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ESCALON MEDICAL CORP  
Form 10-Q  
May 15, 2007

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549

-----

FORM 10-Q

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Mark One

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE  
ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED March 31, 2007

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934

FOR THE TRANSITION PERIOD FROM \_\_\_\_\_ TO \_\_\_\_\_

Commission File Number: 0-20127

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ESCALON MEDICAL CORP.  
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

PENNSYLVANIA  
(STATE OR OTHER JURISDICTION OF  
INCORPORATION OR ORGANIZATION)

33-0272839  
(IRS EMPLOYER  
IDENTIFICATION NO.)

565 EAST SWEDES FORD ROAD, SUITE 200  
WAYNE, PA  
(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)

19087  
(ZIP CODE)

(610) 688-6830  
(REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE)

N/A  
FORMER NAME, FORMER ADDRESS AND FORMER FISCAL YEAR, IF CHANGED SINCE  
LAST REPORT

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

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Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Large accelerated filer Yes  No  Accelerated filer Yes  No   
Non-accelerated filer Yes  No

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 6,370,657 shares of common stock, \$0.001 par value, outstanding as of May 8, 2007.

### ESCALON MEDICAL CORP. FORM 10-Q QUARTERLY REPORT

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PART I. FINANCIAL STATEMENTS

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

ESCALON MEDICAL CORPORATION AND SUBSIDIARIES  
CONDENSED CONSOLIDATED BALANCE SHEETS

|   | MARCH 31,<br>2007 | JUNE 30,<br>2006 |
|---|-------------------|------------------|
|   | -----             | -----            |
|   | (UNAUDITED)       |                  |
| ASSETS  |                   |                  |
| Current assets:   |                   |                  |
| Cash and cash equivalents   | \$ 9,548,207      | \$ 3,379,710     |
| Available for sale securities   | 75,000            | 50,220           |
| Accounts receivable, net  | 4,198,133         | 3,996,243        |
| Inventory, net  | 8,301,816         | 7,122,916        |
| Other current assets  | 267,171           | 362,160          |
|   | -----             | -----            |
| TOTAL CURRENT ASSETS  | 22,390,327        | 14,911,249       |
|   | -----             | -----            |
| Furniture and equipment, net  | 912,024           | 969,956          |
| Goodwill  | 21,072,260        | 21,072,260       |
| Trademarks and trade names, net   | 620,106           | 620,106          |
| Patents, net  | 240,498           | 313,702          |
| Covenant not to compete and customer list, net  | 351,023           | 420,073          |
| Other assets  | 142,709           | 337,421          |
|   | -----             | -----            |
| TOTAL ASSETS  | \$ 45,728,947     | \$ 38,644,767    |
|   | =====             | =====            |
| LIABILITIES AND SHAREHOLDERS' EQUITY  |                   |                  |
| Current liabilities:  |                   |                  |
| Current portion of long-term debt   | \$ 198,966        | \$ 232,837       |
| Accounts payable  | 1,707,663         | 1,558,501        |
| Accrued expenses  | 2,089,556         | 2,503,771        |
|   | -----             | -----            |
| TOTAL CURRENT LIABILITIES   | 3,996,185         | 4,295,109        |
|   | -----             | -----            |
| Long-term debt, net of current portion  | 14,113            | 162,551          |
| Accrued post-retirement benefits  | 1,087,000         | 1,087,000        |
|   | -----             | -----            |
| TOTAL LIABILITIES   | 5,097,298         | 5,544,660        |
|   | -----             | -----            |
| Shareholders equity:  |                   |                  |
| Preferred stock, \$0.001 par value; 2,000,000<br>shares authorized; no shares issued  |                   |                  |
| Common stock, \$0.001 par value; 35,000,000<br>share authorized; 6,386,857 and 6,344,657<br>issued and outstanding at March 31, 2007<br>and June 30, 2006, respectively | 6,387             | 6,345            |
| Common stock warrants   | 1,601,346         | 1,601,346        |
| Additional paid-in capital  | 66,006,248        | 65,699,370       |
| Retained earnings   | (27,035,185)      | (34,122,427)     |
| Accumulated other comprehensive (loss) income   | 52,853            | (84,527)         |
|   | -----             | -----            |

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|  |               |               |
|--|---------------|---------------|
| TOTAL SHAREHOLDERS' EQUITY                 | 40,631,649    | 33,100,107    |
|  | -----         | -----         |
| TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY | \$ 45,728,947 | \$ 38,644,767 |
|  | =====         | =====         |

See notes to condensed consolidated financial statements

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ESCALON MEDICAL CORP. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF INCOME  
(UNAUDITED)

|   | THREE MONTHS ENDED MARCH 31, |              | NINE MONTHS END |
|---|------------------------------|--------------|-----------------|
|   | 2007                         | 2006         | 2007            |
|   | -----                        | -----        | -----           |
| NET REVENUES:                                 |                              |              |                 |
| Product revenue                               | \$ 6,900,461                 | \$7,286,704  | \$20,477,907    |
| Other revenue                                 | 9,658,299                    | 553,054      | 10,885,753      |
|   | -----                        | -----        | -----           |
| REVENUES, NET                                 | 16,558,760                   | 7,839,758    | 31,363,660      |
|   | -----                        | -----        | -----           |
| COSTS AND EXPENSES:                           |                              |              |                 |
| Cost of goods sold                            | 4,036,285                    | 4,382,268    | 11,544,879      |
| Research and development                      | 843,858                      | 717,920      | 2,638,413       |
| Marketing, general and administrative         | 3,361,582                    | 3,283,722    | 10,062,093      |
|   | -----                        | -----        | -----           |
| TOTAL COSTS AND EXPENSES                      | 8,241,725                    | 8,383,910    | 24,245,385      |
|   | -----                        | -----        | -----           |
| INCOME (LOSS) FROM OPERATIONS                 | 8,317,035                    | (544,152)    | 7,118,275       |
|   | -----                        | -----        | -----           |
| OTHER (EXPENSE) AND INCOME:                   |                              |              |                 |
| Gain on sale of available for sale securities | 0                            | 0            | 0               |
| Equity in Ocular Telehealth Management, LLC   | (25,191)                     | (18,508)     | (55,889)        |
| Interest income                               | 54,451                       | 33,974       | 113,385         |
| Interest expense                              | (8,676)                      | (27,515)     | (23,615)        |
|   | -----                        | -----        | -----           |
| TOTAL OTHER INCOME (EXPENSE)                  | 20,584                       | (12,049)     | 33,881          |
|   | -----                        | -----        | -----           |
| NET INCOME (LOSS) BEFORE TAXES                | 8,337,619                    | (556,201)    | 7,152,156       |
|   | -----                        | -----        | -----           |
| Provision for income taxes                    | 66,157                       | 20,024       | 64,914          |
|   | -----                        | -----        | -----           |
| NET INCOME (LOSS)                             | \$ 8,271,462                 | \$ (576,225) | \$ 7,087,242    |
|   | =====                        | =====        | =====           |
| BASIC NET INCOME (LOSS) PER SHARE             | \$ 1.30                      | \$ (0.09)    | \$ 1.11         |
|   | =====                        | =====        | =====           |
| DILUTED NET INCOME (LOSS) PER SHARE           | \$ 1.29                      | \$ (0.09)    | \$ 1.10         |
|   | =====                        | =====        | =====           |
| WEIGHTED AVERAGE SHARES - BASIC               | 6,378,757                    | 6,255,665    | 6,363,251       |
|   | =====                        | =====        | =====           |
| WEIGHTED AVERAGE SHARES - DILUTED             | 6,435,106                    | 6,255,665    | 6,421,321       |
|   | =====                        | =====        | =====           |

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See notes to condensed consolidated financial statements.

