ESCALON

2007 Annual Report

Escalon Announces Initiatives to Streamline Operations, to Enhance Operational Efficiencies and to Return the Company to Profitability

Wayne, PA — September 28, 2006 — Escalon Medical Corp. (Nasdaq Small Cap: ESMC) today announced results for its fiscal fourth quarter and twelve months ended June 30, 2006. Net revenue for fiscal 2006 totaled $29,791,000, a 10.6% increase from the $26,925,000 reported in fiscal 2005. Product revenue increased approximately 15.4% during fiscal year ended June 30, 2006 as compared to the prior fiscal year. The increase is primarily related to strong sales in the Company's Drew, Sonomed, Vascular and Medical/Trek/EMI business units.

For fiscal 2006, the Company reported a net loss of $1,986,000, or $0.32 per diluted share, compared with net income of $2,448,000, or $0.39 per diluted share, in fiscal 2005. Fiscal 2006 net income was negatively impacted by a $2,500,000 loss at the Company's Drew business unit. In addition, during fiscal 2006, costs associated with legal and accounting services for litigation matters relating to IntraLase royalty dispute and other corporate matters were in excess of $500,000. Management anticipates that future costs associated with litigation matters other than IntraLase, will be substantially less than that expended in fiscal 2006.

Streamline Operations

Escalon has recently completed a detailed review of its operations as well as a re-evaluation of the Drew business model and today announced several strategic initiatives that, when fully implemented, are expected to result in an annual reduction in operating expenses of approximately $1.9 million. The Company announced that the following actions are currently underway:

- To reduce costs and expand operating margins, Drew's Connecticut manufacturing facility will be closed and its operations will be moved to Drew's Dallas manufacturing facility. The implementation of this move began in August 2006 and is expected to be completed in early November 2006. Once fully implemented, this initiative is expected to result in total annual savings of approximately $540,000.
- Concurrent with the move of Drew's Connecticut facility to Texas, the Company has implemented cost reduction actions in Dallas. These actions include the elimination of redundant positions and the renegotiation of two of Drew's leases in Dallas, allowing Drew to close one of its buildings and renew a lease on a larger facility. Once fully implemented these initiatives are expected to result in total annual savings of approximately $440,000.
- The Company has implemented rationalization actions within Drew's Barrow, UK facility. This includes the elimination of redundant positions in Barrow; the strategic decision not to renew a lease on one of the Drew Barrow properties that has expired; and the realization of other savings related to the reduction of the Company's footprint in the UK, including IT, storage facilities and vehicles. Once fully implemented, these initiatives are expected to result in total annual savings of approximately $567,000.
- The Company also announced that redundant or non-essential positions were identified at Escalon's corporate headquarters. These positions were eliminated in August and September 2006 for anticipated annual savings in salaries and benefits of approximately $372,000.

These actions are expected to bring cumulative cost reductions, when fully implemented, to approximately $1,900,000 annually. Due to severance and other costs related to the downsizing, approximately $700,000 of these cost reductions are expected to be realized in fiscal 2007.

Commenting on these initiatives, Richard J. DePiano, Chairman and Chief Executive Officer, said, "We have conducted a detailed review of our operations, which has resulted in the implementation of significant changes designed to reduce costs, improve operational efficiencies and heighten asset utilization. We believe that these initiatives will deliver considerable long-term benefits to our organization and will further advance the operational successes that we have achieved with our Drew unit since it was acquired in July 2004. Achievements at Drew have included the strengthening of its manufacturing, sales and marketing capabilities as well as the enhancement of existing products and the development of several new products for launch in 2007. We have also been successful in boosting production capacity, bringing Drew's product quality and customer satisfaction level up to Escalon's standards and improving Drew's distributor network for hematology, diabetes and veterinary applications. Reflective of these efforts we have realized a significant increase in Drew's revenue base as evidenced by a fiscal 2006 growth rate for Drew of 26.2%."

"Looking ahead, we are committed to returning our Drew business segment, and Escalon, to profitability. When combined with anticipated top-line growth throughout our product groups, increased budgeted profits within our legacy Escalon entities and the continued growth of our IntraLase royalty revenue stream, these restructuring initiatives are expected to return the Company to profitability during the second half of fiscal 2007."

Recap of Fiscal 2006

Mr. DePiano continued, "Turning to our operating performance for fiscal 2006, we achieved sales growth across all major product groups and reported 2006 product revenues of $27,544,000, representing growth of 15.4% year-over-year. These results are highlighted by 26.2% top-line growth at our Drew business unit, which realized product revenue of $14,253,000. The performance at Drew was driven by additional sales in the domestic and international markets of diabetes and hematology instruments. Sales of spare parts and reagents and controls, which are used to operate the instruments, also increased during the period to support the increase in the installed base of the related instruments.

"Our Sonomed business unit achieved product revenues of $7,737,000 during 2006, representing growth of 1% year-over-year. The increase in product revenue was primarily the result of an increase in sales of our EZ AB scan ultrasound systems and an increase in export sales, which were partially offset by a decrease in domestic sales and in demand for our pachymeter product.

"Product revenues at our Vascular unit rose 14.5%, year-over-year, to $3,640,000, driven 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 from the Company's distributor network. As part of our commitment to enhance our position in the vascular access market, we appointed Michael O'Donnell as President of Escalon Vascular Access in January 2006. With a strong operational background, an extensive knowledge of Escalon and strong knowledge of the industry, Michael is well-qualified to assume this position. We believe this is a natural transition that strengthens our Company as well as our opportunities for growth." Mr. O'Donnell has over 14 years experience in the medical field and device market and began working for Escalon in 2000 as Escalon Vascular Access' Vice President of Sales. Prior to joining Escalon, Mr. O'Donnell held various sales positions within the industry, including terms at Beckett Healthcare, Infu-Tech and EquipNet.

Mr. DePiano added, "In our Medical/Trek/EMI unit, product revenue increased 10.8% to $1,914,000, primarily attributable to an increase in the Trek business unit revenue from Bausch & Lomb. Also contributing to the increase was an increase in EMI sales of digital imaging systems from the February 2006 acquisition of MRP Group, Inc., a privately held ophthalmic technology solutions provider."

Mr. DePiano concluded, "Looking ahead, our strategic focus remains on the basics of our business and ensuring strong operating performance. We are committed to improving the performance of the Company, maximizing the long-term value of our key products and building our presence worldwide."

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

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

For the fiscal year ended June 30, 2007

Commission File Number 0-20127

ESCALON MEDICAL CORP.

(Exact name of registrant as specified in its charter)

Pennsylvania	**33-0272839**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*

565 E. Swedesford Road, Suite 200, Wayne, PA 19087
(Address of principal executive offices, including zip code)

(610) 688-6830
Registrant's telephone number, including area code:

Securities registered pursuant to section 12(b) of the act:

Common Stock, Par Value $0.001	**Nasdaq Capital Market**
(Title of Class)	*(Name of Each Exchange on which Registered)*

Securities registered pursuant to section 12(g) of the Act:
None

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

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

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

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

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

Large accelerated filer ☐ Accelerated filer ☐ Non-accelerated filer ☑

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant on September 20, 2007, was approximately $25,228,000, computed by reference to the price at which the common equity was last sold on the NASDAQ Capital Market on such date.

As of September 20, 2007, there were 6,386,857 shares of common stock outstanding.

Documents Incorporated by Reference:

Certain information required by Part III of this Annual Report on Form 10-K will be set forth in, and is incorporated by reference from the registrant's Proxy Statement for the 2007 Annual Meeting of Shareholders.

ESCALON MEDICAL CORP.

ANNUAL REPORT ON FORM 10-K
For The Fiscal Year Ended June 30, 2007

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PART I

Item 1. *Business*

Company Overview

Escalon Medical Corp. ("Escalon" or the "Company") is a Pennsylvania corporation initially incorporated in California in 1987, and reincorporated in Pennsylvania in November 2001. Within this document, the "Company" collectively shall mean Escalon and its wholly owned subsidiaries: Sonomed, Inc. ("Sonomed"), Escalon Vascular Access, Inc. ("Vascular"), Escalon Medical Europe GmbH ("EME"), Escalon Digital Vision, Inc. ("EMI"), Escalon Pharmaceutical, Inc. ("Pharmaceutical"), Escalon Holdings, Inc. ("EHI"), Escalon IP Holdings, Inc., Escalon Vascular IP Holdings, Inc., Sonomed IP Holdings, Inc., Drew Scientific Holdings, Inc., and Drew Scientific Group, Plc ("Drew") and its subsidiaries. The Company 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 other governmental authorities require extensive testing of new products prior to sale and have jurisdiction over the safety, efficacy and manufacture of products, as well as product labeling and marketing. The Company's Internet address is www.escalonmed.com.

Drew Business

Drew is a diagnostics company specializing in the design, manufacture and distribution of instruments for blood cell counting and blood analysis. Drew is focused on providing instrumentation and consumables for the physician office and veterinary office laboratories. Drew also supplies the reagent and other consumable materials needed to operate the instruments.

Diabetes Testing

Drew sells two diabetic testing products: the DS5 and the Hb-Gold. The DS5 instrument, dispenser and associated reagent kit measure long-term glucose control in diabetic patients. The system's small size and ease of use make it ideal for main laboratory, clinic or satellite laboratory settings. The Hb-Gold instrument and associated reagent kit provides for the in vitro measurement of certain genetic diseases of the blood. In the United States, this instrument is available for research only.

Hematology

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

Sonomed Business

Sonomed develops, manufactures and markets ultrasound systems for diagnostic or biometric applications in ophthalmology. The systems are of four types: A-Scans, B-Scans, High Frequency B-Scans ("UBMs") and pachymeters.

A-Scans

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

B-Scans

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

UBM

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

Pachymeters

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

Vascular Business

Vascular develops, manufactures and markets vascular access products. These products are Doppler-guided vascular access assemblies used to locate desired vessels for access. Primary specialty groups that use the device are cardiac catheterization labs and interventional radiologists. The Company's vascular products include the PD Access™ and SmartNeedle™ lines of monitors, Doppler-guided bare needles and Doppler-guided infusion needles.

PD Access™ and Smartneedle™ Monitors, Needles and Catheter Products

These devices detect blood flow using Doppler ultrasound technology and differentiate between a venous and arterial vessel. The devices utilize a miniature Doppler ultrasound probe that is positioned within the lumen of a vascular access needle. When a Doppler-guided needle pierces the skin of a patient, the probe and monitor can determine if the user is approaching an artery or vein, guiding them to a successful vascular access.

Emi Business

EMI markets a CFA (Color/Fluorescein Angiography) digital imaging system, designed specifically for ophthalmology. This diagnostic tool, ideal for use in detecting retinal problems in diabetic and elderly patients, provides a high-resolution image, far superior to conventional film in image quality, processing and capture. The instant image display provides users with the necessary clinical information that allows treatment to be performed while the patient is still in the physician's office. On January 30, 2006 EMI acquired substantially all of the assets of MRP Group, Inc. ("MRP") in exchange for 250,000 shares of the Company's common stock and approximately $47,000 in cash. The MRP business consists of ophthalmic technology solutions offering two retinal imaging systems. Approximately 200 of these systems have been installed at leading medical and retinal care centers. The operating results of MRP are included as part of the EMI business unit as of January 30, 2006.

Medical/Trek Business

Medical/Trek manufactures and distributes the following ophthalmic surgical products under the Company's and/or Trek Medical Product's names. Vitreoretinal ophthalmic surgeons primarily utilize these products.

Ispan Intraocular Gases

The Company distributes two intraocular gas products C3F8 and SF6, which are used by vitreoretinal surgeons as a temporary tamponade in detached retina surgery. Under a non-exclusive distribution agreement with Scott

Medical Products ("Scott"), the Company distributes packages of Scott gases in canisters containing up to 25 grams of gas. Along with the intraocular gases, the Company manufactures and distributes a patented disposable universal gas kit, which delivers the gas from the canister to the patient.

Viscous Fluid Transfer Systems

The Company markets viscous fluid transfer systems and related disposable syringe products, which aid surgeons in the process of injecting and extracting Silicone Oil. Adjustable pressures and vacuums provided by the equipment allow surgeons to manipulate the flow of Silicone Oil during surgery. Silicon Oil refers to Adatosil® 5000 Silicone Oil, whose license of distribution rights were sold to Bausch & Lomb Surgical, Inc. Pursuant to that agreement, the Company has not received any revenue from Silicon Oil since August 2005.

Fiber Optic Light Sources

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

Research and Development

The Company conducts development of medical devices for the diagnosis and monitoring of medical disorders in the areas of diabetes, cardiovascular diseases and hematology at the Company's Dallas, Texas, Oxford, Connecticut and Barrow-in-Furness, United Kingdom facilities. The Company conducts medical device and vascular access product development at its New Berlin, Wisconsin facility located near Milwaukee. The development of ultrasound ophthalmic equipment is performed at the Company's Lake Success, New York facility on Long Island. Company-sponsored research and development expenditures for the fiscal years ended June 30, 2007, 2006 and 2005 were approximately $3,461,000, $2,828,000 and $1,893,000, respectively.

Manufacturing and Distribution

The Company leases an aggregate of approximately 39,600 square feet of space at its facilities in Texas, Connecticut and the United Kingdom. These sites are currently used for engineering, product design and development and product assembly. All of the Company's medical devices and consumables for the diagnosis and monitoring of medical disorders in the areas of diabetes, cardiovascular diseases and hematology are distributed from the Company's Dallas, Texas, Oxford, Connecticut and Barrow-in-Furness, United Kingdom facilities. See Business Conditions in Management's Discussion and Analysis of Financial Condition of Results of Operations for additional information.

The Company leases approximately 11,200 square feet of space in New Berlin, Wisconsin, near Milwaukee, for its surgical products and vascular access operations. The facility is currently used for engineering, product design and development, manufacturing and product assembly. The Company also leases approximately 2,500 square feet in Lawrence, Massachusetts used primarily for product design and development in the EMI business unit. The Company subcontracts component manufacture, assembly and sterilization to various vendors. The New Berlin manufacturing facility includes a class 10,000 clean room. A class 10,000 clean room is a controlled environment for producing devices while avoiding any significant contaminants. The cleanliness provided by the clean room exceeds the requirements of the FDA. The Company's ophthalmic surgical products and vascular access products are distributed from the Company's Wisconsin facility.

