entity if (a) the private company lessee and the lessor entity are under common control, (b) the private company lessee has a lease arrangement with the lessor entity, (c) substantially all of the activities between the private company lessee and the lessor entity are related to leasing activities (including supporting leasing activities) between those two entities, and (d) if the private company lessee explicitly guarantees or provides collateral for any obligation of the lessor entity related to the asset leased by the private company, then the principal amount of the obligation at inception of such guarantee or collateral arrangement does not exceed the value of the asset leased by the private company from the lessor entity. The alternative will be effective for annual periods beginning after December 15, 2014, and interim periods within annual periods beginning after December 15, 2015. The adoption of this standard is not expected to have a material impact to the Company's consolidated financial statements.

In April 2014 FASB issued Accounting Standards Update 2014-08 Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360) Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity. Under the new provision only those disposals of components of an entity that represent a strategic shift that has (or will have) a major effect on an entity's operations and financial results will be reported as discontinued operations in the financial statements; a business or nonprofit activity that, on acquisition, meets the criteria to be classified as held for sale is reported in discontinued operations; and a disposal of an equity method investment that meets the definition of discontinued operation is reported in discontinued operations. The adoption of this standard is not expected to have a material impact to the Company's consolidated financial statements.

In May 2014 FASB issued Accounting Standards Update 2014-09 Revenue from Contracts with Customers (Topic 606). Under the new provision, an entity should apply five steps for revenue recognition to depict the transfer of

promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. For a public entity, the amendments in this Update are effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. Early application is not permitted. The adoption of this standard is not expected to have a material impact to the Company's consolidated financial statements.

In June 2014 FASB issued Accounting Standards Update 2014-11 Compensation-Stock Compensation (Topic 718). Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period. The amendments require that a performance target that affects vesting and that could be

achieved after the requisite service period be treated as a performance condition. The adoption of this standard is not expected to have a material impact to the Company’s consolidated financial statements.

3. Intangible Assets

Goodwill, Trademarks and Trade Names

Goodwill, trademarks and trade names represent intangible assets obtained from EOI, Endologix and Sonomed 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 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.

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 at June 30, and at any other time events occur or circumstances indicate that the carrying amount of goodwill may be impaired. As a result of the Company's testing during the years ended June 30, 2014 and 2013, no impairments were recorded.

The following tables present unamortized intangible assets by business segment as of June 30, 2014 and 2013:

| | 2014 Net Carrying Amount | 2013 Net Carrying Amount |
|---|---|---|
| Goodwill | | |
| Sonomed-Escalon | $125,027 | $125,027 |
| Total | $125,027 | $125,027 |

| | 2014 Net Carrying Amount | 2013 Net Carrying Amount |
|---|---|---|
| Trademarks and trade names | | |
| Sonomed-Escalon | $605,006 | $605,006 |
| Total | $605,006 | $605,006 |

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 amortization on patents from continuing operations was approximately $86,000 and $84,000 at June 30, 2014 and 2013, respectively. Amortization expense from continuing operations for the years ended June 30, 2014 and 2013 was $2,000 and $8,000, respectively.

Amortization expense, relating entirely to patents, is estimated to be approximately $2,000 related to patents in each year 2015, 2016 and 2017.

The following table presents amortized intangible assets by business segment as of June 30, 2014:

| | Gross Carrying Amount | Impairment | Adjusted Gross Carrying Amount | Accumulated Amortization | Net Carrying Value |
|---|---|---|---|---|---|
| Amortized Intangible Assets Patents | | | | | |
| Sonomed-Escalon | $90,962 | $— | $90,962 | $(86,162) | $4,800 |
| Total | $90,962 | $— | $90,962 | $(86,162) | $4,800 |

The following table presents amortized intangible assets by business segment as of June 30, 2013:

| | Gross Carrying Amount | Impairment | Adjusted Gross Carrying Amount | Accumulated Amortization | Net Carrying Value |
|---|---|---|---|---|---|
| Amortized Intangible Assets Patents | | | | | |
| Sonomed-Escalon | $90,962 | $— | $90,962 | $(84,250) | $6,712 |
| Total | $90,962 | $— | $90,962 | $(84,250) | $6,712 |

4. Accrued Expenses
The following table presents accrued expenses:

| | June 30, 2014 | June 30, 2013 |
|---|---|---|
| Accrued compensation | $503,857 | $487,225 |
| Warranty accrual | 32,078 | 21,828 |
| Other accruals | 634,008 | 662,228 |
| Total accrued expenses | $1,169,943 | $1,171,281 |

Accrued compensation as of June 30, 2014 and 2013 primarily relates to payroll, vacation accruals, and payroll tax liabilities. Other accruals as of June 30, 2014 and 2013 includes deferred revenue.