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ESCALON MEDICAL CORP. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
(UNAUDITED)

|  | NINE MONTHS ENDED MARCH |              |
|--|-------------------------|--------------|
|  | 2007                    | 2006         |
|  | -----                   | -----        |
| CASH FLOWS FROM OPERATING ACTIVITIES:  |                         |              |
| Net (loss) income  | \$ 7,087,242            | \$ (843,000) |
| Adjustments to reconcile net (loss) income to net cash (used in) operating activities: |                         |              |
| Depreciation and amortization  | 418,916                 | 338,000      |
| Gain on sale of available for sale securities  | 0                       | (1,157,000)  |
| Loss on Ocular Telehealth Management, LLC  | 55,889                  | 69,000       |
| Change in operating assets and liabilities:  |                         |              |
| Accounts receivable, net   | (536,633)               | (428,000)    |
| Inventory, net   | (1,129,712)             | (795,000)    |
| Other current and long-term assets   | 285,723                 | 38,000       |
| Accounts payable, accrued and other liabilities  | 164,270                 | 24,000       |
|  | -----                   | -----        |
| NET CASH (USED IN) OPERATING ACTIVITIES  | 6,345,695               | (2,752,000)  |
|  | -----                   | -----        |
| CASH FLOWS FROM INVESTING ACTIVITIES:  |                         |              |
| Purchase of MRP  | 0                       | (47,000)     |
| Proceeds from the sale of available for sale securities                                | 0                       | 1,157,000    |
| Purchase of distribution rights  | 0                       | (181,000)    |
| Purchase of fixed assets   | (196,180)               | (295,000)    |
|  | -----                   | -----        |
| NET CASH PROVIDED BY/(USED IN) INVESTING ACTIVITIES                                    | (196,180)               | 633,000      |
|  | -----                   | -----        |
| CASH FLOWS FROM FINANCING ACTIVITIES:  |                         |              |
| Principal payments on term loans   | (182,309)               | (153,000)    |
| Issuance of common stock - stock options   | 157,779                 | 296,000      |
|  | -----                   | -----        |
| NET CASH PROVIDED BY/(USED IN) FINANCING ACTIVITIES                                    | (24,530)                | 142,000      |
|  | -----                   | -----        |
| Effect of exchange rate changes on cash and cash equivalents                           | 43,512                  | 15,000       |
|  | -----                   | -----        |
| NET (DECREASE) IN CASH AND CASH EQUIVALENTS  | 6,168,497               | (1,961,000)  |
|  | -----                   | -----        |
| Cash and cash equivalents, beginning of period   | 3,379,710               | 5,115,000    |
| Cash and cash equivalents, end of period   | \$ 9,548,207            | \$ 3,154,000 |
|  | =====                   | =====        |
| SUPPLEMENTAL SCHEDULE OF CASH FLOW INFORMATION:  |                         |              |
| Interest paid  | \$ 23,615               | \$ 47,000    |
|  | =====                   | =====        |
| Income taxes (refund) paid   | \$ (98,412)             | \$ 43,000    |
|  | =====                   | =====        |
| Issuance of common stock for MRP acquisition   | \$ --                   | \$ 1,427,000 |

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(Decrease)/increase in unrealized appreciation on available for sale securities

|           |                |
|-----------|----------------|
| =====     | =====          |
| \$ 24,780 | \$ (1,137,716) |
| =====     | =====          |

See notes to condensed consolidated financial statements

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ESCALON MEDICAL CORP. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY  
FOR THE NINE MONTHS ENDED MARCH 31, 2007  
(UNAUDITED)

|   | COMMON STOCK |         | COMMON STOCK | ADDITIONAL      | ACCUMULATED    |
|---|--------------|---------|--------------|-----------------|----------------|
|   | SHARES       | AMOUNT  | WARRANTS     | PAID-IN CAPITAL | DEFICIT        |
|   | -----        | -----   | -----        | -----           | -----          |
| BALANCE AT JUNE 30, 2006                                    | 6,344,657    | \$6,345 | \$1,601,346  | \$65,699,370    | \$(34,122,427) |
| Net (loss)  |              | 0       | 0            | 0               | 7,087,242      |
| Refund of income taxes related to exercise of stock options |              |         |              | 98,412          |                |
| Exercise of stock options                                   | 42,200       | 42      | 0            | 84,692          | 0              |
| Compensation expense  |              |         |              | 123,774         |                |
| Change in unrealized gains on available for sale securities |              | 0       | 0            | 0               | 0              |
| Foreign currency translation                                |              | 0       | 0            | 0               | 0              |
|   | -----        | -----   | -----        | -----           | -----          |
| BALANCE AT MARCH 31, 2007                                   | 6,386,857    | \$6,387 | \$1,601,346  | \$66,006,248    | \$(27,035,185) |
|   | =====        | =====   | =====        | =====           | =====          |

See notes to condensed consolidated financial statements

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ESCALON MEDICAL CORP. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENT OF OTHER COMPREHENSIVE INCOME (LOSS)  
(UNAUDITED)

|   | THREE MONTHS ENDED MARCH 31, |             | NINE MONTHS ENDED MARCH 31, |             |
|---|------------------------------|-------------|-----------------------------|-------------|
|   | 2007                         | 2006        | 2007                        | 2006        |
|   | -----                        | -----       | -----                       | -----       |
| Net income (loss)   | \$8,271,462                  | \$(576,225) | \$7,087,242                 | \$(843,679) |
| Change in unrealized gains on available for sale securities | \$ 15,870                    | 16,110      | 24,780                      | (1,137,716) |

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|                              |             |             |             |               |
|------------------------------|-------------|-------------|-------------|---------------|
| Foreign currency translation | (7,764)     | (127,340)   | 112,600     | (219,324)     |
|                              | -----       | -----       | -----       | -----         |
| COMPREHENSIVE INCOME (LOSS)  | \$8,279,568 | \$(687,455) | \$7,224,622 | \$(2,200,719) |
|                              | =====       | =====       | =====       | =====         |

See notes to condensed consolidated financial statements.

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ESCALON MEDICAL CORP. AND SUBSIDIARIES  
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
 (UNAUDITED)

1. BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements include the accounts of Escalon Medical Corp. and its subsidiaries, collectively referred to as "Escalon" or the "Company." Escalon's subsidiaries include Sonomed, Inc. ("Sonomed"), Escalon Vascular Access, Inc. ("Vascular"), Escalon Medical Europe GmbH ("EME"), Escalon Digital Vision, Inc. ("EMI"), Escalon Pharmaceutical, Inc. ("Pharmaceutical"), Escalon Holdings, Inc. ("EHI") and Drew Scientific, Inc. and Drew Scientific Group, Plc (collectively "Drew"). All intercompany accounts and transactions have been eliminated. Additionally, the Company's investment in Ocular Telehealth Management, LLC ("OTM") is accounted for under the equity method.

The Company operates in the healthcare market, specializing in the development, manufacture, marketing and distribution of medical devices and pharmaceuticals in the areas of ophthalmology, diabetes, hematology and vascular access. The Company and its products are subject to regulation and inspection by the United States Food and Drug Administration (the "FDA"). The FDA and agencies in other jurisdictions require 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 condensed consolidated financial statements are unaudited and are presented pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC"). Accordingly, these consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto contained in the Company's 2006 Annual Report on Form 10-KSB under the Securities Exchange Act of 1934 (the "Exchange Act"). In the opinion of management, the accompanying consolidated financial statements reflect all adjustments (which are of a normal recurring nature) necessary for a fair presentation of the financial position, results of operations and cash flows for the interim periods presented. The results of operations are not necessarily indicative of the results that may be expected for the full year.

In connection with the presentation of the current period condensed unaudited consolidated financial statements, certain prior period balances have been reclassified to conform with the current period presentation.

2. STOCK-BASED COMPENSATION

In December 2004, the FASB issued SFAS No.123R ("SFAS No.123R") (revised 2004), "Share-Based Payments". SFAS No. 123(R) is a revision of SFAS No. 123 and supersedes ABP Opinion No. 25. SFAS No. 123(R) requires the Company to expense share-based payments, including employee stock options. With limited exceptions, the amount of compensation costs will be measured based on the grant date fair

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value of the equity or liability instrument issued. Compensation cost will be recognized over the period that the optionee provides service in exchange for the award. As a small business issuer as defined in Item 10 of Regulation S-B, the Company was required to adopt this standard in its fiscal year beginning July 1, 2006. The adoption of this standard for the expensing of stock options is expected to reduce pretax earnings in future periods. The impact of adoption of SFAS No. 123R cannot be predicted at this time because it will depend upon the level of share-based payments made in the future and the model the Company elects to utilize.

For the three-month and nine-month periods ended March 31, 2006, the Company accounted for its stock-based awards to employees using the intrinsic value method under Accounting Principles Board ("APB") Opinion No. 25, Accounting for Stock Issued to Employees and related Interpretations.

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Stock-based awards to non-employees were recorded using the fair value method in accordance with SFAS No. 123, Accounting for Stock-Based Compensation.