The Company designs, develops and services its ultrasound ophthalmic products at its approximately 12,200 square foot facility in Lake Success, New York. The Company has achieved ISO9001 certification at all of its manufacturing facilities for all medical devices, ultrasound devices and consumables the Company produces. ISO9001 requires an implemented quality system that applies to product design. These certifications can be obtained only after a complete audit of a company's quality system by an independent outside auditor. These certifications require that facilities undergo periodic reexamination. The Company has obtained European Community certification ("CE") for disposable delivery systems, fiber optic light probes, medical devices and

consumables for the diagnosis and monitoring of medical disorders in the areas of diabetes, cardiovascular diseases and hematology, vascular access products and certain ultrasound models.

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

Governmental Regulations

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

The Company has received the necessary FDA clearances and approvals for all products that the Company currently markets. The FDA and comparable agencies in state and local jurisdictions and in foreign countries impose substantial requirements upon the manufacturing and marketing of pharmaceutical and medical device equipment and related disposables, including the obligation to adhere to the FDA's Good Manufacturing Practice regulations. Compliance with these regulations requires time-consuming detailed validation of manufacturing and quality control practices, FDA periodic inspections and other procedures. If the FDA finds any deficiencies in the validation processes, for example, the FDA may impose restrictions on marketing the specific products until such deficiencies are corrected.

Drew received a warning letter from the FDA in April, 2007 that certain deficiencies were noted during the FDA's audit of the Company's United Kingdom facility. Drew has addressed the deficiencies and has brought the facility into compliance with FDA regulations. As such, the FDA notified Drew in June 2007 that the warning letter was removed.

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

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

Marketing and Sales

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

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

Vascular business unit products are marketed domestically through internal sales and marketing employees located in the United States as well as through an independent sales representative in Europe and a network of domestic and foreign distributors that are managed by the Company's sales team.

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

Service and Support

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

Third Party Reimbursement

It is expected that physicians and hospitals will purchase certain of the Company's products and that they in turn will bill various third party payors for health care services provided to their patients using these products. These payors include Medicare, Medicaid and private insurers. Government agencies generally reimburse health care providers at a fixed rate based on the procedure performed. Third party payors may deny reimbursement if they determine that a procedure performed using any one of the Company's products was unnecessary, inappropriate, not cost-effective, experimental or used for a non-approved indication.

Patents, Trademarks and Licenses

The pharmaceutical and medical device communities place considerable importance on obtaining patent and trade secret protection for new technologies, products and processes for the purpose of strengthening the Company's position in the market place and protecting the Company's economic interests. The Company's policy is to protect its technology by aggressively obtaining patent protection for substantially all of its developments and products, both in the United States and in selected countries outside the United States. It is the Company's policy to file for patent protection in those foreign countries in which the Company believes such protection is necessary to protect its economic interests. The duration of the Company's patents, trademarks and licenses vary through 2020. The Company has 21 United States patents and 19 patents issued abroad that cover the Company's surgical products and pharmaceutical technology.

With respect to the Company's ultrafast laser technology, licensed to Intralase Corp. "Intralase", 16 patents have been issued in the United States and 11 overseas. In 1997, Intralase and Escalon entered into an agreement under which Intralase became the exclusive licensee of these patents, technology and intellectual property owned by the Company. 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, the Company settled all outstanding disputes and litigation with Intralase pursuant to which the Company transferred to Intralase its ownership of all patents and intellectual property formally licensed to Intralase and the license agreement was terminated. See Item 3. Legal Proceedings for additional information.

Drew has approximately 60 patents related to its technology.

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

While in the aggregate the Company's patents are of material importance to its business taken as a whole, the patents, trademarks and licenses that are the most critical to the Company's ability to generate revenues are the following:

- The Escalon trademark is due for renewal on January 19, 2013, and the Company intends to renew the trademark. The Sonomed trademark was renewed on November 25, 2006.

- In the Vascular business unit, the Company has two patents that are of material importance. The first patent is an apparatus for the cannulation of blood vessels. This patent will expire on February 23, 2011. The second patent is also an apparatus for the cannulation of blood vessels. This patent will expire on January 11, 2009. The Vascular unit has also one patent application pending for the cannulation of blood vessels with a hypodermic needle.

Competition

There are numerous direct and indirect competitors of the Company in the United States and abroad. These competitors include ophthalmic-oriented companies that market a broad portfolio of products including prescription ophthalmic pharmaceuticals, ophthalmic devices, consumer products (such as contact lens cleaning solution) and other eye care products; large integrated pharmaceutical companies that market a limited number of ophthalmic pharmaceuticals in addition to many other pharmaceuticals; and smaller specialty pharmaceutical and biotechnology companies that are engaged in the development and commercialization of prescription ophthalmic pharmaceuticals and products and, to some extent, drug delivery systems. The Company's competitors for medical devices and ophthalmic pharmaceuticals include, but are not limited to, Bausch & Lomb, Inc., Alcon Laboratories, Inc., Paradigm Medical, Inc., Quantel, Inc. and Accutome, Inc.

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

Sonomed's principal competitors are Alcon Laboratories, Inc, Quantel, Inc. and Accutome, Inc. Management believes that Sonomed is in a market leadership position. Sonomed has had a leading presence in the ophthalmic ultrasound industry for over 30 years. Management believes that this has helped Sonomed build a reputation as a long-standing operation that provides a quality product, which has enabled the Company to establish effective distribution coverage within the United States market. Sonomed seeks to preserve its position in the market through continued product enhancement. Various competitors offering similar products at a lower price could threaten Sonomed's market position. The development of laser technologies for ophthalmic biometrics and imaging may also diminish the Company's market position. This equipment can be used instead of ultrasound equipment in most, but not all, patients. Such equipment, however, is more expensive.

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

The Vascular access product line is comprised of disposable devices, and currently Vascular has no direct competition. However, a significantly higher priced non-disposable device that facilitates vascular access is currently being marketed. Vascular produces the only device that can be accommodated within a standard needle for assisting medical practitioners in gaining access to a vessel in the human vascular system. There are no similar devices on the market that enable medical practitioners to gain access using their normal procedures. The only similar product utilizes a separate ultrasound monitor, but no disposables are utilized. When using the competing device, medical practitioners need to look at the monitor while advancing the needle into the patient. The perceived disadvantage of the Company's vascular product is that the retail price is substantially greater than the cost of a traditional needle.

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

Human Resources

As of June 30, 2007, the Company employed 167 full-time employees and 12 part-time employees. 80 of the Company's employees are employed in manufacturing, 37 are employed in general and administrative positions, 40 are employed in sales and marketing and 22 are employed in research and development. Escalon's employees are not covered by a collective bargaining agreement, and the Company considers its relationship with its employees to be good.

Item 1A. *Risk Factors*

Cautionary Factors That May Affect Future Results

Certain statements contained in, or incorporated by reference in, this report are forward-looking statements made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995, which provide current expectations or forecasts of future events. Such statements can be identified by the use of terminology such as "anticipate," "believe," "could," "estimate," "expect," "forecast," "intend," "may," "plan," "possible," "project," "should," "will," "would," 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 property and patent protection and infringement, the loss of revenue due to the expiration on termination of certain agreements, the effect of competition on the structure of the markets in which the Company competes, increased legal, accounting and Sarbanes-Oxley compliance costs, defending the Company in litigation matters and the Company's cost-saving initiatives. The reader must carefully consider forward-looking statements and understand that such statements involve a variety of risks and uncertainties, known and unknown, and may be affected by assumptions that fail to materialize as anticipated. Consequently, no forward-looking statement can be guaranteed, and actual results may vary materially. It is not possible to foresee or identify all factors affecting the Company's forward-looking statements, and the reader therefore should not consider the following list of such factors to be an exhaustive statement of all risks, uncertainties or potentially inaccurate assumptions.

Form 10-K

The Company cautions the reader to consider carefully these factors as well as the specific factors discussed with each specific forward-looking statement in this annual report and in the Company's other filings with the Securities and Exchange Commission (the "SEC"). In some cases, these factors have impacted, and in the future (together with other unknown factors) could impact, the Company's ability to implement the Company's business strategy and may cause actual results to differ materially from those contemplated by such forward-looking statements. Any expectation, estimate or projection contained in a forward-looking statement may not be achieved.

The Company also cautions the reader that forward-looking statements speak only as of the date made. The Company undertakes no obligation to update any forward-looking statement, but investors are advised to consult any further disclosures by the Company on this subject in the Company's filings with the SEC, in which the Company discusses in more detail various important factors that could cause actual results to differ from expected or historical results. Although it is not possible to create a comprehensive list of all factors that may cause actual results to differ from the Company's forward-looking statements, the material factors include, without limitation, the following:

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

In the normal course of business, the Company engages in discussions with third parties regarding possible acquisitions, strategic alliances, joint ventures and divestitures. As a result of any such transactions, the Company's financial results may differ from the investment community's expectations in a given quarter. In addition, acquisitions and alliances may require the Company to integrate a different company culture, management team, business infrastructure, accounting systems and financial reporting systems. The Company may not be able to effect any such acquisitions or alliances. The Company may have difficulty developing, manufacturing and marketing the

products of a newly acquired company in a way that enhances the performance of the Company's combined businesses or product lines to realize the value from expected synergies. Depending on the size and complexity of an acquisition, the Company's successful integration of the entity depends on a variety of factors, including the retention of key employees and the management of facilities and employees in separate geographical areas. These efforts require varying levels of management resources, which may divert the Company's attention from other business operations. The Company acquired Drew during the first quarter of fiscal 2005. Drew does not have a history of producing positive operating cash flows and, as a result, at the time of acquisition, was operating under financial constraints and was under-capitalized and has continued to negatively impact the Company's financial results. As Drew is integrated into the Company, management continues to work to reverse the situation, while at the same time seeking to strengthen Drew's market position. The Company loaned approximately $16 million 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, and to expand the sales and marketing and research and development efforts, to fund new product development and underwrite operating losses since its acquisition. The Company cannot rule out that further working capital will be required by Drew. If the Company does not realize the expected benefits or synergies of such transactions, the Company's consolidated financial position, results of operations and stock price could be negatively impacted. Also, the Company's results may be adversely impacted because of acquisition-related costs, amortization costs for certain intangible assets and impairment losses related to goodwill in connection with such transactions. Finally, acquisitions or alliances by the Company may not occur, which could impair the Company's growth.

The Company's results fluctuate from quarter to quarter.

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

- Acquisitions, such as Drew, and subsequent integration of the acquired company, although such acquisitions may not occur;
- The timing and expense of new product introductions by the Company or its competitors, although the Company might not successfully develop new products and any such new products may not gain market acceptance;
- The cancellation or delays in the purchase of the Company's products;
- Fluctuations in customer demand for the Company's products;
- Fluctuations in royalty income;
- The gain or loss of significant customers;
- Changes in the mix of products sold by the Company;
- Competitive pressures on prices at which the Company can sell its products; and
- Announcements of new strategic relationships by the Company or its competitors.
- General economic conditions and other external factors such as energy costs.

The Company sets its spending levels in advance of each quarter based, in part, on the Company's expectations of product orders and shipments during that quarter. A shortfall in revenue, therefore, in any particular quarter as compared to the Company's plan could have a material adverse impact on the Company's results of operations and cash flows. Also, the Company's quarterly results could fluctuate due to general market conditions in the healthcare industry or global economy generally, or market volatility unrelated to the Company's business and operating results.

The company's cost saving initiatives may not be effective.

The Company has implemented cost-saving initiatives that may not be effective in returning the Company to profitability. If these initiatives are insufficient, additional measures may be necessary.

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

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

- The price of the products;
- The continued receipt of regulatory approvals for multiple indications;
- The establishment and demonstration of the clinical safety and efficacy of the Company's products; and
- The advantages of the Company's products over those marketed by the Company's competitors.

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

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

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

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

The FDA and comparable agencies in state and local jurisdictions and in foreign countries impose substantial requirements upon the manufacturing and marketing of pharmaceutical and medical device equipment and related disposables, including the obligation to adhere to the FDA's Good Manufacturing Practice regulations. Compliance with these regulations requires time-consuming detailed validation of manufacturing and quality control processes, FDA periodic inspections and other procedures. If the FDA finds any deficiencies in the validation processes, for example, the FDA may impose restrictions on marketing the specific products until such deficiencies are corrected.

The Company has received CE approval on several of the Company's products that allows the Company to sell the products in the countries comprising the European Community. In addition to the CE mark, however, some foreign countries may require separate individual foreign regulatory clearances. The Company may not be able to obtain regulatory clearances for other products in the United States or foreign markets.

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

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

The success of competitive products could have an adverse impact on the company's business.

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

- Properly identify customer needs;
- Innovate and develop new technologies, services and applications;
- Establish adequate product distribution coverage;
- Obtain and maintain required regulatory approvals from the FDA and other regulatory agencies;
- Protect the Company's intellectual property;
- Successfully commercialize new technologies in a timely manner;
- Manufacture and deliver the Company's products in sufficient volumes on time;
- Differentiate the Company's offerings from the offerings of the Company's competitors;
- Price the Company's products competitively;
- Anticipate competitors' announcements of new products, services or technological innovations; and
- Anticipate general market and economic conditions.

The Company cannot ensure that the Company will be able to compete effectively in the competitive environments in which the Company operates.

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

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

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

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

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

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

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

Future legislation or changes in government programs may adversely impact the market for the company's products.

In the past several years, the federal government and Congress have made proposals to change aspects of the delivery and financing of health care services. The Company cannot predict what form any future legislation may take or its impact on the Company's business. Legislation that sets price limits and utilization controls adversely impact the rate of growth of the markets in which the Company participates. If any future health care legislation were to adversely impact those markets, the Company's product marketing could also suffer, which would adversely impact the Company's business.