5. Long-Term Debt

On December 31, 2008, Drew Scientific, Inc ("Drew") acquired certain assets of Biocode Hycel ("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 included Drew and JAS.

On April 29, 2011 the Company amended its seller financed debt in connection with the Biocode Hycel 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 accrued 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 had agreed to pay the balance of the outstanding amount in euros in full in one payment.
On January 12, 2012 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 was 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 10 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 was 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 intended 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 recorded the entire debt of $4,149,516 as a current liability.
On October 18, 2012, the Company and its debt holder reached an agreement whereby the Company paid off the balance of the seller-provided financing of $4,367,604 with a one-time payment of $2,487,480 resulting in a gain on extinguishment of debt of $1,880,124. The repayment of the debt reduced the Company's debt related to Biocode to zero.
6. Capital Stock Transactions
Stock Option Plans
As of June 30, 2014, the Company had in effect 2 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 995,846 shares of the Company’s common stock remain available for issuance as of June 30, 2014. 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 between one and five years and the options are exercisable over a period no longer than 10 years after

the grant date. As of June 30, 2014, options to purchase 995,846 shares of the Company's common stock were outstanding, of which 853,337 were exercisable, and 142,509 shares were unvested.

The following is a summary of Escalon's stock option activity and related information for the fiscal years ended June 30, 2014 and 2013:

| | 2014 | | 2013 | |
|---|---|---|---|---|
| | Common Stock Options | Weighted Average Exercise Price | Common Stock Options | Weighted Average Exercise Price |
| Outstanding at the beginning of the year | 1,021,688 | $4.58 | 1,021,688 | $4.58 |
| Granted | 136,000 | 1.57 | — | — |
| Exercised | — | — | — | — |
| Forfeited | (161,842) | 5.50 | — | $— |
| Outstanding at the end of the year | 995,846 | $3.89 | 1,021,688 | $4.58 |
| Exercisable at the end of the year | 853,337 | | 1,006,063 | |
| Weighted average fair value of options granted during the year | | $112,973 | | $— |

The following table summarizes information about stock options outstanding as of June 30, 2014:

| | Number Outstanding at June 30, 2014 | Weighted Average Remaining Contractual Life (Years) | Weighted Average Exercise Price | Number Exercisable at June 30, 2014 | Weighted Average Exercise Price |
|---|---|---|---|---|---|
| Range of Exercise Prices | | | | | |
| $1.45 to $2.12 | 192,000 | 8.55 | $1.52 | 68,433 | $1.52 |
| $2.37 to $2.77 | 419,942 | 3.32 | $2.52 | 401,000 | $2.61 |
| $4.97 to $5.59 | 72,000 | 1.33 | $5.06 | 72,000 | $5.06 |
| $6.19 to $6.19 | 168,250 | 0.17 | $6.19 | 168,250 | $6.19 |
| $6.94 to $8.06 | 143,654 | 1.16 | $7.78 | 143,654 | $7.78 |
| Total | 995,846 | | | 853,337 | |

Compensation expense related to stock options for the years ended June 30, 2014 and 2013 was $16,780 and $43,970, 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. All of the common stock warrants expired during the year ended June 30, 2014.

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.

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.

7. Income Taxes

The provision for income taxes for the years ended June 30, 2014 and 2013 consists of the following:

| | 2014 | 2013 |
|---|---|---|
| Current income tax (benefit) provision | | |
| Federal | $(55,500) | $60,000 |
| State | (18,500) | 20,000 |
| | (74,000) | 80,000 |
| Deferred income tax provision | | |
| Federal | 202,370 | 651,773 |
| State | 30,240 | 95,052 |
| Change in valuation allowance | (232,610) | (746,825) |
| | — | — |
| Income tax (benefit) expense | $(74,000) | $80,000 |

During the year ended June 30, 2014, the Company will be liable for the alternative minimum tax based on the estimated taxable income they will report on the federal and state income tax returns.