If the computed fair value of the awards had been amortized to expense over the vesting period of the awards under SFAS No. 123, net income would have been as follows for the period ended:

|   | THREE<br>MONTHS<br>ENDED<br>MARCH 31,<br>2006<br>----- | NINE<br>MONTHS<br>ENDED<br>MARCH 31,<br>2006<br>----- |
|---|--|---|
| Net (loss) as reported  | \$ (576,225)   | \$ (843,679)  |
| Deduct: Total stock-based employee compensation<br>expense determined under fair value based method<br>for all awards, net of related tax effects | (288,848)  | (1,077,870)   |
|   | -----  | -----   |
| PRO FORMA NET (LOSS) INCOME   | \$ (865,073)   | \$ (1,921,549)  |
|   | =====  | =====   |
| (LOSS) EARNINGS PER SHARE:  |  |   |
| BASIC - AS REPORTED   | \$ (0.09)  | \$ (0.14)   |
|   | =====  | =====   |
| BASIC - PRO FORMA   | \$ (0.14)  | \$ (0.32)   |
|   | =====  | =====   |
| DILUTED - AS REPORTED   | \$ (0.09)  | \$ (0.14)   |
|   | =====  | =====   |
| DILUTED - PRO FORMA   | \$ (0.14)  | \$ (0.32)   |
|   | =====  | =====   |

SFAS No. 123 requires the disclosure of pro forma net income had the Company adopted the fair value method in accounting for employee stock-based awards. Under SFAS No. 123, the fair value of stock-based awards to employees is calculated through the use of option-pricing models, even though such models were developed to estimate the fair value of freely tradable, fully transferable options without vesting restrictions, which significantly differ from the Company's stock-option awards. These models also require subjective assumptions, including future stock price volatility and expected time to exercise which



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affect the calculated values. The fair value of these equity awards was estimated at the date of grant using the Black-Scholes option pricing method. For the purposes of applying SFAS 123, the estimated per share value of the options granted during the three-month and nine-month periods ended March 31, 2006 were \$2.65 and \$4.93, respectively. The fair value was estimated using the following assumptions: dividend yield of 0.0%; volatility ranging between 109% and 251%; risk free interest ranging between 4.5% and 4.6%; and expected life of 10 years. The volatility assumption is based on historical volatility seen in the Company's stock. There is no reason to believe that future volatility will compare to historic volatility.

As of March 31, 2007, there was \$139,986 of total unrecognized compensation cost related to non-vested share-based compensation arrangements under the plan. The cost is expected to be recognized over a weighted average period of four years.

Cash received from share option exercises under stock-based payment plans for the nine months ended March 31, 2007 was \$157,779. 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 its non-employee stock-based compensation under the Financial Accounting Standards Board (FASB) Emerging Issues Task Force (EITF) Issue No. 96-18, "Accounting for Equity Instruments that are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services." The fair value of the option issued is used to measure the transaction, as this is more reliable than the fair value of the services received. Fair value is measured as the

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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 three-month and nine-month periods ended March 31, 2007, \$147,808 was recorded as compensation expense.

### 3. EARNINGS PER SHARE

The Company follows Financial Accounting Standards Board Statement No. 128, "Earnings Per Share," in presenting basic and diluted earnings per share. The following table sets forth the computation of basic and diluted earnings per share:

|  | THREE MONTHS<br>ENDED MARCH 31, |              | NINE MONTHS<br>ENDED MARCH 31, |              |
|--|---------------------------------|--------------|--------------------------------|--------------|
|  | 2007                            | 2006         | 2007                           | 2006         |
| NUMERATOR:   |                                 |              |                                |              |
| Numerator for basic and diluted earnings per share |                                 |              |                                |              |
| NET INCOME (LOSS)                                  | \$8,271,462                     | \$ (576,225) | \$7,087,242                    | \$ (843,679) |
| DENOMINATOR:                                       |                                 |              |                                |              |

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|  |           |           |           |           |
|--|-----------|-----------|-----------|-----------|
| Denominator for basic earnings per share - weighted average shares                   | 6,378,757 | 6,255,665 | 6,363,251 | 6,091,938 |
| Effect of dilutive securities:   |           |           |           |           |
| Stock options and warrants   | 56,349    | 0         | 58,020    | 0         |
| Shares reserved for future exchange  | 0         | 0         | 0         | 0         |
|  | -----     | -----     | -----     | -----     |
| DENOMINATOR FOR DILUTED EARNINGS PER SHARE - WEIGHTED AVERAGE AND ASSUMED CONVERSION | 6,435,106 | 6,255,665 | 6,421,321 | 6,091,938 |
|  | -----     | -----     | -----     | -----     |
| BASIC EARNINGS (LOSS) PER SHARE  | \$ 1.30   | \$ (0.09) | \$ 1.11   | \$ (0.14) |
|  | =====     | =====     | =====     | =====     |
| DILUTED EARNINGS (LOSS) PER SHARE  | \$ 1.29   | \$ (0.09) | \$ 1.10   | \$ (0.14) |
|  | =====     | =====     | =====     | =====     |

The impact of dilutive securities were omitted from the earnings per share calculation in the prior period presented as they would reduce the loss per share (anti-dilutive).

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4. INVENTORY

Inventory, stated at lower of cost (determined on a first-in, first-out basis) or market, consisted of the following:

|                     | MARCH 31,<br>2007 | JUNE 30,<br>2006 |
|---------------------|-------------------|------------------|
|                     | -----             | -----            |
|                     | (UNAUDITED)       |                  |
| Raw materials       | \$5,405,590       | \$4,219,836      |
| Work in process     | 701,713           | 809,807          |
| Finished goods      | 2,447,225         | 2,345,985        |
|                     | -----             | -----            |
|                     | 8,554,528         | 7,375,628        |
|                     | -----             | -----            |
| Valuation allowance | (252,712)         | (252,712)        |
|                     | -----             | -----            |
| TOTAL INVENTORY     | \$8,301,816       | \$7,122,916      |
|                     | -----             | -----            |

5. OTHER REVENUE

For the three-month periods ended March 31, 2007 and 2006, royalties totaled \$9,658,000 and \$553,000, respectively. For the nine-month periods ended March 31, 2007 and 2006, royalties totaled \$10,886,000 and \$1,687,000, respectively. These large changes are related to the settlement to the Intralase Corp. ("Intralase") lawsuit which generated a \$9,600,000 settlement during the quarter (see footnote 6). As the settlement covers all past and future royalties no additional royalties will be received in subsequent quarters related to the Intralase License Agreement.

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### 6. LEGAL PROCEEDING

#### INTRALASE

In 1997, IntraLase and Escalon entered into an agreement under which IntraLase became the exclusive licensee of certain patents, technology and intellectual property owned by Escalon Medical. This agreement was amended and restated in October 2000. The original and amended license agreement is referred to as the "License Agreement." Disputes arose between the parties culminating in litigation between the parties.

On February 27, 2007 Escalon entered into an agreement with IntraLase to settle all outstanding disputes and litigation between the parties. Under the settlement agreement, IntraLase made a lump-sum payment to Escalon of \$9,600,000 in exchange for which all pending litigation between the parties was dismissed, the parties exchanged general releases, Escalon transferred to IntraLase its ownership of all patents and intellectual property formerly licensed to IntraLase by Escalon, and the license agreement was terminated. In addition, the payment from IntraLase satisfies all outstanding past, current and future royalties owed or alleged to be owed by IntraLase to Escalon.

### 7. SEGMENTAL INFORMATION

During the three-month and nine-month periods ended March 31, 2007 and 2006, the Company's operations were classified into four principal reportable segments that provide different products or services.

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Separate management of each segment is required because each business unit is subject to different marketing, production and technology strategies.

#### SEGMENTAL STATEMENTS OF OPERATIONS (IN THOUSANDS) - THREE MONTHS ENDED MARCH 31, 2007 AND 2006

|                               | DREW     |          | SONOMED  |          | VASCULAR |        | MEDICAL/T |
|-------------------------------|----------|----------|----------|----------|----------|--------|-----------|
|                               | 2007     | 2006     | 2007     | 2006     | 2007     | 2006   | 2007      |
| REVENUES, NET:                |          |          |          |          |          |        |           |
| Product revenue               | \$ 3,220 | \$ 3,870 | \$ 2,183 | \$ 2,001 | \$ 914   | \$ 893 | \$ 583    |
| Other revenue                 | 59       | 84       | 0        | 0        | 0        | 0      | 9,600     |
| TOTAL REVENUE, NET            | 3,279    | 3,954    | 2,183    | 2,001    | 914      | 893    | 10,183    |
| COSTS AND EXPENSES:           |          |          |          |          |          |        |           |
| Cost of goods sold            | 2,131    | 2,622    | 1,190    | 966      | 351      | 447    | 364       |
| Operating expenses            | 1,842    | 1,923    | 975      | 839      | 609      | 487    | 779       |
| TOTAL COSTS AND EXPENSES      | 3,973    | 4,545    | 2,165    | 1,805    | 960      | 934    | 1,143     |
| (LOSS) INCOME FROM OPERATIONS | (694)    | (591)    | 18       | 196      | (46)     | (41)   | 9,040     |
| OTHER (EXPENSE) AND INCOME:   |          |          |          |          |          |        |           |