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

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

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

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

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

The Company's principal executive officers and technical personnel have extensive experience with the Company's products, the Company's research and development efforts, the development of marketing and sales programs and the necessary support services to be provided to the Company's customers. Also, the Company competes with other companies, universities, research entities and other organizations to attract and retain qualified

personnel. The loss of the services of any of the Company's executive officers or other technical personnel, or the Company's failure to attract and retain other skilled and experienced personnel, could have a material adverse impact on the Company's ability to maintain or expand businesses.

The market price of the company's stock has historically been volatile, and the company has not paid cash dividends.

The volatility of the Company's common stock imposes a greater risk of capital losses on shareholders as compared to less volatile stocks. In addition, such volatility makes it difficult to ascribe a stable valuation to a shareholder's holdings of the Company's common stock. The following factors have and may continue to have a significant impact on the market price of the Company's common stock:

- Any acquisitions, strategic alliances, joint ventures and divestitures that the Company effects, if any;
- Announcements of technological innovations;
- Changes in marketing, product pricing and sales strategies or new products by the Company's competitors;
- Changes in domestic or foreign governmental regulations or regulatory requirements; and
- Developments or disputes relating to patent or proprietary rights and public concern as to the safety and efficacy of the procedures for which the Company's products are used.

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

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

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

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

The company's charter documents and pennsylvania law may inhibit a takeover.

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

There are inherent uncertainties involved in estimates, judgments and assumptions used in the preparation of financial statements in accordance with united states gaap. any changes in estimates, judgments and assumptions used could have a material adverse effect on the company's business, financial position and operating results.

The consolidated financial statements included in the periodic reports the Company files with the SEC are prepared in accordance with accounting principles generally accepted in the United States of America, or GAAP. The preparation of financial statements in accordance with GAAP involves making estimates, judgments and assumptions that affect reported amounts of assets (including intangible assets), liabilities and related reserves, revenues, expenses and income. This includes estimates, judgments and assumptions for assessing the

recoverability of the Company's goodwill and other intangible assets, pursuant to Statement of Financial Accounting Standards, or SFAS, No. 142, Goodwill and Other Intangible Assets, and SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. If any estimates, judgments or assumptions change in the future, the Company may be required to record additional expenses or impairment charges. Any resulting expense or impairment loss would be recorded as a charge against our earnings and could have a material adverse impact on our financial condition and operating results. Estimates, judgments and assumptions are inherently subject to change in the future, and any such changes could result in corresponding changes to the amounts of assets (including goodwill and other intangible assets), liabilities, revenues, expenses and income. Any such changes could have a material adverse effect on the Company's financial position and operating results.

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

- product returns,
- allowances for doubtful accounts,
- inventories and related reserves,
- intangible assets and Goodwill,
- income and other tax accruals,
- deferred tax asset valuation allowances,
- discounts and allowances,
- warranty obligations, and
- contingencies and litigation.

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

The company will be exposed to risks relating to evaluations of internal control over financial reporting required by section 404 of the sarbanes-oxley act of 2002.

The Company anticipates spending a substantial amount of management time and resources to comply with changing laws, rules, regulations and standards relating to corporate governance and public disclosure, including the Sarbanes-Oxley Act of 2002 and regulations promulgated by the SEC.

Under the current and proposed rules and regulations of the SEC, the Company is currently not required to comply with the requirements of Section 404 of the Sarbanes-Oxley Act of 2002 until the Company files our Annual Report on Form 10-K for the Company's fiscal year ending June 30, 2008, as long as the Company continues to meet the definition of a non-accelerated filer. In the Company's Annual Report on Form 10-K for the year ending June 30, 2008, the Company's management will be required to provide an assessment as to the effectiveness of the Company's internal control over financial reporting, which assessment will be deemed furnished to rather than filed with the SEC. In the Company's Annual Report on Form 10-K for the year ending June 30, 2008 and for each fiscal year thereafter, the Company's management will be required to provide an assessment as to the effectiveness of the Company's internal control over financial reporting and the Company's independent registered public accounting firm will be required to provide an attestation as to the Company's management's assessment, which assessment and attestation will be filed with the SEC. The assessment and attestation processes required by Section 404 are relatively new to the Company. Accordingly, the Company may encounter problems or delays in completing our

obligations and receiving an unqualified report on the Company's internal control over financial reporting by our independent registered public accounting firm.

While the Company believes that it will be able to timely meet the Company's obligations under Section 404 and that the Company's management will be able to certify as to the effectiveness of the Company's internal control over financial reporting, there is no assurance that the Company will do so. If the Company is unable to timely comply with Section 404, the Company's management is unable to certify as to the effectiveness of the Company's internal control over financial reporting or the Company's independent registered public accounting firm is unable to attest to that certification, the price of the Company's common stock may be adversely affected. Even if the Company timely meets the certification and attestation requirements of Section 404, it is possible that the Company's independent registered public accounting firm will advise the Company that they have identified significant deficiencies and/or material weaknesses, which may also adversely affect the price of our common stock.

Substantially All of Our Cash and Cash Equivalents and Marketable Securities are Held at a Single Financial Institution.

Substantially all of the Company's cash and cash equivalents and short-term marketable securities are presently held at one national financial institution. Accordingly, the Company is subject to credit risk if this financial institution is unable to repay the balance in the account or deliver the Company's securities or if the financial institution should become bankrupt or otherwise insolvent. Any of the above events could have a material and adverse effect on the Company's business and financial condition.

Item 1B. *Unresolved Staff Comments:*

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

Item 2. *Properties*

The Company currently leases an aggregate of approximately 61,800 square feet of space for its (i) corporate offices in Wayne, Pennsylvania, (ii) Drew has an administrative office and manufacturing facility in Barrow-in-Furness, United Kingdom, an administrative office and manufacturing facility in Dallas, Texas, and a manufacturing facility in Oxford, Connecticut. (iii) Sonomed has a manufacturing facility in Lake Success, New York, and (iv) Vascular has a manufacturing facility in New Berlin, Wisconsin. The corporate offices in Pennsylvania cover approximately 7,100 square feet and expire in April 2008. The facility in the United Kingdom covers approximately 8,000 square feet whose lease expires in September 2009. The facility in Texas covers approximately 20,000 whose lease expires in March 2014. The Connecticut facility lease covers approximately 3,300 square feet and expires in January 2008. The New York facility leases covering approximately 12,200 square feet, expires in October 2011. The Wisconsin lease, covering approximately 11,200 square feet of space expires in July 2015. Annual rent under all of the Company's lease arrangements was approximately $866,000.

Item 3. *Legal Proceedings*

Intralase Corp.

In 1997, Intralase and the Company entered into an agreement under which Intralase became the exclusive licensee of certain patents, technology and intellectual property owned by the Company. 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, the Company 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 the Company of $9,600,000 in exchange for which all pending litigation between the parties was dismissed, the parties exchanged general releases, the Company transferred to Intralase its ownership of all patents and intellectual property formerly licensed to Intralase by the Company, and the license agreement was terminated. In addition, the settlement payment from Intralase is deemed satisfaction for all outstanding past, current and future royalties owed or alleged to be owed by Intralase to the Company.

Institute of Child Health

Drew entered into a license agreement with the Institute of Child Health ("ICH") on May 10, 1993 to use ICH's intellectual property to manufacture, lease, sell, use and sublicense certain products and all related consumables used therein in the testing of blood and fluids. Under the license agreement Drew was obligated to pay royalties to ICH on the products and consumables. On January 23, 2006, the Company received a letter from ICH alleging that Drew had failed to remit certain moneys due under the license agreement and has sought an accounting to determine such amount due.

Both parties continue to amicably negotiate a mutually agreeable solution to this matter. Drew does not believe that the ultimate disposition of this issue will have a material effect on the Company's financial statements.

Other Legal Proceedings

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

Item 4. ***Submission of Matters to a Vote of Security Holders***

No matters were submitted to a vote of security holders during the quarter ended June 30, 2007.

PART II.

Item 5. ***Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities***

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

	High	Low
Fiscal year ended June 30, 2007		
Quarter ended September 30, 2006	$5.19	$4.06
Quarter ended December 31, 2006	$4.19	$2.35
Quarter ended March 31, 2007	$4.38	$2.55
Quarter ended June 30, 2007	$4.53	$3.75
Fiscal year ended June 30, 2006		
Quarter ended September 30, 2005	$9.08	$5.71
Quarter ended December 31, 2005	$5.85	$4.54
Quarter ended March 31, 2006	$5.99	$4.59
Quarter ended June 30, 2006	$5.34	$4.40

As of September 20, 2007, there were 4,333 holders of record of the Company's common stock. On September 20, 2007 the closing price of the Company's Common Stock as reported by the NASDAQ Capital Market was $6.40 per share.

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

Item 6. *Selected Financial Data*

The following selected financial data are derived from the consolidated financial statements of the Company. The data should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" included herein in Item 7 and the financial statements and related notes to consolidated financial statements thereto included herein in Item 8.

Escalon Medical Corp. and Subsidiaries
Selected Financial Data-Statement of Operation

	For the Years Ended June 30,				
	2007	**2006**	**2005**	**2004**	**2003**
	(Amounts in thousands, except per share amounts)				
Statement of Operations Data:					
Net Revenues:					
Product revenue	$27,893	$27,544	$23,864	$12,348	$11,191
Other revenue	10,945	2,247	3,060	2,373	2,175
Revenues, net	38,838	29,791	26,924	14,721	13,366
Costs and expenses:					
Cost of goods sold	15,771	16,004	13,158	5,476	4,896
Marketing, general and administrative	13,806	13,995	12,556	5,206	780
Research and development	3,461	2,828	1,893	776	5,034
Write-down of license and distribution rights	0	0	0	0	196
Total costs and expenses	33,039	32,827	27,607	11,458	10,906
(Loss) income from operations	5,799	(3,036)	(683)	3,263	2,460
Other (Expense) and Income:					
Gain on sale of available for sale securities	75	1,157	3,412	0	0
Equity in Ocular Telehealth Management, LLC	(88)	(174)	(64)	0	0
Interest income	208	162	69	59	3
Interest expense	(29)	(64)	(55)	(407)	(638)
Total Other (Expense) and Income	166	1,082	3,362	(348)	(635)
Net (loss) income before taxes	5,965	(1,955)	2,679	2,915	1,825
Provision for income taxes	51	31	232	173	112
Net (Loss) Income	$ 5,914	$(1,986)	$ 2,447	$ 2,742	$ 1,713
Basic net (loss) income per share	$ 0.96	$ (0.32)	$ 0.42	$ 0.70	$ 0.51
Diluted net (loss) income per share	$ 0.93	$ (0.32)	$ 0.39	$ 0.64	$ 0.48
Weighted Average Shares — Basic Used In Per Share Calculation	6,152	6,152	5,832	3,897	3,365
Weighted Average Shares — Diluted Used In Per Share Calculation	6,361	6,152	6,231	4,304	3,573

Escalon Medical Corp. and Subidiaries
Selected Financial Data-Balance Sheet

	At June 30,				
	2007	2006	2004	2003	2005
	(Amounts in thousands)				
Balance Sheet Data:					
Cash and cash equivalents	$ 8,879	$ 3,380	$ 5,116	$ 12,602	$ 298
Working capital	17,238	10,616	13,613	13,966	889
Total assets	45,017	38,645	40,049	29,457	16,890
Long-term debt, net of current portion	0	163	392	2,396	4,080
Total liabilities	5,612	5,545	5,530	5,996	7,951
Accumulated deficit	(28,208)	(34,122)	(32,136)	(34,585)	(37,326)
Total shareholders' equity	39,406	33,100	34,519	23,461	8,939

No cash dividends were paid in any of the periods presented.

Item 7. ***Management's Discussion and Analysis of Financial Condition and Results of Operations***

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

The Company operates primarily in five reportable business segments: Drew, Sonomed, Vascular, Medical/Trek and EMI.

Drew is a diagnostics company specializing in the design, manufacture and distribution of instruments for blood cell counting and blood analysis. Drew is focused on providing instrumentation and consumables for the physician office and veterinary office laboratories. Drew also supplies the reagent and other consumable materials needed to operate the instruments.

Sonomed develops, manufactures and markets ultrasound systems used for diagnosis or biometric applications in ophthalmology.

Vascular develops, manufactures and markets vascular access products.

Medical/Trek develops, manufactures and distributes ophthalmic surgical products under the Escalon Medical Corp. and/or Trek Medical Products names.

EMI manufactures and markets digital camera systems for ophthalmic fundus photography. For a more complete description of these businesses and their products, see Item 1 — Description of Business.

Executive Overview — Fiscal Years Ended June 30, 2007 and 2006

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

- Product revenue increased approximately 0.6% during fiscal year ended June 30, 2007 as compared to the prior fiscal year. The increase is primarily related to strong sales in the Company's Sonomed and EMI business units which increased approximately 27.0% and 241.9%, respectively, offset by sales decreases in the Drew and Vascular business units of 18.4% and 4.8%, respectively. Sales in the Medical/Trek business units increased approximately 0.8% when compared to the prior 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 shares were sold at $19.8226 per share and yielded net proceeds of $1,157,336 after the payment of brokers' commissions and other fees. During 2007, Intralase accepted a $25 per share tender offer for all its outstanding shares. The Company received $75,000 for its remaining holdings in Intralase of 3,000 shares. The net proceeds for each of the transactions were recorded as other income.
- Other revenue increased approximately $8,698,000 or 387.1% during the fiscal year ended June 30, 2007 as compared to the prior fiscal year. The increase is due primarily to the $9,600,000 settlement reached with Intralase on February 27, 2007 as described in Item 3 above.
- Cost of goods sold as a percentage of product revenue decreased to approximately 56.5% of revenues during the fiscal year ended June 30, 2007, as compared to approximately 58.1% of product revenue for the prior fiscal year. Gross margins in the Drew business unit have historically been lower than those in the Company's other business units. Cost of goods sold in the Drew business unit was approximately 66.1% of product revenue during the fiscal year ended June 30, 2007 as compared to approximately 64.7% in the prior fiscal year. The aggregate cost of goods sold as a percentage of product revenue of the Sonomed, Vascular, EMI and Medical/Trek business units during fiscal year ended June 30, 2007 decreased to approximately 49.7% of product revenue from approximately 51.0% in the prior fiscal year.
- Operating expenses increased approximately 0.8% during the fiscal year ended June 30, 2007 as compared to the prior fiscal year. The modest increase was due to increased research and development costs of

$606,000, primarily at Drew, offset by a decrease in selling, general and administrative costs of $467,000 primarily due to the realization of savings related to the cost reduction plan implemented in the first quarter of fiscal year 2007.