Income taxes (benefit) as a percentage of income (loss) for the years ended June 30, 2014 and 2013 differ from statutory federal income tax rate due to the following:

| | 2014 | 2013 |
|---|---|---|
| Statutory federal income tax rate | 34.00% | 34.00% |
| (Decrease) in deductable timing differences | (62.23)% | (52.00)% |
| Net operating loss carryforward | 12.00% | 21.00% |
| Effective income tax rate | (16.23)% | 3.00% |

As of June 30, 2014, the Company had deferred income tax assets of $11,414,000. The deferred income tax assets have a valuation allowance of $11,414,000. 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, 2014 and 2013 are as follows:

| | 2014 | 2013 |
|---|---|---|
| Deferred income tax assets: | | |
| Net operating loss carryforward | $10,396,247 | $10,325,622 |
| Executive post retirement costs | 320,821 | 348,703 |
| General business credit | 207,698 | 207,698 |
| Allowance for doubtful accounts | 105,982 | 139,251 |
| Accrued vacation | 122,292 | 111,529 |
| Inventory reserve | 67,361 | 67,361 |
| Accelerated amortization on goodwill and other intangible assets | 182,979 | 402,451 |
| Accelerated depreciation | — | 36,860 |
| Warranty reserve | 10,907 | 7,422 |
| Total deferred income tax assets | 11,414,287 | 11,646,897 |
| Valuation allowance | (11,414,287) | (11,646,897) |

As of June 30, 2014, the Company has a valuation allowance of $11,414,287, 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 $29,684,000 and $3,166,000, respectively, of which $5,699,000 and $1,206,000, respectively, will expire over the next 10 years, and $23,985,000 and $1,960,000, respectively, will expire in years 11 through twenty-four.

The Company continues to monitor the realization of its deferred tax assets based on changes in circumstances, for 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 2010. 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, 2014, 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.

8. 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, 2014 are as follows:

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| Year Ending June 30, | Lease Obligations |
|---|---|
| 2015 | $455,187 |
| 2016 | 417,142 |
| 2017 | 384,896 |
| 2018 | 133,223 |
| 2019 | 84,023 |
| Thereafter | 42,506 |
| Total | $1,516,977 |

The table above includes amounts related to a lease signed for new corporate office space which is scheduled to be occupied on October 6, 2014. Rent expense charged to continuing operations during the years ended June 30, 2014 and 2013 was approximately $506,000 and $606,000, respectively, including equipment rent and property rent.

The Company guaranteed the lease payment for BHH. The lease is expected to expire 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, 2013 through the end of the remaining lease term, net of contractual or estimated sublease rental income. The Company has accrued lease termination costs of $593,000 and $493,000 as of June 30, 2014 and 2013, respectively. 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. The Company will review these judgments and estimates on a quarterly basis and continue to 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.

9. Retirement and Post-Retirement Plans

The Company adopted a 401(k) retirement plan effective January 1, 1994. The Company’s employees become eligible for 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, 2014 and 2013.

On June 23, 2005, the Company entered into a Supplemental Executive Retirement Benefit Agreement with its Chairman . 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:

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- If the covered executive retires, the Company would be obligated to pay the executive $8,491 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 $8,491 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 $8,491 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, 2014 and 2013 approximately $944,000 and $1,026,000 was accrued for retirement benefits, respectively. These amounts represent the approximate present value of the supplemental retirement benefits awarded using 2% discount rate. The Company began making monthly payments under this agreement on January 1, 2013. The changes related to post-retirement plans for the years ended June 30, 2014 and 2013 were as follows:

| | 2,014 | 2,013 |
|---|---|---|
| Balance July 1, | $1,025,597 | $1,042,252 |
| Actuarial adjustment | 15,965 | 38,213 |
| Payment of benefits | (97,972) | (54,868) |
| Balance June 30, | $943,590 | $1,025,597 |

10. 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 had 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 following table summarizes the results of discontinued operations of BHH for the years ended June 30, 2014 and 2013 (in thousands):

| For the years ended June 30, | 2014 | 2013 |
|---|---|---|
| Revenue, net | $— | $— |
| Cost of goods | — | — |
| Marketing, general and administrative | 99 | 187 |
| Research & development | — | — |
| Total costs and expenses | 99 | 187 |
| Loss from discontinued operations | $(99) | $(187) |

Net loss of approximately $187,000 for the year ended June 30, 2013 is related to a continuing lease obligation of $155,000 and legal fees of $32,000.