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|  |          |          |          |          |         |         |          |
|--|----------|----------|----------|----------|---------|---------|----------|
| Gain on sale of available<br>for sale securities | 0        | 0        | 0        | 0        | 0       | 0       | 0        |
| Equity in OTM                                    | 0        | 0        | 0        | 0        | 0       | 0       | (25)     |
| Interest income                                  | 0        | 0        | 0        | 0        | 0       | 0       | 54       |
| Interest expense                                 | (8)      | (26)     | 0        | 0        | 0       | (1)     | 0        |
|  | -----    | -----    | -----    | -----    | -----   | -----   | -----    |
| TOTAL OTHER (EXPENSE) AND<br>INCOME              | (8)      | (26)     | 0        | 0        | 0       | (1)     | 29       |
|  | -----    | -----    | -----    | -----    | -----   | -----   | -----    |
| INCOME (LOSS) BEFORE TAXES                       | (702)    | (617)    | 18       | 196      | (46)    | (42)    | 9,069    |
|  | -----    | -----    | -----    | -----    | -----   | -----   | -----    |
| Income taxes                                     | 0        | 0        | 37       | 14       | 1       | 0       | 28       |
|  | -----    | -----    | -----    | -----    | -----   | -----   | -----    |
| NET INCOME (LOSS)                                | \$ (702) | \$ (617) | \$ (19)  | \$ 182   | \$ (47) | \$ (42) | \$ 9,041 |
|  | =====    | =====    | =====    | =====    | =====   | =====   | =====    |
| Depreciation and<br>amortization                 | \$ 86    | \$ 65    | \$ 5     | \$ 6     | \$ (30) | \$ 28   | \$ 33    |
| Assets   | \$17,562 | \$17,592 | \$14,088 | \$13,802 | \$3,717 | \$3,850 | \$10,362 |
| Expenditures for<br>long-lived assets            | \$ 50    | \$ 33    | \$ 15    | \$ 1     | \$ 6    | \$ 0    | \$ 120   |

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SEGMENTAL STATEMENTS OF OPERATIONS (IN THOUSANDS) -  
NINE MONTHS ENDED MARCH 31, 2007 AND 2006

|  | DREW     |          | SONOMED  |          | VASCULAR |         | MEDICAL/T |
|--|----------|----------|----------|----------|----------|---------|-----------|
|  | 2007     | 2006     | 2007     | 2006     | 2007     | 2006    | 2007      |
|  | -----    | -----    | -----    | -----    | -----    | -----   | -----     |
| REVENUES, NET:                                   |          |          |          |          |          |         |           |
| Product revenue                                  | \$ 8,722 | \$11,071 | \$ 7,208 | \$ 5,802 | \$2,527  | \$2,703 | \$ 2,020  |
| Other revenue                                    | 184      | 228      | 0        | 0        | 0        | 0       | 10,702    |
|  | -----    | -----    | -----    | -----    | -----    | -----   | -----     |
| TOTAL REVENUE, NET                               | 8,906    | 11,299   | 7,208    | 5,802    | 2,527    | 2,703   | 12,722    |
|  | -----    | -----    | -----    | -----    | -----    | -----   | -----     |
| COSTS AND EXPENSES:                              |          |          |          |          |          |         |           |
| Cost of goods sold                               | 5,812    | 7,091    | 3,597    | 2,955    | 969      | 1,105   | 1,167     |
| Operating expenses                               | 5,835    | 5,763    | 2,705    | 2,802    | 1,609    | 1,503   | 2,553     |
|  | -----    | -----    | -----    | -----    | -----    | -----   | -----     |
| TOTAL COSTS AND EXPENSES                         | 11,647   | 12,854   | 6,302    | 5,757    | 2,578    | 2,608   | 3,720     |
|  | -----    | -----    | -----    | -----    | -----    | -----   | -----     |
| (LOSS) INCOME FROM<br>OPERATIONS                 | (2,741)  | (1,555)  | 906      | 45       | (51)     | 95      | 9,002     |
|  | -----    | -----    | -----    | -----    | -----    | -----   | -----     |
| OTHER (EXPENSE) AND<br>INCOME:                   |          |          |          |          |          |         |           |
| Gain on sale of available<br>for sale securities | 0        | 0        | 0        | 0        | 0        | 0       | 0         |
| Equity in OTM                                    | 0        | 0        | 0        | 0        | 0        | 0       | (56)      |
| Interest income                                  | 0        | 0        | 0        | 0        | 0        | 0       | 113       |
| Interest expense                                 | (23)     | (46)     | 0        | 0        | 0        | (1)     | 0         |
|  | -----    | -----    | -----    | -----    | -----    | -----   | -----     |
| TOTAL OTHER (EXPENSE) AND<br>INCOME              | (23)     | (46)     | 0        | 0        | 0        | (1)     | 57        |

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|                                    |            |            |          |          |         |         |          |
|------------------------------------|------------|------------|----------|----------|---------|---------|----------|
| (LOSS) AND INCOME BEFORE TAXES     | (2,764)    | (1,601)    | 906      | 45       | (51)    | 94      | 9,059    |
| Income taxes                       | 0          | 0          | 37       | 14       | 1       | 0       | 27       |
| NET (LOSS) INCOME                  | \$ (2,764) | \$ (1,601) | \$ 869   | \$ 31    | \$ (52) | \$ 94   | \$ 9,032 |
| Depreciation and amortization      | \$ 228     | \$ 188     | \$ 16    | \$ 16    | \$ 62   | \$ 62   | \$ 74    |
| Assets                             | \$17,562   | \$17,592   | \$14,088 | \$13,802 | \$3,717 | \$3,850 | \$10,362 |
| Expenditures for long-lived assets | \$ 139     | \$ 139     | \$ 15    | \$ 15    | \$ 7    | \$ 13   | \$ 129   |

8. RELATED-PARTY TRANSACTIONS

The Company and a member of the Company's Board of Directors are founding and equal members of OTM. OTM is a diagnostic telemedicine company that provides remote examination, diagnosis and management of disorders affecting the human eye. OTM's initial product 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 March 31, 2007, Escalon had invested \$271,000 in OTM. As of March 31, 2007, Escalon owned 45% of OTM. The Company provides administrative support functions to OTM. From inception on October 22, 2003 through March 31, 2007, OTM had revenue of approximately \$21,400 and incurred expenses of approximately \$264,000.

Two relatives of a senior executive officer have provided legal services as either an employee or a consultant to the Company. Richard DePiano, Jr. is the son of the Chief Executive Officer ("CEO") and serves as Chief Operating Officer and General Counsel to the Company. His salary plus bonus for the nine-month periods ended March 31, 2007 and 2006 were \$152,000 and \$135,115, respectively. Caryn Lindsey, the daughter-in-law of the CEO, acted as a consultant and employee for the Company in 2005. For the nine-month periods ended March 31, 2007 and 2006 Ms. Lindsey received consulting fees and salary of \$0 and \$68,954, respectively.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FORWARD LOOKING STATEMENTS

Certain statements contained in, or incorporated by reference in, this report are forward-looking statements made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995, which provide current expectations or forecasts of future events. Such statements can be identified by the use of terminology such as "anticipate," "believe," "could," "estimate," "expect," "forecast," "intend," "may," "plan," "possible," "project," "should," "will," and similar words or expressions. The Company's forward-looking statements include certain information relating to general business strategy, growth strategies, financial results, liquidity, product development, the introduction of new products, the 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

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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 and defending the Company in litigation matters. 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 list of such factors contained in its periodic report on Form 10-KSB for the year ended June 30, 2006 to be an exhaustive statement of all risks, uncertainties or potentially inaccurate assumptions.

### EXECUTIVE OVERVIEW - NINE-MONTH PERIOD ENDED MARCH 31, 2007

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

- Product revenue decreased approximately 2% during the nine-month period ended March 31, 2007 as compared to the same period last fiscal year. The decrease is primarily related to decreases in the Drew and Vascular business units. Revenue at Drew and Vascular decreased 21.2% and 6.5%, respectively, during the nine-month period ended March 31, 2007 when compared to the same period last fiscal year. These decreases were offset by strong sales in the Company's Sonomed and Medical/Trek/EMI business units. Sales at Sonomed and Medical/Trek/EMI increased approximately 24.2% and 53.1%, respectively, during the nine-month period ended March 31, 2007 compared to the same period last fiscal year.
- During July 2005, the Company sold 58,555 shares of IntraLase common stock that had originally been received by the Company in connection with the license of its laser properties to IntraLase in 1997. The stock was sold at \$19.8226 per share and yielded net proceeds of \$1,157,336 after the payment of brokers' commissions and other fees. The net proceeds were recorded as other income in the nine-month period ended March 31, 2006.