Results of Operations

Fiscal Years Ended June 30, 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 fiscal years ended June 30, 2007 and 2006. Table amounts are in thousands:

	Fiscal Years Ended June 30,		
	2007	2006	% Change
Product revenue:			
Drew	$11,627	$14,253	(18.4)%
Sonomed	9,823	7,737	27.0%
Vascular	3,467	3,640	(4.8)%
EMI	1,484	434	241.9%
Medical/Trek	1,492	1,480	0.8%
Total	$27,893	$27,544	1.3%

Consolidated product revenue increased approximately $349,000, or 1.3%, to $27,893,000 during the year ended June 30, 2007 as compared to the last fiscal year.

In the Drew business unit, product revenue decreased $2,626,000, or 18.4% as compared to last fiscal year. The decrease is primarily due to the non-renewal of two OEM agreements and the continued delay in the introduction of Drew's new line of products in fiscal 2007. In July 2007, Drew received 510(k) clearance from the FDA to market the new TRILOGY Analyzer. TRILOGY, a multifunction analyzer used in determination of analytes in body fluids, is an open system intended for clinical use in a professional setting for use with various chemistry assays. Drew anticipates receiving approval on its new D3 Analyzer in the second quarter of fiscal 2008 which will provide two upgraded instruments for sale in fiscal 2008. Additionally, Drew anticipates submitting its new DS-360 Analyzer for FDA approval in the second half of fiscal 2008.

Product revenue increased $2,086,000, or 27.0%, to $9,823,000 in the Sonomed business unit as compared to the 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 as well as increased sales of the new VuMax high frequency systems and an overall increase in export sales.

Product revenue decreased $173,000, or 4.8%, to $3,467,000, at the Vascular business unit during the year ended June 30, 2007 as compared to last fiscal year. The decrease was primarily caused by a decrease in revenues from Company's distributor network due to the termination of its relationship with several distributors during 2006 and 2005. This decrease was partially offset by an increase in direct sales to end users by the Company's domestic sales team. The Company continues to replace the territories of the terminated distributors with direct sales efforts.

Product revenue increased $1,050,000 or 241.9% in the EMI business unit when compared to the last fiscal year. This increase is attributable to the increase in sales of the digital imaging systems from the January 2006 MRP acquisition. The EMI product offering continues to expand and has seen significant market acceptance during the year ended June 30, 2007.

In the Medical/Trek business unit, product revenue increased $12,000 or 0.8% to $1,492,000 during the year ended June 30, 2007 as compared to the last fiscal year.

The following table presents consolidated other revenue by reportable business unit for the fiscal years ended June 30, 2007 and 2006. Table amounts are in thousands:

	Fiscal Years Ended June 30,		
	2007	2006	% Change
Other Revenue:			
Drew	$ 243	$ 283	(14.1)%
Sonomed	0	0	0.0%
Vascular	0	0	0.0%
EMI	0	0	0.0%
Medical/Trek	10,702	1,964	444.9%
Total	$10,945	$2,247	387.1%

Consolidated other revenue increased by approximately $8,698,000, or 387.1%, to $10,945,000 during the fiscal year ended June 30, 2007 as compared to the prior fiscal year. The increase is primarily due to the $9,600,000 settlement reached with Intralase on February 27, 2007. 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, the Company transferred to Intralase its ownership of patents and intellectual property formerly licensed to Intralase by the Company, and the License Agreement was terminated. In addition, the payment from Intralase satisfied all outstanding past, current and future royalties owed or alleged to be owed by Intralase to the Company.

Other revenue from the prior year of $1,964,000 and the amount in the current year in excess of the $9,600,000 Intralase settlement of $1,102,000 are related to royalties received from Intralase license agreement received prior to the settlement and royalties received by Drew related to the Bio-Rad license agreement.

The following table presents consolidated cost of goods sold by reportable business unit and as a percentage of related unit product revenues for the fiscal years ended June 30, 2007 and 2006. Table amounts are in thousands:

	Fiscal Years Ended June 30,			
	2007	%	2006	%
Cost of Goods Sold:				
Drew	$ 7,681	66.1%	$ 9,225	64.7%
Sonomed	4,976	50.7%	3,962	51.2%
Vascular	1,393	40.2%	1,535	42.2%
EMI	711	47.9%	290	66.8%
Medical/Trek	1,011	67.8%	992	67.0%
Total	$15,772	56.5%	$16,004	58.1%

Consolidated cost of goods sold totaled approximately $15,772,000, or 56.5% of product revenue, for the fiscal year ended June 30, 2007 as compared to $16,004,000 or 58.1 of product revenue, for the prior fiscal year.

Cost of goods sold in the Drew business unit totaled $7,681,000, or 66.1% of product revenue, for the fiscal year ended June 30, 2007 as compared to $9,225,000, or 64.7% of product revenue, for the prior fiscal year. The increase in the cost of goods sold as a percentage of revenue is due to the margin compression related to the continued aging of Drew's existing product offering. The decrease in instrument gross margins was partially offset by an increase in the sale of higher volume spare parts and continued sales of higher gross margin reagents. This margin compression is expected to continue until Drew's updated product offering comes on line for sale during fiscal 2008.

Cost of goods sold in the Sonomed business unit totaled $4,976,000, or 50.7% of product revenue, for the fiscal year ended June 30, 2007 as compared to $3,962,000, or 51.2% of product revenue, for prior fiscal year. The primary reason for the decrease as a percentage of product revenue was an increase in the percentage of domestic

sales during the period. The Company historically experiences a higher selling price per unit on its domestic product sales.

Cost of goods sold in the Vascular business unit totaled $1,393,000, or 40.2% of product revenue, for fiscal year ended June 30, 2007 as compared to $1,535,000, or 42.2% of product revenue, for the last fiscal year. The decrease as a percentage of product revenue was due to lower overtime and higher production efficiencies in the current period as compared to the prior year.

Cost of goods sold in the EMI business unit totaled $711,000, or 47.9% of product revenue, for fiscal year ended June 30, 2007 as compared to $290,000, or 66.8% of product revenue, for the last fiscal year. The significant improvement in gross margins is related to improved production techniques implemented during the year and EMI's ability to drive down the cost of components due to increased purchases made during the year to keep pace with its significant sales growth.

Cost of goods sold in the Medical/Trek business unit totaled $1,011,000, or 67.8% of product revenue, for the fiscal year ended June 30, 2007 as compared to $992,000, or 67.0% of product revenue, for the last 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 fiscal years ended June 30, 2007 and 2006. Table amounts are in thousands:

	Fiscal Years Ended June 30,		
	2007	2006	% Change
Marketing, General and Administrative:			
Drew	$ 5,475	$ 6,006	(8.9)%
Sonomed	1,931	2,098	(8.0)%
Vascular	1,598	1,682	(5.0)%
EMI	480	550	(12.7)%
Medical/Trek	4,323	3,659	18.2%
Total	$13,807	$13,995	(1.4)%

Consolidated marketing, general and administrative expenses decreased $188,000, or 1.4%, to $13,807,000 during the fiscal year ended June 30, 2007 as compared to the prior fiscal year.

Marketing, general and administrative expenses in the Drew business unit decreased $531,000, or 8.9%, to $5,475,000 as compared to the same period last fiscal year. The decrease is primarily due to the realization of previously announced cost reductions initiated during the first quarter of the 2007 fiscal year, offset by related charges incurred in consolidating our foot print in the United Kingdom down to one site from three in the previous year, and from increased legal and severance costs. The full effect of our previously announced cost reduction plan is expected to be realized during fiscal 2008.

Marketing, general and administrative expenses in the Sonomed business unit decreased by $167,000, or 8.0%, to $1,931,000 as compared to the prior fiscal year. The decrease is due primarily to the decreased need, as compared to the prior fiscal year, for travel and advertising expenses related to the introduction and expansion into international markets related to the roll out of Sonomed's new UBM Instrument.

Marketing, general and administrative expenses in the Vascular business unit decreased $84,000, or 5.0%, to $1,598,000 as compared to the same period last fiscal year. The decrease was due mainly to the discontinuance of the relationship with an under performing European sales consultant and a more efficient approach to domestic sales travel and other marketing related expenses, including printed material and attendance at trade shows.

Marketing, general and administrative expenses in the EMI business unit decreased $70,000 or 12.7% to $480,000 as compared to last fiscal year. The decrease is primarily related to additional costs incurred in the prior year on printed and other advertising materials.

The Medical/Trek business unit's marketing, general and administrative expenses increased $664,000 or 18.2% to $4,323,000 as compared to the last fiscal year. The increase was due primarily to $163,000 incurred during

this fiscal year under the new SFAS No. 123(R) rules, increased discretionary bonuses of $175,000, increased corporate salaries of approximately $194,000 and increased third party consultants in accounting, valuation services, and information technology of $68,000 and increased insurance costs of $64,000.

The following table presents consolidated research and development expenses by reportable business unit and as a percentage of related unit product revenues for the fiscal years ended June 30, 2007 and 2006. Table amounts are in thousands:

	Fiscal Years Ended June 30,		
	2007	2006	% Change
Research and Development:			
Drew	$2,355	$1,734	35.8%
Sonomed	495	511	(3.1)%
Vascular	172	164	4.9%
EMI	350	85	311.8%
Medical/Trek	89	334	(73.4)%
Total	$3,461	$2,828	22.4%

Consolidated research and development expenses increased $633,000, or 22.4%, to $3,461,000 during the fiscal year ended June 30, 2007 as compared to the prior fiscal year. Research and development expenses were primarily expenses associated with the planned introduction of new or enhanced products in the Drew and EMI business units.

Research and development expenses in the Drew business unit increased $621,000, or 35.8%, to $2,355,000. The increase is primarily due to increased employee headcount, consulting and other related product development expenses for Drew's continued research on two new instruments, the Drew DS-360 and the XL2280.

Research and development expenses in the Sonomed business unit decreased $16,000 to $495,000 as compared to the last fiscal year. The decrease is primarily due to a completion of Sonomed's new UBM instrument in the prior year offset by continued enhancements to Sonomed's existing products.

Research and development in the EMI business unit increased $265,000 to $350,000 as compared to the last fiscal year. The increase is due to additional employees related to continued development and enhancement of the Company's digital ophthalmic product offerings.

Research and development in the Medical/Trek business unit decreased $245,000 to $89,000 as compared to the last fiscal year. This decrease is due primarily to the elimination of the corporate research and development department in the first quarter of fiscal 2007 related to the Company's previously announced cost reduction plan.

Gain on sale of available for sale securities was approximately $75,000 and $1,157,000 during the fiscal years ended June 30, 2007 and 2006, respectively due to the sale of 3,000 shares and 58,585 shares of Intralase common stock during fiscal 2007 and 2006, respectively. The Company has no remaining available for sale securities.

The Company recognized a loss of approximately $88,000 and $174,000 related to its investment in Ocular Telehealth Management ("OTM") during the fiscal years ended June 30, 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. (See note 14 of the notes to consolidated financial statements.)

Interest income was $208,000 and $162,000 for the fiscal years ended June 30, 2007 and 2006, respectively. The increase was due to higher cash balances and effective yields on investments.

Interest expense was $29,000 and $64,000 for the fiscal years ended June 30, 2007 and 2006, respectively.

Results of Operations

Fiscal Years Ended June 30, 2006 and 2005

The following table shows consolidated product revenue by business unit as well as identifying trends in business unit product revenues for the fiscal years ended June 30, 2006 and 2005. Table amounts are in thousands:

	Fiscal Years Ended June 30,		
	2006	2005	% Change
Product Revenue:			
Drew	$14,253	$11,294	26.2%
Sonomed	7,737	7,663	1.0%
Vascular	3,640	3,180	14.5%
Medical/Trek/EMI	1,914	1,727	10.8%
Total	$27,544	$23,864	15.4%

Consolidated product revenue increased approximately $3,680,000, or 15.4%, to $27,544,000 during the year ended June 30, 2006 as compared to fiscal year 2005.

In the Drew business unit, product revenue increased $2,959,000, or 26.2% as compared to fiscal year 2005. The increase is primarily due to additional sales in the domestic and international markets of diabetics and hematology instruments. Sales of spare parts and reagents and controls, which are used to operate the instruments, also increased during the period to support the increase in the installed base of the related instruments.

Product revenue increased $74,000, or 1%, to $7,737,000 in the Sonomed business unit as compared to fiscal year 2005. The increase in product revenue was primarily caused by an increase in sales of the Company's EZ AB scan ultrasound systems and an increase in export sales, which were partially offset by a decrease in domestic sales and in demand for the Company's pachymeter product. The domestic market for pachymeters had previously expanded due to enhanced techniques in glaucoma screening performed by optometrists, who had historically not been users of the pachymeter. Domestic demand for the pachymeter returned to historic levels during the fourth quarter of fiscal 2004 due to market saturation and increased price competition within the marketplace.

Product revenue increased $460,000, or 14.5%, to $3,640,000, at the Vascular business unit during the year ended June 30, 2006 as compared to fiscal year 2005. 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 from the Company's distributor network. The Company terminated its relationship with several of its distributors during fiscal year 2005.

In the Medical/Trek/EMI business unit, product revenue increased $187,000 or 10.8% to $1,914,000 during the year ended June 30, 2006 as compared to the fiscal year 2005. The increase in Medical/Trek/EMI product revenue is primarily attributed to an increase in the Trek business unit revenue from Bausch & Lomb. Also contributing to the increase was an increase in EMI sales of digital imaging systems from the MRP acquisition. (See note 12 of the notes to consolidated financial statements.)