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Assets and liabilities of discontinued operations of BHH included in the consolidated balance sheets are summarized as follows at June 30, 2014 and 2013 (in thousands):

| | June 30, 2014 | June 30, 2013 |
|---|---|---|
| Assets | | |
| Cash | $— | $— |
| Accounts receivable | — | — |
| Inventory | — | — |
| Other current assets | — | — |
| Fixed assets | — | — |
| Covenant not to compete and customer list, net | — | — |
| Other assets | — | — |
| Total assets | — | — |
| Liabilities | | |
| Accounts payable | — | — |
| Accrued expenses | — | — |
| Accrued lease termination costs | 593 | 493 |
| Total liabilities | 593 | 493 |
| Net assets of discontinued operations | $(593) | $(493) |

Discontinued operation of ECD

On October 3, 2012 the Company sold its Clinical Diagnostics Business to ERBA Diagnostics, Inc. The ECD consisted of Drew Scientific, Inc., and its wholly owned subsidiaries JAS and Drew Scientific Limited Co. The sales price was $6,500,000 in cash and gain on sale of assets was approximately $2,717,069. The following table summarizes the gain on sales

(in thousands):

| | October 3, 2012 |
|---|---|
| Sales Price | $6,500 |
| Broker's fee | (325) |
| Net Proceeds | 6,175 |
| Net Assets Sold | (3,458) |
| Gain on Sale of Assets | $2,717 |

| | |
|---|---|
| Net assets sold | |
| Assets: | |
| Cash and cash equivalents | $4 |
| Accounts receivable, net | 1,661 |
| Inventory, net | 1,997 |
| Other current assets | 113 |
| Furniture and equipment, net | 287 |
| Goodwill | 93 |
| Trademarks and trade names, net | 89 |
| Customer list, net | 462 |
| Total Assets | 4,706 |
| | |
| Liabilities: | |
| Accounts payable | 639 |
| Accrued expenses | 609 |
| Total liabilities | 1,248 |
| Net assets sold | $3,458 |

On October 18, 2012, the Company and its debt holder reached an agreement whereby the Company paid the balance of the seller-provided financing plus accrued interest related to the purchase of certain assets of Biocode of $4,367,604 with a one-time payment of $2,487,480 resulting in a gain on extinguishment of debt of $1,880,124. The repayment of the debt has reduced the Company's debt related to Biocode to zero.

The following tables summarize the results of discontinued operations for the years ended June, 2014 and 2013 (in thousands):

| For the years ended June 30, | 2014 | 2013 |
|---|---|---|
| Revenue, net | $— | $3,825 |
| Cost of goods sold | — | 2,384 |
| Marketing, general and administrative | 7 | 1,256 |
| Research & development | — | 75 |
| Total costs and expenses | 7 | 3,715 |
| Other expense | — | — |
| Net (loss) income from discontinued operations | (7) | 110 |
| Gain from sale of assets and debt settlement net of tax (CTA included) | — | 4,014 |
| Net income (loss) from discontinued operations before tax | (7) | 4,124 |
| Income tax benefit (expense) | 74 | (80) |
| Net income from discontinued operations, net of tax | $67 | $4,044 |

The total gain from the extinguishment of debt of $1,880,124, the gain on the sale of assets of ECD of $2,712,163, and net income from discontinued operations related to ECD of $110,383 offset by the cumulative translation adjustment ("CTA") related to Drew of $578,422, and the net loss from discontinued operations related to BHH of $186,750 was before tax.

Assets and liabilities of discontinued operations of ECD included in the consolidated balance sheets are summarized as follows as of June 30, 2014 and 2013 (in thousands):

| | June 30, 2014 | June 30, 2013 |
|---|---|---|
| Assets | | |
| Accounts receivable | $— | $— |
| Inventory | — | — |
| Other assets | — | — |
| Total current assets | — | — |
| Furniture and fixture | — | — |
| Non-current accounts receivable | — | — |
| Goodwill | — | — |
| Intangible assets | — | — |
| Total non-current assets | — | — |
| Total Assets | — | — |
| Liabilities | | |
| Accounts payable | — | — |
| Accrued expenses and taxes | — | 80 |
| Total liabilities | — | 80 |
| Net assets of discontinued operations | $— | $(80) |

11. Segment Reporting

Management reviews financial information, allocates resources and manages the business as two segments, Sonomed-Escalon 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 Escalon Medical Corp. segment presents the administrative corporate operations of the consolidated group.