Other revenue increased approximately \$9,199,000, or 545.3%, during the nine-month period ended March 31, 2007 as compared to the same period last fiscal year. The increase is attributable to increased royalties received from the IntraLase License Agreement as a result of the settlement agreement. Under the settlement agreement, IntraLase made a lump sum payment to Escalon of \$9,600,000 in exchange for which all pending litigation between the parties was dismissed, the parties exchanged general releases, Escalon transferred to IntraLase its ownership of patents and intellectual property formerly licensed to IntraLase by Escalon, and the License Agreement has terminated. In addition, the payment from IntraLase satisfied all outstanding past, current and future royalties owed or alleged to be owed by IntraLase to Escalon.

- Cost of goods sold as a percentage of product revenue decreased slightly to approximately 58.5% of revenues during the nine-month

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period ended March 31, 2007, as compared to approximately 60.2% of product revenue for the same period last fiscal year. Gross margins in the Drew business unit have historically been lower than those in the Company's other business units. The aggregate cost of goods sold as a percentage of product revenue of the Sonomed, Vascular and Medical/Trek/EMI business units during the nine-month period ended March 31, 2007, remained steady at approximately 50.0% of product revenue.

- Operating expenses decreased approximately 1.9% during the nine-month period ended March 31, 2007 as compared to the same period in the prior fiscal year. The decrease was due to a significant decrease in legal fees related to the IntraLase litigation, offset by an increase in research and development related to Drew.

### COMPANY OVERVIEW

The following discussion should be read in conjunction with interim condensed consolidated financial statements and the notes thereto, which are set forth elsewhere in this report.

The Company operates in the healthcare market specializing in the development, manufacture, marketing and distribution of medical devices and pharmaceuticals in the areas of ophthalmology, diabetes, hematology and vascular access. The Company and its products are subject to regulation and inspection by the 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 Company's Internet address is [www.escalonmed.com](http://www.escalonmed.com).

### 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 for SFAS 142. 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 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 an immediate 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 collectibility is reasonably assured.

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

#### VALUATION OF INTANGIBLE ASSETS

The Company annually evaluates for impairment its intangible assets and goodwill in accordance with SFAS 142, "Goodwill and Other Intangible Assets," or whenever events or changes in circumstances indicate that the carrying value may not be recoverable. These intangible assets include goodwill, trademarks and trade names. Factors the Company considers important that could trigger an impairment review include significant under-performance relative to historical or projected future operating results or significant negative industry or economic trends. If these criteria indicate that the value of the intangible asset may be impaired, an evaluation of the recoverability of the net carrying value of the asset is made. If this evaluation indicates that the intangible asset is not recoverable, the net carrying value of the related intangible asset will be reduced to fair value. 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. No impairment losses were recorded for goodwill, trademarks and trade names during any of the periods presented based on these evaluations.

#### INCOME/(LOSS) PER SHARE

The Company computes net income/(loss) per share under the provisions of SFAS No. 128, Earnings per Share (SFAS 128), and Staff Accounting Bulletin, No. 98 (SAB 98).

Under the provisions of SFAS 128 and SAB 98, basic and diluted net income/(loss) per share are 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 effect 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



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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 of the deferred tax assets, which arise from temporary differences between the tax and financial statement recognition of revenue and expense. SFAS

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109 also requires that the deferred tax assets be reduced by a valuation allowance, if based on the available evidence, it is more likely than 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 March 31, 2007, the Company has recorded a full valuation allowance against the Company's net operating losses due to the 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 carry forwards. Any reduction would reduce (increase) the income tax expense (benefit) in the period such determination is made by the Company.

### THREE- AND NINE-MONTH PERIODS ENDED MARCH 31, 2007 AND 2006

The following table shows consolidated product revenue by business unit as well as identifying trends in business unit product revenues for the three- and nine-month periods ended March 31, 2007 and 2006. Dollar amounts are in thousands:

|                       | THREE-MONTH PERIOD ENDED MARCH 31, |         |          | NINE-MONTH PERIOD ENDED MARCH 31, |          |          |
|-----------------------|------------------------------------|---------|----------|-----------------------------------|----------|----------|
|                       | 2007                               | 2006    | % CHANGE | 2007                              | 2006     | % CHANGE |
| PRODUCT REVENUES, NET |                                    |         |          |                                   |          |          |
| Drew                  | \$3,220                            | \$3,871 | -16.8%   | \$ 8,722                          | \$11,071 | -21.2%   |
| Sonomed               | 2,183                              | 2,001   | 9.1%     | 7,208                             | 5,802    | 24.2%    |

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|                  |         |         |       |          |          |       |
|------------------|---------|---------|-------|----------|----------|-------|
| Vascular         | 914     | 893     | 2.4%  | 2,527    | 2,703    | -6.5% |
| Medical/Trek/EMI | 583     | 522     | 11.7% | 2,021    | 1,320    | 53.1% |
|                  | -----   | -----   | ----- | -----    | -----    | ----- |
| TOTAL            | \$6,900 | \$7,287 | -5.3% | \$20,478 | \$20,896 | -2.0% |
|                  | =====   | =====   | ===== | =====    | =====    | ===== |

Product revenue decreased approximately \$387,000, or 5.3%, to \$6,900,000 during the three-month period ended March 31, 2007 as compared to the same period last fiscal year.

In the Drew business unit, product revenue decreased \$651,000, or 16.8%, as compared to the same period last fiscal year. The decrease is primarily due to a reduction of approximately \$900,000 in international sales of diabetic and hematology instruments. This decrease was partially off set by a significant increase in sales of spare parts. Reagents and controls sales remained constant during the period.

Product revenue increased \$182,000, or 9.1%, at the Sonomed business unit as compared to the same period last fiscal year. The increase in product revenue was caused by an increase in sales of the Company's EZ AB scan ultrasound systems, primarily into international markets.

Product revenue increased \$21,000, or 2.4%, to \$914,000 in the Vascular business unit during the three-month period ended March 31, 2007 as compared to the same period last fiscal year. The increase in product revenue in the Vascular business unit was primarily caused by an increase in direct sales to end users by the Company's domestic sales team. These increases were partially offset by decreases in revenue

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from the Company's distributor network and a slight decrease in international sales. The Company terminated its relationship with several of its distributors during the prior fiscal year.

In the Medical/Trek/EMI business unit, product revenue increased \$61,000, or 11.7%, to \$583,000 during the three-month period ended March 31, 2007 as compared to the same period last fiscal year. The increase in Medical/Trek/EMI product revenue is primarily attributed to an increase of approximately \$108,000 in EMI sales of digital imaging systems.

Product revenue decreased approximately \$418,000, or 2.0%, to \$20,478,000 during the nine-month period ended March 31, 2007 as compared to the same period last fiscal year.

In the Drew business unit, product revenue decreased \$2,349,000, or 21.2 %, as compared to the same period last fiscal year. As in the three-month period ended March 31, 2007, the decrease is primarily due a reduction in international sales of diabetics and hematology instruments, partially offset by a significant increase in sales of spare parts, with reagents and controls sales remaining flat.

Product revenue increased \$1,406,000, or 24.2%, at the Sonomed business unit as compared to the same period last fiscal year. The increase in product revenue was primarily caused by an increase in sales of the Company's EZ AB scan ultrasound systems, primarily in international markets, as well as continued demand for Sonomed's existing product line.

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Product revenue decreased \$176,000, or 6.5%, to \$2,527,000 at the Vascular business unit during the nine-month period ended March 31, 2007 as compared to the same period last fiscal year. The decrease in product revenue in the Vascular business unit was primarily caused by a decrease in revenue from the Company's distributor network and decreased foreign sales. The Company terminated its relationship with several of its distributors during the prior fiscal year.

In the Medical/Trek/EMI business unit, product revenue increased \$701,000, or 53.1%, to \$2,021,000 during the nine-month period ended March 31, 2007 as compared to the same period last fiscal year. The increase in Medical/Trek/EMI product revenue is primarily due to an increase of approximately \$722,000 in EMI sales of digital imaging systems as a result of the January 30, 2006 acquisition of MRP Group, Inc. ("MRP").

Other revenue increased by approximately \$9,106,000 to \$9,659,000 during the three-month period ended March 31, 2007 as compared to the same period last fiscal year. The increase is primarily due to a settlement of \$9,600,000 with IntraLase. (See note 6 the notes to the condensed consolidated financial statements.)

Other revenue increased by approximately \$9,199,000 to \$10,886,000 during the nine-month period ended March 31, 2007 as compared to the same period last fiscal year. The increase is primarily due to a settlement of \$9,600,000 with IntraLase. (See note 6 of the notes to the condensed consolidated financial statements.)