Other revenue decreased by approximately $813,000, or 26.5%, to $2,246,000 during the fiscal year ended June 30, 2006 as compared to fiscal year 2005. The decrease is primarily due to an approximately $1,283,000 decrease in royalties received from Bausch & Lomb in connection with its sales of Silicone Oil. The Company's contract with Bausch & Lomb called for annual step-downs in the calculation of Silicone Oil revenue to be received by the Company from 64% from August 13, 2003 to August 12, 2004 to 45% from August 13, 2004 to August 12, 2005. The Company's contract with Bausch & Lomb ended in August 2005, and accordingly, the Company received no royalties after the termination date and will receive no future royalties under this agreement. (See note 11 of the notes to consolidated financial statements for a description of the step-down provisions under the contract with Bausch & Lomb.) Royalties from Bio-Rad related to an OEM agreement between Bio-Rad and Drew increased by approximately $51,000 to $282,508 due to higher sales of Drew's products in covered areas. While this agreement terminated as of May 15, 2005, the parties have continued to operate under the terms of the expired agreement pending negotiation of a potential extension and/or revision.

The following table presents consolidated cost of goods sold by reportable business unit and as a percentage of related unit product revenues for the fiscal years ended June 30, 2006 and 2005. Table amounts are in thousands:

	Fiscal Years Ended June 30,			
	2006	%	2005	%
Cost of Goods Sold:				
Drew	$ 9,225	64.7%	$ 7,554	66.9%
Sonomed	3,962	51.2%	3,115	40.7%
Vascular	1,535	42.2%	1,432	45.0%
Medical/Trek/EMI	1,282	67.0%	1,058	61.3%
Total	$16,004	58.1%	$13,159	55.1%

Consolidated cost of goods sold totaled approximately $16,004,000, or 58.1% of product revenue, for the fiscal year ended June 30, 2006 as compared to $13,159,000 or 55.1% of product revenue for fiscal year 2005.

Cost of goods sold in the Drew business unit totaled $9,225,000, or 64.7% of product revenue, for the fiscal year ended June 30, 2006 as compared to $7,554,000, or 66.9% of product revenue, for fiscal year 2005. The decrease in the cost of goods sold as a percentage of revenue was due to a shift in the mix of products sold and a decrease in manufacturing gains experienced in fiscal year 2005. Instrument and OEM sales historically have lower margins than the sales of reagents and controls, which are used to operate the instruments.

Cost of goods sold in the Sonomed business unit totaled $3,962,000, or 51.2% of product revenue, for the fiscal year ended June 30, 2006 as compared to $3,115,000, or 40.7% of product revenue for fiscal year 2005. The primary reason for the increase was an increase in the percentage of international sales during the period. The Company historically experiences a lower selling price per unit on its international product sales. In addition, the Company experienced a significantly higher margin in the prior year on pachymeters sales due to significant market demand. The demand returned to normal commencing in the fourth quarter of fiscal 2004.

Cost of goods sold in the Vascular business unit totaled $1,535,000, or 42.2% of product revenue, for fiscal year ended June 30, 2006 as compared to $1,432,000, or 45.0% of product revenue for fiscal year 2005. The Company experienced lower overtime and higher production efficiencies in the current period as compared to fiscal year 2005.

Cost of goods sold in the Medical/Trek/EMI business unit totaled $1,282,000, or 67% of product revenue, for fiscal year ended June 30, 2006 as compared to $1,058,000, or 61.3% of product revenue for fiscal year 2005. Fluctuations in Medical/Trek/EMI cost of goods sold primarily emanates from product mix, which was primarily controlled by market demand. Further contributing to the increase was the integration of MRP into the existing EMI product lines.

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 fiscal years ended June 30, 2006 and 2005. Table amounts are in thousands:

	Fiscal Years Ended June 30,		
	2006	2005	% Change
Marketing, General and Administrative:			
Drew	$ 6,006	$ 4,104	46.3%
Sonomed	2,098	1,608	30.4%
Vascular	1,682	1,424	18.1%
Medical/Trek/EMI	4,209	5,420	(22.3)%
Total	$13,995	$12,556	11.5%

Consolidated marketing, general and administrative expenses increased $1,439,000, or 11.5%, to 13,995,000 during the fiscal year ended June 30, 2006 as compared to fiscal year 2005.

Marketing, general and administrative expenses in the Drew business unit increased $1,902,000, or 46.4%, to $6,006,000 as compared to fiscal year 2005. The increase is primarily due to higher personnel and advertising costs related to improving the image of the Drew brand with both customers and distributors, improving the product distributor network and expanding the management team, which ultimately helped contribute to the 11.5% increase in product revenue when compared to fiscal year 2005.

Marketing, general and administrative expenses in the Sonomed business unit increased by $490,000, or 30.5%, to $2,098,000 as compared to fiscal year 2005. The increase is due primarily to increased personnel, travel and advertising and trade show expenses related to the expansion into international markets and the roll out of Sonomed's new UBM Instrument.

Marketing, general and administrative expenses in the Vascular business unit increased $258,000, or 18.2%, to $1,682,000 as compared to fiscal year 2005. Sales salaries and other personnel-related expenses increased approximately $157,000, travel related expenses for sales personnel increased by approximately $90,000, advertising increased by approximately $9,000 and the expense for customer samples increased by approximately $19,000 when compared to fiscal year 2005. All of the increases were related to supporting a higher volume of business during the current period as compared to fiscal year 2005. Legal expenses increased $49,000 over the prior period due to additional patent applications, planning and review.

Marketing, general and administrative expenses in the Medical/Trek/EMI business unit decreased $1,211,000 or 22.4% to $4,209,000 as compared to fiscal year 2005. Of the decrease, $1,087,000 is due to a one-time supplemental retirement benefit awarded in June 2005 to the Company's Chairman and CEO (see note 10 to the consolidated financial statements). EMI marketing, general and administrative expenses increased to $560,000 from $222,000 experienced in fiscal year 2005 due mainly to the integration of MRP with the EMI lines, and the joint marketing and integration of the Company's product line with ANKA Systems. Legal expenses were $754,000, a 22,000 increase over fiscal year 2005. The Company expects litigation costs due to Intralase and other matters to continue to impact earnings in the near term.

Research and development expenses increased $935,000, or 49.4%, to $2,828,000 during the fiscal year ended June 30, 2006 as compared to fiscal year 2005. Drew accounted for $1,734,000 of the $2,828,000 incurred for the year. These funds relate to the continued research on Drew's two new instruments the Drew 360 and the XL22. Approximately $510,000 was incurred during the period by Sonomed as it finalized the development of its new UBM Instrument. The remainder was incurred on various projects by legacy Escalon Companies to continue to enhance and improve their product lines.

Gain on sale of available for sale securities was approximately $1,157,000 and $3,412,000 for the fiscal years ended June 30, 2006 and 2005, respectively. The decrease was due to the sale of fewer shares of Intralase common stock in July 2005. (See note 15 of the notes to consolidated financial statements.)

The Company recognized a loss of approximately $174,000 and $64,000 related to its investment in OTM during the fiscal years ended June 30, 2006 and 2005, 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. (See note 12 of the notes to consolidated financial statements.)

Interest income was $162,000 and $69,000 for the fiscal years ended June 30, 2006 and 2005, respectively. The increase was due to higher cash balances and effective yields on investments.

Interest expense was $64,000 and $55,000 for the fiscal years ended June 30, 2006 and 2005 respectively. The Company paid off several of its debt facilities to several entities in advance of their maturities during the fiscal year ended June 30, 2005. Additionally, the Company reversed accrued loan commitment fees as a result of the satisfaction of the debt and the release by the lender of those fees. The fees were originally accrued based on contract terms.

Liquidity and Capital Resources

The following table presents overall liquidity and capital resources from continuing operations during the fiscal years ended June 30, 2007 and 2006. Table amounts are in thousands:

	June 30, 2007	June 30, 2006
Current Ratio:		
Current assets	$ 21,763	$ 14,911
Less: Current liabilities	4,525	4,295
Working Capital	$ 17,238	$ 10,616
Current Ratio	4.8 TO 1	3.5 TO 1
Debt to Total Capital Ratio:		
Notes payable and current maturities	$ 150	$ 233
Long-term debt	0	163
Total debt	$ 150	$ 396
Total equity	39,406	33,100
Total Capital	$ 39,556	$ 33,496
Total Debt to Total Capital	0.4%	1.2%

Working Capital Position

Working capital increased $6,622,000 as of June 30, 2007 and the current ratio increased to 4.8 to 1 from 3.5 to 1 when compared to June 30, 2006. The increase in working capital was caused primarily by an increase in cash of $5,499,000 from $3,380,000 to $8,879,000 in 2006 and 2007, respectively. Accounts receivable increased $657,000 from $3,996,000 in 2006 to $4,653,000 in 2007. Overall total current assets increased $6,852,000 from $14,911,000 in 2006 to $21,763,000 in 2007. Total current liabilities which consist of current portion of long term debt, accounts payable and accrued expenses increased $230,000, from $4,295,000 in 2006 to $4,525,000 in 2007.

Cash Provided by or Used in Operating Activities

During fiscal 2007, the Company generated approximately $5,783,000 of cash for operating activities. In fiscal 2006, the Company used approximately $2,605,000 in operating activities. The net increase in cash generated from operating activities of approximately $8,388,000 in fiscal 2007 as compared to fiscal 2006 is due primarily to the following factors:

Income/loss from operations increased approximately $7,901,000 in fiscal 2007 as compared to fiscal 2006, from $(1,986,000) to $5,915,000 in 2007. The net income in 2007 was driven by net income in the legacy Escalon companies of approximately $9,585,000 offset by a net loss at our Drew division of approximately $3,670,000. The income in the legacy Escalon companies includes the $9,600,000 settlement reached with Intralase as described in Item 3 above. The loss at Drew was primarily driven by revenue decreases due to the non-renewal of two OEM agreements and the delay in the introduction of several new key products due to development setbacks and increased research and development expenses related to continued research on two new instruments, the DS-360 and the XL2280 and completion of the new Trilogy Analyzer which received FDA approval during July 2007.

Cash Flows Used in Investing and Financing Activities

Cash flows used in investing activities for 2007 were approximately $216,000. This amount is made up of the net proceeds of $75,000 realized on the sale of the remaining Intralase securities held by the Company as available for sale securities, purchases of fixed assets of $260,000 and investment in OTM of $31,000.

Cash flows generated by investing activities of approximately $783,000 during fiscal 2006 relate primarily to the net proceeds of approximately $1,157,000 realized on the sale of a portion of the Intralase securities held by the Company as available for sale securities. The securities that were sold were originally acquired in connection with the license of intellectual laser properties to Intralase (see note 15 to the consolidated financial statements). Partially offsetting the cash realized on the securities sale were costs related to the purchase of fixed assets during 2006 of $327,000 and costs related to the MRP acquisition of $47,000.

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

Cash flows used in financing activities in the amount of $62,000 during 2007 relate to repayment of debt of $245,000, offset by the proceeds $183,000 from the issuance of common stock options.

Cash flows generated in financing activities were approximately $147,000 during the fiscal year ended June 30, 2006. The Company received proceeds of $374,000 from the issuance of common stock upon the exercise of stock options. This was partially offset by repayment of debt of $227,000.

Debt History

Drew has long-term debt facilities through the Texas Mezzanine Fund and through Symbiotics, Inc. The Texas Mezzanine Fund debt provided for interest at fixed rate of 8% per annum until July 1, 2005. The interest rate was then adjusted to the prime rate plus 4% per annum. Each June 1, the rate will be adjusted to the prime rate plus 4% per annum. The debt has a minimum interest rate of 8% per annum to a maximum interest rate of 18% per annum. The interest rate on the Texas Mezzanine Fund was 10.25% per annum and 8% per annum as of June 30, 2006 and 2005, respectively. Drew is required to pay the Texas Mezzanine Fund 1% of fiscal year revenues over $11,500,000 as defined in a revenue participation agreement. The note is due in June 2008 and is secured by certain assets of Drew. The outstanding balance as of June 30, 2007 was $133,534. 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% per annum. The outstanding balance on the Symbiotics as of June 30, 2007 was approximately $16,666.

Off-Balance Sheet Arrangements and Contractual Obligations

The Company was not a party to any off-balance sheet arrangements as of and for the fiscal years ended June 30, 2007 and 2006. The following table presents the Company's contractual obligations as of June 30, 2007 (interest is not included in the table as it is not material):

	Total	Less Than 1 Year	1-3 Years	3-5 Years	More Than 5 Years
Long-term debt	$ 150,200	$150,200	$ 0	$ 0	$ 0
Operating lease agreements	2,746,091	657,452	968,734	792,819	327,086
Total	$2,896,291	$807,652	$968,734	$792,819	$327,086

Forward-Looking Statement About Significant Items Likely to Impact Liquidity

On July 23, 2004, the Company acquired approximately 67% of the outstanding ordinary shares of Drew, pursuant to the Company's exchange offer for all of the outstanding ordinary shares of Drew and subsequently acquired the remaining shares during the fiscal year ended June 30, 2005. As of June 30, 2006, the Company has acquired all of the outstanding ordinary shares of Drew. Drew does not have a history of producing positive operating cash flows and, as a result, at the time of acquisition, was operating under financial constraints and was under-capitalized. As Drew is integrated into the Company, management continues to work to reverse the situation, while at the same time seeking to strengthen Drew's market position. The Company has loaned approximately $16 million to Drew. The funds have been primarily used to procure components to build up inventory to support the

manufacturing process as well as to pay off accounts payable and debt of Drew. The Company may need to provide further working capital for Drew.

Common Stock

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

- Shareholders' equity of $2,500,000 or market value of listed securities of $35,000,000 or net income from continuing operations (in the latest fiscal year or two of the last three fiscal years) of $500,000;
- 500,000 publicly held shares;
- $1,000,000 market value of publicly held shares;
- A minimum bid price of $1;
- 300 round lot shareholders;
- Two market makers; and
- Compliance with corporate governance standards.

As of June 30, 2007, Escalon complied with these requirements.