The table below sets forth the loss from continuing operations for the years ended June 30, 2014 and 2013.

| | Sonomed Escalon | | Corporate | | Total | |
|---|---|---|---|---|---|---|
| | 2014 | 2013 | 2014 | 2013 | 2014 | 2013 |
| Revenues, net: | | | | | | |
| Product revenue | $12,354 | $11,497 | $— | $— | $12,354 | $11,497 |
| Total revenue, net | 12,354 | 11,497 | — | — | 12,354 | 11,497 |
| Costs and expenses: | | | | | | — |
| Cost of goods sold | 6,292 | 5,905 | — | — | 6,292 | 5,905 |
| Marketing, general & admin | 4,698 | 5,300 | 415 | 419 | 5,113 | 5,719 |
| Research & development | 1,306 | 1,105 | — | — | 1,306 | 1,105 |
| Goodwill impairment | — | — | — | — | — | — |
| Total costs and expenses | 12,296 | 12,310 | 415 | 419 | 12,711 | 12,729 |
| Income (loss) from operations | 58 | (813) | (415) | (419) | (357) | (1,232) |
| Other (expense) and income: | | | | | | |
| Other income (expense) | — | — | 7 | 78 | 7 | 78 |
| Interest income | — | — | — | — | — | — |
| Interest expense | — | — | — | (79) | — | (79) |
| Total other (expense) and income | — | — | 7 | (1) | 7 | (1) |
| Income (loss) before taxes | 58 | (813) | (408) | (420) | (350) | (1,233) |
| Income taxes benefit from continuing operations | — | — | — | — | — | — |
| Net (loss) income from continuing operations | $58 | $(813) | $(408) | $(420) | $(350) | $(1,233) |

The Company operates in the healthcare market, specializing in the development, manufacture and marketing of ophthalmic medical devices and pharmaceuticals. 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, 2014 and 2013, 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, 2014 and 2013. Foreign sales in 2014 increased $706,192 or 15% to $5,420,401.

| | 2014 | 2013 |
|---|---|---|
| Sonomed-Escalon | $5,420,401 | $4,714,209 |
| Total | $5,420,401 | $4,714,209 |
| | | |
| Total Net Revenue | $12,353,796 | $11,496,834 |
| | 43.9 % | 41.0 % |

12. Related Party Transactions

Escalon and a former 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, 2013. The Company provided administrative support functions to OTM. On May 9, 2013 the board member related to OTM resigned from the board of directors and is therefore no longer a related party. Additionally, the Company has come to an agreement with OTM to discontinue any additional efforts and investment related to OTM and was wrote off its remaining investment in OTM during fiscal year ended June 30, 2013.

During the year ended June 30, 2013, 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 was 1.25% per month, which was 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. Related party interest expense for the years ended June 30, 2014 and 2013 was $0 and $11,250, respectively. The entire amount due of $332,216 including accrued interest of $32,216, was paid in full on October 5, 2012. There were no amounts due to Mr. DePiano as of June 30, 2014 and 2013.

13. 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 on the Company's June 30, 2012 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. There was no debt outstanding as of June 30, 2014.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINACIAL 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 affect 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, 2014.

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 the Company's 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 pursuant to temporary rules of the Securities and Exchange Commission that permits the Company 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 2014 that would have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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ITEM 9B OTHER INFORMATION
None

PART III

ITEM 10 DIRECTORS, EXECUTIVE OFFICERS AND COPORATE 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

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, 2014 and 2013
Consolidated Statements of Operations for the years ended June 30, 2014 and 2013
Consolidated Statements of Comprehensive Income (Loss) for the years ended June 2014 and 2013
Consolidated Statements of Shareholders' Equity for the years ended June 30, 2014 and 2013
Consolidated Statements of Cash Flows for the years ended June 30, 2014 and 2013
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) |
| 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) ** |

| | |
|---|---|
| 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) |
| 10.37 | 2013 Equity Incentive Plan dated December 27, 2013. |
| 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. |

(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.

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, Jr.
Richard J. DePiano, Jr.
Chief Executive Officer

Dated: September 26, 2014

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<br>Richard J. DePiano | Chairman | September 26, 2014 |
| By: | /s/ Richard J. DePiano, Jr.<br>Richard J. DePiano, Jr. | Chief Executive Officer (Principal Executive Officer) | September 26, 2014 |
| By: | /s/ Robert M. O'Connor<br>Robert M. O'Connor | Chief Financial Officer<br>(Principal Financial and Accounting Officer) | September 26, 2014 |
| By: | /s/ Sean Closkey<br>Sean Closkey | Director | September 26, 2014 |
| By: | /s/ William L.G. Kwan<br>William L.G. Kwan | Director | September 26, 2014 |
| By: | /s/ Lisa Napolitano<br>Lisa Napolitano | Director | September 26, 2014 |
| By: | /s/ Fred Choate<br>Fred Choate | Director | September 26, 2014 |