The following table presents consolidated cost of goods sold by reportable business unit and as a percentage of related unit product revenues for the three- and nine-month periods ended March 31, 2007 and 2006. Dollar amounts are in thousands:

|                    | THREE-MONTH PERIOD ENDED MARCH 31 |      |       |      | NINE-MONTH PERIOD ENDED MARCH 31 |      |        |      |
|--------------------|-----------------------------------|------|-------|------|----------------------------------|------|--------|------|
|                    | 2007                              |      | 2006  |      | 2007                             |      | 2006   |      |
|                    | \$                                | %    | \$    | %    | \$                               | %    | \$     | %    |
| COST OF GOODS SOLD |                                   |      |       |      |                                  |      |        |      |
| Drew               | 2,131                             | 66.2 | 2,622 | 67.7 | 5,812                            | 66.6 | 7,091  | 64.1 |
| Sonomed            | 1,190                             | 54.5 | 965   | 48.2 | 3,597                            | 49.9 | 2,955  | 50.9 |
| Vascular           | 351                               | 38.4 | 447   | 50.1 | 969                              | 38.3 | 1,105  | 40.9 |
| Medical/Trek/EMI   | 364                               | 62.4 | 348   | 66.7 | 1,167                            | 57.7 | 860    | 65.2 |
| TOTAL              | 4,036                             | 58.5 | 4,382 | 60.1 | 11,545                           | 56.4 | 12,011 | 57.5 |

Cost of goods sold totaled approximately \$4,036,000, or 58.5% of product revenue, for the three-month period ended March 31, 2007 as compared to \$4,382,000, or 60.2% of product revenue, for the same period last fiscal year.

Cost of goods sold in the Drew business unit totaled \$2,131,000, or 66.2% of product revenue, for the three-month period ended March 31, 2007 as compared to \$2,622,000, or 67.7% of product revenue, for the same period last fiscal

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year. The decrease in the cost of goods sold as a percentage of revenue was due to increased sales of high margin spare parts during the current period.

Cost of goods sold in the Sonomed business unit totaled \$1,190,000, or 54.5% of product revenue, for the three-month period ended March 31, 2007 as compared to \$965,000, or 48.2% of product revenue, for the same period last fiscal year. The primary reason for the increase as a percentage of revenue was an increase in the percentage of sales during the period that were international sales. The Company historically experiences a lower selling price per unit on its international product sales.

Cost of goods sold in the Vascular business unit totaled \$351,000, or 38.4% of product revenue, for the three-month period ended March 31, 2007 as compared to \$447,000, or 50.1% of product revenue, for the same period last fiscal year. The Company experienced a significant decrease in overtime and higher production efficiencies in the current period as compared to the prior period.

Cost of goods sold in the Medical/Trek/EMI business unit totaled \$364,000, or 62.4% of product revenue, during the three-month period ended March 31, 2007 as compared to \$348,000, or 66.7% of product revenue, during the same period last fiscal year. The decrease as a percentage of revenues is due primarily to the integration of MRP into the existing EMI product lines and the resultant cost of goods sold for EMI of 49.5% of product revenues as compared to 76.4% of product revenue for the same period last fiscal year.

Cost of goods sold totaled approximately \$11,545,000, or 56.4 % of product revenue, for the nine-month period ended March 31, 2007 as compared to \$12,011,000, or 57.5% of product revenue, for the same period last fiscal year.

Cost of goods sold in the Drew business unit totaled \$5,812,000, or 66.6% of product revenue, for the nine-month period ended March 31, 2007 as compared to \$7,091,000, or 64.1% of product revenue, for the same period last fiscal year. The increase in Drew's cost of goods sold as a percentage of revenue was due to the product mix during the period, which consisted of lower margin sales of Drew's aging product line combined with higher margin spare part sales.

Cost of goods sold in the Sonomed business unit remained relatively unchanged over the same period last year, totaling \$3,597,000 or 49.9% of product revenue, for the nine-month period ended March 31, 2007 as compared to \$2,955,000, or 50.9% of product revenue, for the same period last fiscal year.

Vascular business unit totaled \$969,000, or 38.3% of product revenue, for the nine-month period ended March 31, 2007 as compared to \$1,105,000, or 40.9% of product revenue, for the same period last fiscal year. The primary factors affecting the decrease in cost of goods sold as a percentage of product revenue were the increase in direct sales to end users and corresponding decrease in sales through the Company's distributor network, where the Company generally experiences lower price per unit on its products.

Cost of goods sold in the Medical/Trek/EMI business unit totaled \$1,167,000, or 57.7% of product revenue, during the nine-month period ended March 31, 2007 as compared to \$860,000, or 65.2% of

product revenue, during the same period last fiscal year. The decrease as a percentage of revenues is due primarily to the integration of MRP into the existing EMI product lines and the resultant cost of goods sold for EMI of 45.2% of product revenues as compared to 71.0% of revenues for the same period last

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fiscal year.

The following table presents consolidated marketing, general and administrative expenses as well as identifying trends in business unit marketing, general and administrative expenses for the three- and nine-month periods ended March 31, 2007 and 2006. Dollar amounts are in thousands:

|                                       | THREE-MONTH PERIOD ENDED MARCH 31, |         |          | NINE-MONTH PERIOD EN |          |
|---------------------------------------|------------------------------------|---------|----------|----------------------|----------|
|                                       | 2007                               | 2006    | % CHANGE | 2007                 | 2006     |
| MARKETING, GENERAL AND ADMINISTRATIVE |                                    |         |          |                      |          |
| Drew                                  | \$1,313                            | \$1,434 | -8.4%    | \$ 3,973             | \$ 4,440 |
| Sonomed                               | 813                                | 784     | 3.7%     | 2,382                | 2,415    |
| Vascular                              | 547                                | 411     | 33.1%    | 1,489                | 1,390    |
| Medical/Trek/EMI                      | 689                                | 655     | 5.2%     | 2,218                | 2,151    |
| TOTAL                                 | \$3,362                            | \$3,283 | 2.4%     | \$10,062             | \$10,396 |

Marketing, general and administrative expenses increased \$78,000, or 2.4%, to \$3,362,000 during the three-month period ended March 31, 2007 as compared to the same period last fiscal year.

Marketing, general and administrative expenses in the Drew business unit decreased \$121,000, or 8.4%, to \$1,313,000 as compared to the same period last fiscal year. The Drew decrease is primarily due to the realization of previously announced cost reductions initiated during the first quarter of fiscal year 2007.

Marketing, general and administrative expenses in the Sonomed business unit increased by \$29,000, or 3.7%, to \$813,000 as compared to the same period last fiscal year. Marketing and sales salaries and travel expenses, related to additional sales personnel, increased by approximately \$90,000 as part of the Company's focus on increasing domestic and foreign revenues. During the three-month period ended March 31, 2006 the Company incurred advertising expenses of approximately \$30,000 related to exhibits and brochures for the Company's Ultrasound Biomicroscopes instrument ("UBM"). Such expenditures were not incurred during the same period this fiscal year.

Marketing, general and administrative expenses in the Vascular business unit increased \$136,000, or 33.1%, to \$547,000 as compared to the same period last fiscal year. This increase is made up mainly of increases in salaries and other personnel-related expenses related to supporting a higher volume of business during the current period as compared to the same period in the prior fiscal year.

Marketing, general and administrative expenses in the Medical/Trek/EMI business unit increased \$34,000, or 5.2%, to \$689,000 as compared to the same period last fiscal year. Administrative expenses increased approximately \$89,000. Corporate salaries and related expenses increased nearly \$41,000, due primarily to the addition of additional accounting personnel. Legal fees increased approximately \$35,000, due primarily to expenditures related to finalizing the settlement with IntraLase (see note 6 to the notes to condensed consolidated financial statements). Investor relations and insurance expenditures increased by \$57,000 and \$18,000, respectively. These increases were partially offset by decreases in outside accounting fees of approximately \$56,000. The outside accounting decrease was primarily due to a reduction on

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Sarbanes-Oxley work in view of the compliance extension for non-accelerated filers such as the Company. Sales and marketing expenses increased \$39,000 due primarily to costs related to the trade show booth for the American Academy of Ophthalmology meeting.

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Marketing, general and administrative expenses decreased \$334,000, or 3.2%, to \$10,062,000 during the nine-month period ended March 31, 2007 as compared to the same period last fiscal year.

Marketing, general and administrative expenses in the Drew business unit decreased \$467,000, or 10.5%, to \$3,973,000 as compared to the same period last fiscal year. As in the period ended March 31, 2007, the reduction is primarily due to the realization of cost reductions initiated during the first quarter of fiscal year 2007.

Marketing, general and administrative expenses in the Sonomed business unit decreased \$33,000, or 1.4%, to \$2,382,000 as compared to the same period last fiscal year. Marketing and sales salaries and related expenses decreased approximately \$74,000 due to the temporary reduction of the in-house sales force. This reduction was partially offset by an increase of approximately \$62,000 in amounts paid to independent agents utilized primarily in Europe related to the Company's goal of continuing to increase international revenues. Commissions decreased approximately \$56,000 due to increases in direct and distributor sales. Advertising decreased nearly \$40,000 due mainly to nonrecurring spending that occurred during 2006 for start-up expenses relating to the Company's new UBM. Legal fees decreased approximately \$32,000. This decrease is primarily due to the non-recurrence of fees incurred during 2006 to resolve a dispute with a supplier and fees related to researching intellectual property ownership issues for licensing for use in potential new products.