Critical Accounting Policies

The preparation of financial statements requires management to make estimates and assumptions that impact amounts reported therein. The most significant of those involve the application of Statement of Accounting Standards ("SFAS") No. 142 "Goodwill and Other Intangible Assets," discussed further in the notes to consolidated financial statements included in this Form 10-K. The financial statements are prepared in conformity with accounting principles generally accepted in the United States of America, and, as such, include amounts based on informed estimates and judgments of management. For example, estimates are used in determining valuation allowances for deferred income taxes, uncollectible receivables, obsolete inventory, sales returns and rebates and purchased intangible assets. Actual results achieved in the future could differ from current estimates. The Company used what it believes are reasonable assumptions and, where applicable, established valuation techniques in making its estimates.

Revenue Recognition

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

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

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

(distributor's) creditworthiness. Based on this determination, the Company believes that 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 is computed by dividing the net income/(loss) for the period by the weighted average number of shares of common stock outstanding during the period. The calculation of diluted net income/(loss) per share excludes potential common shares if the impact is anti-dilutive. Basic earnings per share are computed by dividing net income/(loss) by the weighted average number of shares of common stock outstanding during the period. Diluted earnings per share are determined in the same manner as basic earnings per share, except that the number of shares is increased by assuming exercise of dilutive stock options and warrants using the treasury stock method.

Taxes

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

In determining income/(loss) for financial statement purposes, management must make certain estimates and judgments. These estimates and judgments occur in the calculation of certain tax liabilities and in the determination of the recoverability of certain deferred tax assets, which arise from temporary differences between the tax and financial statement recognition of revenue and expense. SFAS 109 "Accounting for Income Taxes" also requires that the deferred tax assets be reduced by a valuation allowance, if based on the available evidence, it is more likely that not that all or some portion of the recorded deferred tax assets will not be realized in future periods.

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

Through June 30, 2007, the Company has recorded a full valuation allowance against the Company's net operating losses due to uncertainty of their realization as a result of the Company's earnings history, the number of years the Company's net operating losses and tax credits can be carried forward, the existence of taxable temporary differences and near-term earnings expectations. The amount of the valuation allowance could decrease if facts and

circumstances change that materially increase taxable income prior to the expiration of the loss carryforwards. Any reduction would reduce (increase) the income tax expense (benefit) in the period such determination is made by the Company.

Stock Based Compensation

Effective July 1, 2007, the Company adopted the fair value recognition provisions of Statement of Financial Accounting Standards 123(R) ("SFAS 123(R)") "Share-Based Payments". SFAS 123(R) is a revision of SFAS No. 123 and supersedes ABP Opinion No. 25. The Company used the modified prospective transition method and therefore did not have to restate results for prior periods. Under this transition method, stock-based compensation expense for 2006 includes compensation expense for all stock-based compensation awards granted prior to, but not yet vested as of, July 1, 2006, based on the grant date fair value estimate in accordance with the original provisions of SFAS 123. Stock-based compensation expense for all stock-based compensation awards granted after July 1, 2006 is based on the grant-date fair value estimate in accordance with the provisions of SFAS 123(R). The Company will recognize these compensation costs on a straight-line basis over the requisite service period of the award.

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

Prior to the adoption of SFAS 123(R), the Company accounted for stock-based compensation in accordance with APB 25.

Recently Issued Accounting Standards

In July 2006, the Financial Accounting Standards Board, or FASB, issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes — an interpretation of FASB Statement No. 109, or FIN 48. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in the enterprise's financial statements. This Interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in the tax return. This Interpretation is effective for fiscal years beginning after December 15, 2006. The Company is currently evaluating the effect this Interpretation will have on the Company's financial position, liquidity and statement of operations, but do not expect the effect to be significant.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements, or SFAS No. 157. SFAS No. 157 establishes a framework for measuring fair value and expands the disclosures on fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact of the adoption of SFAS No. 157 on the Company's consolidated financial statements. The Company does not expect the effect to be significant.

On September 29, 2006, the FASB issued FASB Statement No. 158, Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, and amendment of FASB Statements Nos. 87, 88, 106 and 132(R), or FAS 158. FAS 158 requires companies to recognize a net liability or asset to report the funded status of their defined benefit pension and post retirement benefit plans. The Company does not any defined benefit plans and therefore the effect of adoption at December 31, 2006 has not had an impact on the Company's financial condition, results of operations or cash flows.

In September 2006, the SEC staff issued Staff Accounting Bulletin No. 108 "Considering the Effects of Prior Year Misstatement when Quantifying Misstatements in the Current Year Financial Statements," or SAB 108. SAB 108 was issued in order to eliminate the diversity in practice surrounding how public companies quantify financial statement misstatements. The Company does not expect SAB 108 will have a material effect on our financial statements.

Item 7A. ***Quantitative and Qualiitative Disclosure About Market Risk***

Market risk represents the risk of loss that may impact our consolidated financial position, results of operations or cash flows. In the normal course of doing business, we are exposed to the risks associated with foreign currency exchange rates and changes in interest rates.

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 June 30, 2007 were variable at prime plus 4%, currently 10.25% per annum, on the Texas Mezzanine Fund debt, and were fixed at 5.00% per annum, on the Symbiotics, Inc. term debt. (See note 6 of the notes to consolidated financial statements for further information regarding the Company's debt obligations.)

	2007	Total
Texas Mezzanine Fund Note	$ 133,534	$133,534
Interest rate	Prime Plus 4%	
Symbiotics, Inc. Note	$ 16,666	$ 16,666
Interest rate	5.00%	
Total	$ 150,200	$150,200

Currency Fluctuations

For the years ended June 30, 2007, 2006 and 2005, approximately 12.5%, 12.8% and 14.5%, respectively, of our net revenues were generated in currencies other than the United States dollar. Fluctuations in the value of foreign currencies relative to the United States dollar affect our reported results of operations. If the United States dollar weakens relative to the foreign currency, then our earnings generated in the foreign currency will, in effect, increase when converted into United States dollars and vice versa. Exchange rate differences resulting from the strength or weakness of the United States dollar against the Euro and the United Kingdom Pound Sterling resulted in increases of approximately $279,000 in net revenues in 2007 compared to 2006, $37,000 in net revenues in 2006 compared to 2005 and a decrease of approximately $52,000 in net revenues in 2005 compared to 2004.. During the three years ended June 30, 2007, no subsidiary was domiciled in a highly inflationary environment and the impact of inflation and changing prices on our net sales and revenues and on loss from continuing operations was not material.

During 2007, our subsidiary in the United Kingdom generated 12.5% of our net product revenues. Conducting an international business inherently involves a number of difficulties, risks, and uncertainties, such as export and trade restrictions, inconsistent and changing regulatory requirements, tariffs and other trade barriers, cultural issues, longer payment cycles, problems in collecting accounts receivable, political instability, local economic downturns, seasonal reductions in business activity in Europe during the traditional summer vacation months, and potentially adverse tax consequences.

Item 8. ***Financial Statements and Supplementary Data***

ESCALON MEDICAL CORP.

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and
Stockholders of Escalon Medical Corporation

We have audited the accompanying balance sheets of Escalon Medical Corporation as of June 30, 2007 and 2006, and the related statements of income, stockholders' equity and comprehensive income, and cash flows for each of the years in the three-year periods ended June 30, 2007. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Escalon Medical Corporation as of June 30, 2007 and 2006, and the results of its operations and its cash flows for each of the years in the three-year period ended June 30, 2007 in conformity with accounting principles generally accepted in the United States of America.

Mayer Hoffman McCann P.C.

Plymouth Meeting, Pennsylvania
September 27, 2007

ESCALON MEDICAL CORP. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

	June 30, 2007	June 30, 2006
ASSETS		
Current assets:	$ 8,879,462	$ 3,379,710
Available for sale securities	0	50,220
Accounts receivable, net	4,653,073	3,996,243
Inventory, net	7,761,370	7,122,916
Other current assets	469,107	362,160
Total Current Assets	21,763,012	14,911,249
Furniture and equipment, net	873,191	969,956
Goodwill	21,072,260	21,072,260
Trademarks and trade names	620,106	620,106
Patents, net	216,228	313,702
Covenant not to compete and customer list, net	326,860	420,073
Other assets	145,556	337,421
Total Assets	$ 45,017,213	$ 38,644,767
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term debt	$ 150,200	$ 232,837
Accounts payable	1,626,274	1,558,501
Accrued expenses	2,748,133	2,503,771
Total Current Liabilities	4,524,607	4,295,109
Long-term debt, net of current portion	0	162,551
Accrued post-retirement benefits	1,087,000	1,087,000
Total Liabilities	5,611,607	5,544,660
Shareholders equity:		
Preferred stock, $0.001 par value; 2,000,000 shares authorized; no shares issued common stock, $0.001 par value; 35,000,000 share authorized; 6,386,857 and 6,344,657 issued and outstanding at June 30, 2007 and June 30, 2006, respectively	6,387	6,345
Common stock warrants	1,601,346	1,601,346
Additional paid-in capital	66,045,050	65,699,370
Accumulated (deficit)	(28,207,824)	(34,122,427)
Accumulated other comprehensive (loss) income	(39,353)	(84,527)
Total Shareholders' Equity	39,405,606	33,100,107
Total Liabilities and Shareholders' Equity	$ 45,017,213	$ 38,644,767

See notes to consolidated financial statements

ESCALON MEDICAL CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

	For the Years Ended June 30,		
	2007	**2006**	**2005**
Net Revenues:			
Product revenue	$27,892,738	$27,543,785	$23,864,322
Other revenue	10,945,042	2,246,913	3,060,300
Revenues, Net	38,837,780	29,790,698	26,924,622
Costs and Expenses:			
Cost of goods sold	15,771,254	16,003,904	13,158,061
Marketing, general and administrative	13,806,399	13,994,788	12,556,374
Research and development	3,461,322	2,828,196	1,892,706
Total Costs and Expenses	33,038,975	32,826,888	27,607,141
Income (Loss) From Operations	5,798,805	(3,036,190)	(682,519)
Other (Expense) and Income:			
Gain on sale of available for sale securities	75,000	1,157,336	3,411,761
Equity in Ocular Telehealth Management, LLC	(87,852)	(173,844)	(63,613)
Interest income	208,457	161,588	69,262
Interest expense	(28,753)	(63,521)	(55,116)
Total Other Income	166,852	1,081,559	3,362,294
Net Income (Loss) Before Taxes	5,965,657	(1,954,631)	2,679,775
Provision for income taxes	51,054	31,309	231,664
Net Income (Loss)	$ 5,914,603	$ (1,985,940)	$ 2,448,111
Basic Net Income (Loss) Per Share	$ 0.93	$ (0.32)	$ 0.42
Diluted Net Income (Loss) Per Share	$ 0.92	$ (0.32)	$ 0.39
Weighted Average Shares — Basic	6,374,929	6,152,455	5,831,564
Weighted Average Shares — Diluted	6,434,275	6,152,455	6,231,024

See notes to consolidated financial statements

ESCALON MEDICAL CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY
For the Years Ended June 30, 2007, 2006 and 2005

	Common Stock		Common Stock Warrants	Additional Paid-In Capital	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
	Shares	Amount					
Balance at June 30, 2005	5,963,477	$5,964	$1,601,346	$63,898,190	$(32,136,487)	$ 1,149,836	$34,518,849
Comprehensive Income (Loss):							
Net (loss)	0	0	0	0	(1,985,940)	0	(1,985,940)
Change in unrealized gains on available for sale securities	0	0	0	0	0	(1,157,097)	(1,157,097)
Foreign currency translation	0	0	0	0	0	(77,266)	(77,266)
Total Comprehensive Income (loss)	0	0	0	0	(1,985,940)	(1,234,363)	(3,220,303)
Exercise of stock options	131,180	131	0	296,123	0	0	296,254
Income tax benefit from exercise of stock options	0	0	0	77,807	0	0	77,807
Purchase of assets of MRP	250,000	250	0	1,427,250	0	0	1,427,500
Balance at June 30, 2006	6,344,657	$6,345	$1,601,346	$65,699,370	$(34,122,427)	$ (84,527)	$33,100,107
Comprehensive Income:							
Net income	0	0	0	0	$ 5,914,603	0	5,914,603
Change in unrealized gains on available for sale securities	0	0	0	0	0	(50,220)	(50,220)
Foreign currency translation	0	0	0	0	0	95,394	95,394
Total Comprehensive Income							
Exercise of stock options	42,200	$ 42	0	$ 84,692	0	0	84,734
Compensation expense	0	0	0	$ 162,576	0	0	162,576
Income tax benefit from exercise of stock options	0	0	0	$ 98,412	0	0	98,412
Balance at June 30, 2007	6,386,857	6,387	1,601,346	66,045,050	(28,207,824)	(39,353)	39,405,606