Marketing, general and administrative expenses in the Vascular business unit increased \$99,000, or 7.1%, to \$1,489,000 as compared to the same period last fiscal year. Administrative salaries and related expenses increased nearly \$66,000 reallocation of personnel to properly reflect time contributed to Vascular. Sales travel and related expenditures increased approximately \$40,000 as part of efforts to increase direct domestic sales while show expenses increased \$14,000.

Marketing, general and administrative expenses in the Medical/Trek/EMI business unit increased \$67,000, or 3.1%, to \$2,218,000 as compared to the same period last fiscal year. Legal fees increased approximately \$180,000, due primarily to expenditures related to finalizing the settlement with IntraLase. See note 6 of the notes to the condensed consolidated financial statements. Accounting fees increased \$43,000, mainly due to higher third party consulting fees for tax and temporary services. Amortization expense, related mainly to the MRP acquisition, increased \$63,000. Also, the 2007 nine month period includes approximately \$125,000 expensed under SFAS No. 123(R) related to options granted to members of the Board of Directors. Offsetting these increases was an increase in corporate allocations to the subsidiaries as well as, decreases in consulting, corporate travel and related expenses, business taxes and exhibit expenses of \$34,000, \$48,000, \$26,000 and \$61,000, respectively.

The following table presents consolidated research and development expenses as well as identifying trends in business unit research and development expenses for the three- and nine-month periods ended March 31, 2007 and 2006. Dollar amounts are in thousands:

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|                          | THREE-MONTH PERIOD<br>ENDED MARCH 31, |       |          | NINE-MONTH PERIOD<br>ENDED MARCH 31, |         |          |
|--------------------------|---------------------------------------|-------|----------|--------------------------------------|---------|----------|
|                          | 2007                                  | 2006  | % CHANGE | 2007                                 | 2006    | % CHANGE |
| RESEARCH AND DEVELOPMENT |                                       |       |          |                                      |         |          |
| Drew                     | \$529                                 | \$489 | 8.2%     | \$1,862                              | \$1,323 | 40.7%    |
| Sonomed                  | 161                                   | 54    | 198.1%   | 323                                  | 387     | -16.5%   |
| Vascular                 | 62                                    | 42    | 47.6%    | 120                                  | 113     | 6.2%     |
| Medical/Trek/EMI         | 92                                    | 133   | -30.8%   | 333                                  | 313     | 6.4%     |
| TOTAL                    | \$844                                 | \$718 | 17.5%    | \$2,638                              | \$2,136 | 23.5%    |

Research and development expenses increased \$126,000, or 17.5%, to \$844,000 during the three-month period ended March 31, 2007 as compared to the same period last fiscal year.

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Research and development expenses related primarily expenses associated with the planned introduction of new and/or enhanced products in the Drew business unit. Research and development expenses in the Drew business unit increased \$40,000, or 8.2%, to \$529,000 as compared to the same period last fiscal year. The increase is primarily due to additional salaries, benefits and consulting fees associated with the development of several new hematology and diabetic instruments.

Research and development increased approximately \$107,000 in the Sonomed business unit due primarily to an increase of nearly \$91,000 in consulting fees related to additional UBM improvements.

Research and development expenses in the Medical/Trek/EMI business unit decreased \$41,000 to \$92,000 as compared to the same period last fiscal year. Expenditures were reduced by approximately \$107,000 due to the realization of cost reductions initiated during the first quarter of fiscal year 2007. This decrease was partially offset by an increase of approximately \$67,000 related to expenditures for the development of the Company's new digital ophthalmic platform.

Research and development expenses increased \$502,000, or 23.5%, to \$2,638,000 during the nine-month period ended March 31, 2007 as compared to the same period last fiscal year. Research and development expenses were primarily expenses associated with the planned introduction of new and/or enhanced products in the Drew, Sonomed and EMI business units.

Research and development expenses in the Drew business unit increased \$539,000, or 40.7%, to \$1,862,000 as compared to the same period last fiscal year. The increase is primarily due to additional salaries and benefits and consulting fees associated with the development of several new hematology and diabetic instruments.

Research and development expenses in the Sonomed business unit decreased \$64,000 to \$323,000 as compared to the same period last fiscal year. The

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decrease is primarily due to a reduction of consulting (approximately \$38,000) and prototype expenses (approximately \$16,000) for development of the Company's new UBM machines completed during 2006.

Research and development expenses in the Medical/Trek/EMI business unit increased \$20,000 to \$333,000 as compared to the same period last fiscal year. The increase is primarily due to \$196,000 higher expenditures relate to development of the Company's new digital ophthalmic program off set partially by the reduction in corporate expenditures of approximately \$165,000 due to the realization of cost reductions initiated during the first quarter of fiscal year 2007.

Gain on sale of available for sale securities was approximately \$1,157,000 in the nine-month period ended March 31, 2006 due to the sale of 58,585 shares of IntraLase common stock in July 2005. There was no similar transaction during the same period of the current fiscal year. There were no sales of available-for-sale securities during the nine-month period ended March 31, 2007.

The Company recognized a loss of \$25,000 and \$19,000 related to its investment in OTM during the three-month periods ended March 31, 2007 and 2006, respectively, and \$56,000 and \$70,000 for the nine-month periods ended March 31, 2007 and 2006, respectively. Commencing July 1, 2005, the Company began recognizing all of the losses of OTM in its consolidated financial statements. OTM is an early stage privately held company. Prior to July 1, 2005, the share of OTM's loss recognized by the Company was in direct proportion to the Company's ownership equity in OTM. OTM began operations during the three-month period ended September 30, 2004.

Interest income was \$54,000 and \$34,000 for the three-month periods ended March 31, 2007 and 2006, respectively, and 113,000 and \$112,000 for the nine-month periods ended March 31, 2007 and 2006, respectively. The increase was due to higher effective yields on investments.

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Interest expense was \$9,000 and \$28,000 for the three-month periods ended March 31, 2007 and 2006, respectively, and \$24,000 and \$47,000 for the nine-month periods ended March 31, 2007 and 2006, respectively.

### LIQUIDITY AND CAPITAL RESOURCES

Changes in overall liquidity and capital resources from continuing operations during the three-month period ended March 31, 2007 are reflected in the following table (in thousands):

|                           | MARCH 31,<br>2007 | JUNE 30,<br>2006 |
|---------------------------|-------------------|------------------|
|                           | -----             | -----            |
| CURRENT RATIO:            |                   |                  |
| Current assets            | \$ 22,390         | \$ 14,911        |
| Less: Current liabilities | 3,996             | 4,295            |
|                           | -----             | -----            |
| WORKING CAPITAL           | \$ 18,394         | \$ 13,613        |
|                           | =====             | =====            |
| CURRENT RATIO             | 5.6 TO 1          | 3.5 TO 1         |
|                           | =====             | =====            |



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### DEBT TO TOTAL CAPITAL RATIO:

|                                      |           |           |
|--------------------------------------|-----------|-----------|
| Notes payable and current maturities | \$ 199    | \$ 233    |
| Long-term debt                       | 14        | 163       |
|                                      | -----     | -----     |
| Total debt                           | \$ 213    | \$ 396    |
|                                      | -----     | -----     |
| Total equity                         | 40,632    | 33,100    |
|                                      | -----     | -----     |
| TOTAL CAPITAL                        | \$ 40,845 | \$ 33,496 |
|                                      | =====     | =====     |
| TOTAL DEBT TO TOTAL CAPITAL          | 0.5%      | 1.8%      |
|                                      | =====     | =====     |

### WORKING CAPITAL POSITION

Working capital increased approximately \$4,781,000 as of March 31, 2007 and the current ratio increased to 5.6 to 1 from 3.5 to 1 when compared to June 30, 2006. The increase in working capital was primarily related to the settling of the Intralase litigation (see note 6 of the notes to condensed consolidated financial statements).

### CASH USED IN OPERATING ACTIVITIES

During the nine-month periods ended March 31, 2007 and 2006, the Company generated/(used) approximately \$6,346,000 and \$(2,753,000) of cash for operating activities, respectively. The net decrease in cash used for operating activities of approximately \$9,099,000 for the nine-month period ended March 31, 2007 as compared to the same period in the prior fiscal year is due primarily to the following factors:

The Company had net income of \$7,087,000 and experienced net cash out flows from increases in accounts receivable and inventory of approximately \$537,000 and \$1,130,000, respectively. These cash out flows were partially offset by an increase in accounts payable of \$164,000 and non-cash expenditures on depreciation and amortization of \$418,000. In the prior fiscal period the cash used in operating activities of \$2,753,000 was related to net loss in the prior year of \$844,000 and by a gain on sale of marketable securities in the amount of \$1,157,000, along with increases in inventory and accounts receivable of \$795,000 and \$428,000, respectively, offset by \$338,000 in non-cash items.