ESCALON MEDICAL CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years Ended June 30,		
	2007	2006	2005
Cash Flows from Operating Activities:			
Net income (loss)	$5,914,603	$(1,985,940)	$ 2,448,111
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Depreciation and amortization	590,846	440,952	387,651
Post retirement benefits	0	0	1,087,000
Compensation expense related to stock options	162,576	0	0
Gain on sale of available for sale securities	(75,000)	(1,157,336)	(3,411,761)
Reserve on notes receivable	0	100,000	50,000
Loss on Ocular Telehealth Management, LLC	87,852	173,844	63,613
Abandonment of leasehold improvements	0	0	12,458
Change in operating assets and liabilities:			
Accounts receivable, net	(656,830)	761,834	(838,624)
Inventory, net	(638,454)	(1,189,207)	(1,882,149)
Other current and long-term assets	84,918	19,880	63,750
Accounts payable, accrued and other liabilities	312,135	230,643	(1,330,009)
Net Cash Provided by (Used In) Operating Activities	5,782,645	(2,605,330)	(3,349,960)
Cash Flows from Investing Activities:			
Proceeds from the sale of available for sale securities	75,000	1,157,336	3,411,761
Investment in Ocular Telehealth Management, LLC	(31,000)	0	(256,000)
Purchase of fixed assets	(259,705)	(327,340)	(104,396)
Purchase of MRP, net of cash acquired	0	(47,060)	0
Purchase of Drew, net of cash acquired	0	0	151,459
Acquistion costs, related to Drew	0	0	(1,015,362)
Net Cash (Used In) Provided by Investing Activities	(215,705)	782,936	2,187,462
Cash Flows from Financing Activities:			
Principal payments on term loans	(245,188)	(226,749)	(4,441,761)
Issuance of common stock — stock options	183,146	374,061	29,795
Line of credit repayment	0	0	(1,905,822)
Net Cash (Used In) Provided by Financing Activities	(62,042)	147,312	(6,317,788)
Effect of exchange rate changes on cash and cash equivalents	(5,146)	(60,980)	(5,913)
Net Increase (Decrease) In Cash and Cash Equivalents	5,499,752	(1,736,062)	(7,486,199)
Cash and cash equivalents, beginning of period	3,379,710	5,115,772	12,601,971
Cash and cash equivalents, end of period	$8,879,462	$ 3,379,710	$ 5,115,772
Supplemental Schedule of Cash Flow Information:			
Interest paid	$ 25,217	$ 37,586	$ 198,647
Income taxes refund (paid)	$ 98,412	$ (1,133)	$ 327,176
Issuance of common stock for Drew acquisition	$ 0	$ 0	$ 7,430,438
Issuance of common stock for MRP acquisition	$ 0	$ 1,427,500	$ 0
(Decrease)/increase in unrealized appreciation on available for sale securities	$ (50,220)	$(1,157,097)	$ 1,207,317

See notes to consolidated financial statements

ESCALON MEDICAL CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Organization and Description of Business and Business Conditions

Escalon Medical Corp. ("Escalon" or the "Company") is a Pennsylvania corporation initially incorporated in California in 1987, and reincorporated in Pennsylvania in November 2001. Within this document, the "Company" collectively shall mean Escalon and its wholly owned subsidiaries: Sonomed, Inc. ("Sonomed"), Escalon Vascular Access, Inc. ("Vascular"), Escalon Medical Europe GmbH ("EME"), Escalon Digital Vision, Inc. ("EMI"), Escalon Pharmaceutical, Inc. ("Pharmaceutical"), Escalon Holdings, Inc. ("EHI"), Escalon IP Holdings, Inc., Escalon Vascular IP Holdings, Inc., Sonomed IP Holdings, Inc., Drew Scientific Holdings, Inc., and Drew Scientific Group, Plc ("Drew") and its subsidiaries. All intercompany accounts and transactions have been eliminated. 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 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.

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

The Drew business unit has experienced significant losses and negative cash flow from operations in the last two years. Management has begun to implement cost reductions in each of Drew's three locations in order to bring Drew's cost structure in line with anticipated revenues. Management anticipates that these cuts combined with budgeted profits in legacy Escalon entities and the continued growth of its Intralase royalty revenue stream will provide sufficient liquidity in the coming fiscal year.

2. Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All intercompany accounts and transactions have been eliminated.

Use of Estimates

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

Cash and Cash Equivalents

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

Fair Value of Financial Instruments

The Company follows Statement of Financial Accounting Standards No. 107 ("SFAS" 107"), "Disclosure about Fair Value of Financial Instruments". The carrying amounts for cash and cash equivalents, accounts receivable, line of credit, accounts payable and accrued liabilities approximate their fair value because of their

short-term maturity. The carrying value of available for sale securities approximates market based-upon market arms-length transactions in the underlying security. The carrying amounts of long-term debt approximate fair value since the Company's interest rates approximate current interest rates. While we believe the carrying value of the assets and liabilities is reasonable, considerable judgment is used to develop estimates of fair value; thus the estimates are not necessarily indicative of the amounts that could be realized in a current market exchange.

Marketable Securities

The Company reports debt and marketable securities in accordance with Statement of Financial Accounting Standards No. 115 ("SFAS 115"), "Accounting for Certain Investments in Debt and Equity Securities." All of the equity securities held by the Company at June 30, 2007 and 2006 are classified as available for sale securities. Accordingly, amounts are reported at fair value, with unrealized gains and losses excluded from earnings and reported as a separate component of shareholders' equity (see note 15).

Revenue Recognition

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

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

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

With respect to additional consideration related to the sale of Silicone Oil by Bausch & Lomb and the licensing of the Company's intellectual laser technology, revenue is recognized upon notification from the other parties of amount earned or upon receipt of royalty payments.

Provision has been made for estimated sales returns based on historical experience.

Shipping and Handling Revenues and Costs

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

Inventories

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

	June 30, 2007	June 30, 2006
Raw materials	$4,825,018	$4,219,836
Work in process	680,994	809,807
Finished goods	2,556,913	2,345,985
	8,062,925	7,375,628
Valuation allowance	(301,555)	(252,712)
Total Inventory	$7,761,370	$7,122,916

Valuation allowance activity for the years ended June 30 was as follows:

	June 30, 2007	June 30, 2006
Balance, July 1	$252,712	$166,668
Provision for valuation allowance	65,221	87,475
Write-off's	(16,378)	(1,431)
Balance, June 30	$301,555	$252,712

Accounts Receivable

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

	June 30, 2007	June 30, 2006
Balance, July 1	$ 649,577	$ 490,465
Provision for bad debts	96,000	347,968
Write-off's	(178,699)	(188,856)
Balance, June 30	$ 566,878	$ 649,577

Property and Equipment

Property and equipment is recorded at cost. Leasehold improvements are amortized on a straight-line basis over the lesser of the estimated useful life of the asset or lease term. Depreciation on property and equipment is recorded using the straight-line method over the estimated economic useful life of the related assets. Estimated useful lives are generally 3 to 5 years for computer equipment and software, 5 to 7 years for furniture and fixtures and 5 to 10 years for production and test equipment. Depreciation expense for the years ended June 30, 2007, 2006 and 2005 was $394,517, $324,458 and $321,142 respectively.

Property and equipment consist of the following at:

	June 30, 2007	June 30, 2006
Equipment	$ 2,157,562	$ 2,289,994
Furniture and Fixtures	62,846	65,891
Leasehold Improvements	135,895	128,866
	2,356,303	2,484,751
Less: Accumulated depreciation and amortization	(1,483,112)	(1,514,795)
	$ 873,191	$ 969,956

Long-lived Assets

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

Intangible Assets

The Company follows Statement of Financial Accounting Standards No. 142 ("SFAS 142"), "Goodwill and Other Intangible Assets," which discontinues the amortization of goodwill and identifiable intangible assets that have indefinite lives. In accordance with SFAS 142, these assets are tested for impairment on an annual basis.

Accrued Warranties

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

Business Combinations

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

Stock-based Compensation

Effective July 1, 2006, the Company adopted the fair value recognition provisions of SFAS 123(R), using the modified prospective transition method. Under this transition method, stock based compensation expense for the year ended June 30, 2007 included compensation expense for all stock-based compensation awards granted prior to, but not yet vested as of July 1, 2006, based on the grant date fair value estimate in accordance with the original

provisions of SFAS 123. On June 30, 2006, the Compensation Committee of the Company approved the acceleration of vesting of all of the outstanding stock options to purchase shares of the Company's common stock. The acceleration applied to all stock options outstanding as of June 30, 2006 under the Company's 1991 Stock Option Plan, 1992 Stock Option Plan, 1993 Stock Option Plan, 1999 Stock Option Plan and 2004 Equity Incentive Plan. Since all options issued prior to July 1, 2006 were accelerated, and therefore fully vested, there was no compensation expense recorded in fiscal year 2007 related to these options.

Stock-based compensation expense for all share-based payment awards granted after July 1, 2006 is based on the grant date fair value estimate in accordance with the provisions of SFAS 123(R). As of June 30, 2007, there was $127,052 of total unrecognized compensation cost related to non-vested share-based compensation arrangements under the plans. The cost is expected to be recognized over a weighted average period of four years.

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 value of the Company's common stock on the date that the commitment for performance by the counterparty has been reached or the counterparty's performance is complete. The fair value of the equity instrument is charged directly to compensation expense and additional paid-in capital.

For the years ended June 30, 2006 and 2005 the Company reported stock-based compensation through the disclosure-only requirements of the Statement of Financial Accounting Standards No. 123 ("SFAS 123"), "Accounting for Stock-Based Compensation," as amended by Statement of Financial Accounting Standards No. 148 ("SFAS 148"), "Accounting for Stock-Based Compensation — Transition and Disclosure — an Amendment to FASB No. 123." Compensation expense for options is measured using the intrinsic value method in accordance with Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25"). Under APB 25, because the exercise price of the Company's employee stock options is generally equal to the market price of the Company's underlying stock on the date of grant, no compensation expense is recognized.

SFAS 123 establishes an alternative method of expense recognition for stock-based compensation awards based on fair values. The following table illustrates the impact on net income and earnings per share if the Company had applied the fair value recognition provisions of SFAS 123.

	2006	2005
Net (loss) income, as reported	$(1,985,940)	$2,448,111
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(288,848)	(539,026)
Pro forma net (loss) income	$(2,274,788)	$1,909,085
(Loss) earnings per share:		
Basic — as reported	$ (0.323)	$ 0.420
Basic — pro forma	$ (0.370)	$ 0.327
Diluted — as reported	$ (0.323)	$ 0.393
Diluted — pro forma	$ (0.370)	$ 0.306

The Company has followed the guidelines of SFAS 123 to establish the valuation of its stock options. The fair value of these equity awards was estimated at the date of grant using these Black-Scholes option pricing method. For the purposes of pro forma disclosures, the estimated fair value of the equity awards is amortized to expense over

the options' vesting period. For the purposes of applying SFAS 123, the estimated per share value of the options granted during the fiscal years ended June 30, 2006 and 2005 was $5.52 and $4.93, respectively. The fair value was estimated using the following assumptions: dividend yield of 0.0%; volatility ranging between 0.60 and 2.51; risk free interest ranging between 3.30% and 4.5%; and expected life of 10 years. The volatility assumption is based on volatility seen in the Company's stock over the last five years. This assumption was made according to the guidance of SFAS 123. There is no reason to believe that future volatility will compare to historic volatility.

Research and Development

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

Advertising Costs

Advertising costs are charged to operations as incurred. Advertising expense for the years ended June 30, 2007, 2006 and 2005 was $134,811, $279,670 and $190,963 respectively.

Net Income (Loss) Per Share

Earnings (loss) per share is computed by dividing net income (loss) by the weighted average number of shares of common stock outstanding during the year. All outstanding stock options and warrants are considered potential common stock. The dilutive effect, if any, of stock options and warrants is calculated using the treasury stock method.

A reconciliation of the denominator of the basic and diluted earnings per share for the three years ended June 30, 2007, 2006 and 2005 is as follows:

	2007	2006	2005
Basic Weighted average shares outstanding	6,374,929	6,152,455	5,831,564
Effect of diluted securities Stock Options and warrants	59,346	0	399,460
Diluted weighted average shares outstanding	6,434,275	6,152,455	6,231,024

As of June 30, 2006, the impact of all dilutive securities were omitted from the diluted earnings per share calculation as they reduce the loss per share (anti-dilutive). As of June 30, 2007, 2006, and 2005, 120,000 warrants, which were issued in March 2004 (see note 6), to purchase shares of Escalon common stock were outstanding. These warrants were excluded from the calculation of diluted earnings per share as the exercise price of the warrants exceeded the average share price of the Company's common stock for of the year ended June 30, 2005 making the warrants anti-dilutive.

Income Taxes

The Company accounts for income taxes using the asset and liability method. Under this method, deferred tax assets and liabilities are recognized based on the difference between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted rates in effect in the years when those temporary differences are expected to reverse. The impact on deferred taxes of a change in tax rates, should a change occur, is recognized in income in the period that include the enactment date.

Comprehensive Income

The Company reports comprehensive income in accordance with the provision of SFAS No. 130, "Reporting Comprehensive Income," which establishes standards for reporting comprehensive income and its component in

financial statements. Comprehensive income, as defined, includes all changes in equity during a period from non-owner sources.

Foreign Currency Translation

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

New Accounting Pronouncements

In July 2006, the Financial Accounting Standards Board, or FASB, issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes — an interpretation of FASB Statement No. 109, or FIN 48. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in the enterprise's financial statements. This interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in the tax return. This interpretation is effective for fiscal years beginning after December 15, 2006. The Company is currently evaluating the effect this interpretation will have on the Company's financial position, liquidity and statement of operations, but do not expect the effect to be significant.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements, or SFAS No. 157. SFAS No. 157 establishes a framework for measuring fair value and expands the disclosures on fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact of the adoption of SFAS No. 157 on the Company's consolidated financial statements. However, the Company does not expect the effect to be significant.

On September 29, 2006, the FASB issued FASB Statement No. 158, Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, and amendment of FASB Statements Nos. 87, 88, 106 and 132(R), or FAS 158. FAS 158 requires companies to recognize a net liability or asset to report the funded status of their defined benefit pension and post retirement benefit plans. The Company does not have any defined benefit plans and therefore the effect of adoption has not had an impact on the Company's financial condition, results of operations or cash flows.

In September 2006, the Securities and Exchange Commission staff issued Staff Accounting Bulletin No. 108 "Considering the Effects of Prior Year Misstatement when Quantifying Misstatements in the Current Year Financial Statements," or SAB 108. SAB 108 was issued in order to eliminate the diversity in practice surrounding how public companies quantify financial statement misstatements. The Company does not expect SAB 108 will have a material effect on the Company's financial statements.

3. Intangible Assets

Goodwill, Trademarks and Trade Names

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

The Company adopted SFAS 142 effective July 1, 2001. Under SFAS 142, goodwill and identified intangible assets that have indefinite lives are no longer amortized but reviewed for impairment annually or more frequently if certain indicators arise.

In accordance with SFAS 142, effective July 1, 2001, the Company discontinued the amortization of goodwill and identifiable intangible assets that have indefinite lives. Intangible assets that have finite lives continue to be amortized over their estimated useful lives. Management has evaluated the carrying value of goodwill and its identifiable intangible assets that have indefinite lives during each of the fiscal years subsequent to July 1, 2001, utilizing discounted cash flows of the respective business units. After evaluating the discounted cash flow of each of its respective business units, management concluded that the carrying value of goodwill and identifiable intangible assets did not exceed their fair values and therefore were not impaired. In accordance with SFAS 142, these intangible assets will continue to be assessed on an annual basis, and impairment, if any, would be recorded as a charge against income from operations.