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### CASH FLOWS (USED IN) PROVIDED BY INVESTING AND FINANCING ACTIVITIES

Cash flows used in investing activities of \$215,000 is related to fixed asset purchases during the nine-month period ended March 31, 2007. The decrease in cash flows from investing activities from the prior fiscal period was \$848,000. The change relates primarily to the net proceeds of approximately \$1,157,000 realized from the sale of a majority of the remaining shares of the IntraLase securities held by the Company as available for sale securities. Partially offsetting the cash realized from the securities sale was cash utilized for fixed asset additions and for distribution rights of approximately \$476,000.

Cash flows used by financing activities were approximately \$24,000 during the nine-month period ended March 31, 2007. During the period, the Company made scheduled long-term debt repayments of approximately \$182,000 and received \$158,000 from the exercise of stock options during the period.

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### DEBT HISTORY

Drew has long-term debt facilities through the Texas Mezzanine Fund and through Symbiotics, Inc. The Texas Mezzanine Fund term debt is payable in monthly installments of \$14,200, which includes interest at a fixed rate of 8.00%. The note is due in April 2008 and is secured by certain assets of Drew. The outstanding balance as of March 31, 2007 was \$171,000. The Symbiotics, Inc. term debt, which originated from the acquisition of a product line from Symbiotics, Inc., is payable in monthly principal installments of \$8,333 plus interest at a fixed rate of 5.00%. The outstanding balance as of March 31, 2007 was \$42,000.

### OFF-BALANCE SHEET ARRANGEMENTS AND CONTRACTUAL OBLIGATIONS

The Company was not a party to any off-balance sheet arrangements during the three- and six-month periods ended March 31, 2007 and 2006.

The following table presents the Company's contractual obligations as of March 31, 2007 (interest is not included in the table as it is immaterial):

|                            | TOTAL              | LESS THAN<br>1 YEAR | 1-3 YEARS          | 3-5 YEARS        | MORE THAN<br>5 YEARS |
|----------------------------|--------------------|---------------------|--------------------|------------------|----------------------|
|                            | -----              | -----               | -----              | -----            | -----                |
| Long-term debt             | \$ 213,079         | \$198,966           | \$ 14,113          | \$ 0             | \$ 0                 |
| Operating lease agreements | 2,316,297          | 785,366             | 1,105,807          | 425,124          | 0                    |
|                            | -----              | -----               | -----              | -----            | -----                |
| <b>TOTAL</b>               | <b>\$2,529,376</b> | <b>\$984,332</b>    | <b>\$1,119,920</b> | <b>\$425,124</b> | <b>\$ 0</b>          |
|                            | =====              | =====               | =====              | =====            | =====                |

### SIGNIFICANT ITEMS LIKELY TO IMPACT LIQUIDITY

Drew does not have a history of producing positive operating cash flows and, as a result, at the time of acquisition in 2005, was operating under financial constraints and was undercapitalized. As Drew is integrated into the Company, management has been working to reverse the situation, while at the same time seeking to strengthen Drew's market position. As of March 31, 2007, the Company has loaned approximately \$13,200,000 to Drew. The funds have been primarily used to procure components to build up inventory to support the manufacturing process, to pay off accounts payable and debt of Drew, to fund new product development and underwrite operating losses incurred since acquisition. The Company anticipates that further working capital will likely be required by Drew.

### ITEM 3: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

#### INTEREST RATE RISK

The table below provides information about the Company's financial instruments consisting of both variable and fixed interest rate debt obligations. For debt obligations, the table represents principal cash flows and related interest rates by expected maturity dates. Interest rates as of March 31, 2007 were variable at prime plus 4%, currently 10.25% per annum, on the

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Texas Mezzanine Fund debt, and were fixed at 5.00% per annum, on the Symbiotics, Inc. term debt.

|                           | 2007      | 2008          |
|---------------------------|-----------|---------------|
|                           | -----     | -----         |
| Texas Mezzanine Fund Note | \$ 99,896 | \$ 71,183     |
| Interest rate             | 10.25%    | Prime Plus 4% |
| Symbiotics, Inc. Note     | \$ 42,000 | \$ 0          |
| Interest rate             | 5.00%     | 5.00%         |
|                           | -----     | -----         |
| TOTAL                     | \$141,896 | \$ 71,183     |
|                           | =====     | =====         |

### EXCHANGE RATE RISK

Prior to the acquisition of Drew, the price of all product sold overseas was denominated in United States Dollars, and consequently the Company incurred no exchange rate risk on revenue. However, a portion of Drew's product revenue is denominated in United Kingdom Pounds and Euros. During the three-month periods ended March 31, 2007 and 2006, Drew recorded approximately \$985,000 and \$881,000 respectively, of revenue denominated in United Kingdom Pounds and Euros, respectively. During the nine-month periods ended March 31, 2007 and 2006, Drew recorded approximately \$2,525,000 and \$3,046,000, respectively, of revenue denominated in United Kingdom Pounds and Euros, respectively.

Drew incurs a portion of its expenses denominated in United Kingdom Pounds. During the three-month periods ended March 31, 2007 and 2006, Drew incurred approximately \$957,000 and \$931,000, respectively, of expense denominated in United Kingdom Pounds. During the nine-month periods ended March 31, 2007 and 2006, Drew recorded approximately \$3,101,000 and \$3,325,000, respectively, of expense denominated in United Kingdom Pounds and Euros, respectively. The Company's Sonomed and Vascular business units incur an immaterial portion of their marketing expenses in the European market, the majority of which are transacted in Euros.

The Company may begin to experience fluctuations, beneficial or adverse, in the valuation of currencies in which the Company transacts its business, namely the United States Dollar, the United Kingdom Pound and the Euro.

### ITEM 4. CONTROLS AND PROCEDURES

#### (A) EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

The Company's management, with the participation of the Company's Chief Executive Officer and Principal Financial and Accounting Officer, has established disclosure controls and procedures to ensure that material information relating to the Company, including its consolidated subsidiaries, is made known to the officers who certify the Company's financial reports and to other members of senior management and the Board of Directors.

Based on their evaluation of the effectiveness of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of March 31, 2007, the Chief Executive Officer and Principal

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Financial and Accounting Officer of the Company have concluded that such disclosure controls and procedures are effective to ensure that the information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, and that information required to be disclosed in the reports that the Company files or submits under the Exchange Act is accumulated and communicated to the Company's management, including its Chief Executive Officer and Principal Financial and Accounting Officer, to allow timely decisions regarding required disclosure.

### (B) INTERNAL CONTROL OVER FINANCIAL REPORTING

There have not been any changes in the Company's internal control over financial reporting (as such term is defined in Rule 13a-15(f) under the Exchange Act), during the fiscal quarter ended March 31, 2007 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

## PART II. OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

See note 6 of the notes to the condensed consolidated financial statements for further information regarding the Company's legal proceedings.

### ITEM 1A. RISK FACTORS

Drew has received notice from the FDA that certain deficiencies were noted during the FDA's recent audit of the Company's United Kingdom facility. Drew has addressed the deficiencies and believes that it has brought the facility into compliance with FDA regulations. Drew is communicating with the FDA concerning its remediation of the deficiencies, however, Drew may face further adverse findings, rulings and fines from the FDA, which may result in the delay or delivery of certain products. Drew has alternative sources for the products manufactured at the Drew United Kingdom facility. In the event of any adverse FDA action the use of Drew's alternative suppliers will have an adverse effect on gross margins.

There are no other material changes from the risks previously disclosed in our Annual Report on Form 10-KSB for the period ended June 30, 2006.

### ITEM 6. EXHIBITS

31.1 Certificate of Chief Executive Officer under Rule 13a-14(a).

31.2 Certificate of Principal Financial and Accounting Officer under Rule 13a-14(a).

32.1 Certificate of Chief Executive Officer under Section 1350 of Title 18 of the United States Code.

32.2 Certificate of Principal Financial and Accounting Officer under Section 1350 of Title 18 of the United States Code.

## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the

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registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

ESCALON MEDICAL CORP.  
(Registrant)

Date: May 15, 2007

By: /s/ Richard J. DePiano

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Richard J. DePiano  
Chairman and Chief Executive Officer

Date: May 15, 2007

By: /s/ Robert O'Connor

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Robert O'Connor  
Chief Financial Officer