The following table presents unamortized intangible assets by business unit as of June 30, 2007 and 2006:

	2007 Net Carrying Amount	2006 Net Carrying Amount
Goodwill		
Sonomed	$ 9,525,550	$ 9,525,550
Drew	9,574,655	9,574,655
Vascular	941,218	941,218
Medical/Trek/EMI	1,030,837	1,030,837
Total	$21,072,260	$21,072,260

	2007 Net Carrying Amount	2006 Net Carrying Amount
Trademarks and Tradenames		
Sonomed	$616,906	$616,906
Medical/Trek/EMI	3,200	3,200
Total	$620,106	$620,106

Patents

It is the Company's practice to seek patent protection on processes and products in various countries. Patent application costs are capitalized and amortized over their estimated useful lives, not exceeding 17 years, on a straight-line basis from the date the related patents are issued. Costs associated with patents no longer being pursued are expensed. Accumulated patent amortization was $365,729 and $263,799 at June 30, 2007 and 2006, respectively. Amortization expense for the years ended June 30, 2007, 2006 and 2005 was $98,404, $75,150 and $66,509, respectively.

Amortization expense, relating entirely to patents, is estimated to be approximately $62,000 for 2008, $42,000 for 2009 thru 2011 and $21,000 for 2012.

Covenant Not to Compete and Customer List

The Company recorded the value of a covenant not to compete and a customer list as intangible assets as part of the acquisition of MRP (See note 12). The valuation was based on the fair market value of these assets at the time of acquisition. These assets are amortized over their estimate useful lives, not exceeding 5 years, on a straight-line basis from the date of acquisition. Accumulated amortization was $116,109 and $22,986 at June 30, 2007 and 2006, respectively. Amortization expense for the years ended June 30, 2007, 2006 and 2005 was $93,213, $22,986 and $0 respectively.

The following table presents amortized intangible assets by business unit as of June 30, 2007:

	Gross Carrying Amount	Impairment	Adjusted Gross Carrying Amount	Accumulated Amortization	Net Carrying Value
Amortized Intangible Assets Patents					
Drew	$279,740	$0	$279,740	$(154,474)	$125,266
Vascular	36,916	0	36,916	(36,916)	0
Medical/Trek/EMI	265,301	0	265,301	(174,339)	90,962
Total	$581,957	$0	$581,957	$(365,729)	$216,228
Covenant not to Compete/Customer List					
Medical/Trek/EMI	$442,969	$0	$442,969	$(116,109)	$326,860
Total	$442,969	$0	$442,969	$(116,109)	$326,860

Amortization expense, relating entirely to covenant not to compete and the customer list is estimated to be approximately $93,000 each for the years 2008 thru 2010 and $47,000 for 2011.

The following table presents amortized intangible assets by business unit as of June 30, 2006:

	Gross Carrying Amount	Impairment	Adjusted Gross Carrying Amount	Accumulated Amortization	Net Carrying Value
Amortized Intangible Assets Patents					
Drew	$275,284	$0	$275,284	$ (90,955)	$184,329
Vascular	36,916	0	36,916	(18,458)	18,458
Medical/Trek/EMI	265,301	0	265,301	(154,386)	110,915
Total	$577,501	$0	$577,501	$(263,799)	$313,702
Covenant Not To Compete/Customer List					
Medical/Trek/EMI	$442,969	$0	$442,969	$ (22,896)	$420,073
Total	$442,969	$0	$442,969	$ (22,896)	$420,073

4. Note Receivable

In connection with a co-marketing agreement with Anka Systems, Inc. (“Anka”), in October 2005, the Company extended a $400,000 loan to Anka (See note 17). Anka is an early stage privately held company. Under the terms of this note, repayment was due within six months after written demand or immediately upon an event of default. On February 16, 2006, the Company demanded repayment in accordance with the terms of the note. The note was paid in full in April 2006.

5. Accrued Expenses

The following table presents accrued expenses:

	June 30, 2007	June 30, 2006
Accrued compensation	$1,694,394	$1,260,139
Warranty accruals	255,740	255,740
Legal accruals	0	221,369
Other accruals	797,999	766,523
Total Accrued Expenses	$2,748,133	$2,503,771

In addition to normal accruals, other accruals as of June 30, 2007 and 2006 relate to the remaining lease payments on a facility that ceased manufacturing operations prior to the Drew acquisition, accruals for litigation existing prior to the Drew acquisition, franchise and ad valorem tax accruals and other sundry operating expenses accruals.

Accrued compensation as of June 30, 2007 and 2006 primarily relates to payroll, bonus and vacation accruals, and payroll tax liabilities.

6. Long-Term Debt

The Company has two long-term debt facilities through its Drew subsidiary: the Texas Mezzanine Fund and Symbiotics, Inc. The Texas Mezzanine Fund debt provided for interest at fixed rate of 8% per annum until July 1, 2005. The interest rate was then adjusted to the prime rate plus 4% per annum. Each June 1, the rate will be adjusted to the prime rate plus 4% per annum. The debt has a minimum interest rate of 8% per annum to a maximum interest rate of 18% per annum. The interest rate on the Texas Mezzanine Fund was 12% per annum and 10.25% per annum as of June 30, 2007 and 2006, respectively. Drew is required to pay an additional interest payment to the Texas Mezzanine Fund of 1% of fiscal year revenues over $11,500,000 as defined in a revenue participation agreement. The note is due in June 2008 and is secured by certain assets of Drew. The outstanding balance of the note was $133,534 and $278,717 as of June 30, 2007 and 2006, respectively. The Symbiotics, Inc. term debt, which originated from the acquisition of a product line from Symbiotics, Inc., is payable in monthly installments of $8,333 with interest at a fixed rate of 5% per annum. The outstanding balance of this note was $16,666 and $116,671 as of June 30, 2007 and 2006, respectively.

The schedule below presents principal amortization for the next five years under each of the Company's loan agreements as of June 30, 2007:

Twelve Months Ending June 30,	Texas Mezzanine	Symbiotics	Total
2008	$133,534	$16,666	150,200
2009			0
Total	$133,534	$16,666	150,200
Current portion of long-term debt			150,200
Long-term portion			$ 0

7. Capital Stock Transactions

Stock Option Plans

As of June 30, 2007, Escalon had in effect five employee stock option plans which provide for incentive and non-qualified stock options. After accounting for shares issued upon exercise of options, a total of 1,281,352 shares

of the Company's common stock remain available for issuance as of June 30, 2007. Under the terms of the plans, options may not be granted for less than the fair market value of the Common Stock at the date of grant. Vesting generally occurs ratably over five years and the option is exercisable over a period no longer than 10 years after the grant date. As of June 30, 2007, options to purchase 810,227 shares of the Company's common stock were outstanding and exercisable, and 416,317 shares were reserved for future grants.

On June 30, 2006, the Compensation Committee of the Company approved the acceleration of vesting of all of the outstanding stock options to purchase shares of the Company's common stock. The acceleration applies to all stock options outstanding as of June 30, 2006 under the Company's 1991 Stock Option Plan, 1992 Stock Option Plan, 1993 Stock Option Plan, 1999 Stock Option Plan and 2004 Equity Incentive Plan.

The Company took this action in order to reduce the future compensation expense associated with unvested stock options following the adoption of Statement of Financial Accounting Standards No. 123, Share Based Payment (revised 2004) ("SFAS 123R"). The Company was required to apply the expense recognition provisions of SFAS 123R beginning in the first quarter of fiscal 2007. As a result of the acceleration, the Company expects to reduce the stock option expense it otherwise would be required to record in connection with the accelerated options by approximately $1.18 million over the original option vesting periods.

The Company's Board of Directors took this action with the belief that it is in the best interest of our shareholders, as it will reduce the Company's reported compensation expense in future periods. In addition, because some of these options have exercise prices in excess of the current market value, the Board also believed that these options might not have been fully achieving the Company's original objective of employee retention and incentive compensation. The senior officers of the Company who are subject to reporting under Section 16(a) of the Securities Exchange Act of 1934 will be subject to the following restriction with respect to the sale of shares purchased upon exercise of a stock option whose vesting has been accelerated: Such sale shall be prohibited until the earlier of: (i) the date on which the option would otherwise have vested; (ii) twelve months from the date of the extension; or (iii) termination of employment.

The following is a summary of Escalon's stock option activity and related information for the fiscal years ended June 30, 2007, 2006 and 2005:

	2007		2006		2005	
	Common Stock Options	Weighted Average Exercise Price	Common Stock Options	Weighted Average Exercise Price	Common Stock Options	Weighted Average Exercise Price
Outstanding at the beginning of the year	920,685	$5.31	847,210	$4.20	618,706.00	$3.40
Granted	117,000	$2.65	318,400	$6.63	242,004.00	$6.13
Exercised	(42,000)	$2.00	(121,183)	$2.22	(13,500.00)	$2.24
Forfeited	(130,650)	$5.52	(123,742)	$1.00	—	$ —
Outstanding at the end of the year	865,035	$5.31	920,685	$5.31	847,210	$4.20
Exercisable at the end of the year	810,227		920,685		581,556	
Weighted average fair value of options granted during the year		$2.65		$6.63		$6.13

The following table summarizes information about stock options outstanding as of June 30, 2007:

Range of Exercise Prices	Number Outstanding at June, 30 2007	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Number Exercisable at June 30, 2007	Weighted Average Exercise Price
$1.45 to $2.12	120,981	3.24	$1.88	120,981	$1.88
$2.37 to $2.77	243,675	6.58	$2.62	188,867	$2.61
$4.97 to $5.59	74,000	8.28	$5.05	74,000	$5.05
$6.19 to $6.19	168,250	7.08	$6.19	168,250	$6.19
$6.94 to $8.06	258,129	7.47	$7.41	258,129	$7.41
Total	865,035			810,227	

Sale of Common Stock and Warrants

On March 17, 2004, the Company completed a $10,400,000 private placement of common stock and common stock purchase warrants to accredited and institutional investors. The Company sold 800,000 shares of its common stock at $13.00 per share. The investors also received warrants to purchase an additional 120,000 shares of common stock at an exercise price of $15.60 per share. If not exercised, the warrants expire on September 13, 2009. The securities were sold pursuant to the exemptions from registration of Rule 506 of Regulation D and Section 4(2) under the Securities Act of 1933. The Company has subsequently filed a registration statement with the Securities and Exchange Commission, declared effective on April 20, 2004, to register for resale by the holders all of the common stock issued in conjunction with this private placement and common stock purchasable upon exercise of the warrants.

The net proceeds to the Company from the offering, after costs associated with the offering, of $9,787,918, have been allocated among common stock and warrants based on their relative fair values. The Company used the Black-Sholes pricing model to determine the fair value of the warrants to be $1,601,346.

8. Income Taxes

The provision for income taxes for the years ended June 30, 2007, 2006 and 2005 consists of the following:

	2007	2006	2005
Current income tax provision			
Federal	$ —	$ —	$ 100,000
State	51,054	31,309	131,664
	51,054	31,309	231,664
Deferred income tax provision			
Federal	1,704,463	(1,962,685)	1,572,610
State	399,812	(460,383)	370,026
Change in valuation allowance	(2,104,275)	(2,423,068)	(1,942,636)
	—	—	—
Income tax expense	$ 51,054	$ 31,309	$ 231,664

Income taxes as a percentage of income for the years ended June 30, 2007, 2006 and 2005 differ from statutory federal income tax rate due to the following:

	2007	2006	2005
Statutory federal income tax rate	34.0%	(34.0)%	34.0%
Change in valuation allowance	(34.0)%	34.0%	(34.0)%
State income taxes, net of federal and income tax impact			4.9%
Other			3.7%
Effective income tax rate	—	—	8.6%

As of June 30, 2007, the Company had deferred income tax assets of $12,347,516. The deferred income tax assets have been reduced by a $10,607,531 valuation allowance. The valuation allowance is based on uncertainty with respect to the ultimate realization of net operating loss carryforwards.

The components of the net deferred tax income tax assets and liabilities as of June 30, 2007 and 2006 are as follows:

	2007	2006
Deferred income tax assets:		
Net operating loss carryforward	$ 11,063,841	$ 12,837,989
Accrued bonus	62,560	273,966
Executive post retirement costs	369,580	456,540
General business credit	450,199	450,199
Allowance for doubtful accounts	90,734	146,876
Accrued vacation	158,885	202,722
Inventory reserve	83,318	84,601
Accelerated depreciation	41,967	382,450
Warranty reserve	26,432	95,574
Total deferred income tax assets	12,347,516	14,930,826
Valuation allowance	(10,607,531)	(12,711,806)
	1,739,985	2,214,020
Deferred income tax liabilities:		
Accelerated amortization	(1,739,985)	(2,214,020)
Total deferred income tax liabilities	(1,739,985)	(2,214,020)
	$ —	$ —

As of June 30, 2007, the Company has a valuation allowance of $10,607,531, which primarily relates to the federal net operating loss carryforwards. The valuation allowance is a result of management evaluating its estimates of the net operating losses available to the Company as they relate to the results of operations of acquired businesses subsequent to their being acquired by Escalon. The Company evaluates a variety of factors in determining the amount of the valuation allowance, including the Company's earnings history, the number of years the Company's operating loss and tax credits can be carried forward, the existence of taxable temporary differences, and near term earnings expectations. Future reversal of the valuation allowance will be recognized either when the benefit is realized or when it has been determined that it is more likely than not that the benefit will be realized through future earnings. Any tax benefits related to stock options that may be recognized in the future through reduction of the associated valuation allowance will be recorded as additional paid-in capital. The Company has available federal

and state net operating loss carry forwards of approximately $31,856,000 and $2,643,000, respectively, of which $26,487,000 and $1,048,000, respectively, will expire over the next ten years, and $5,369,000 and $1,595,000, respectively, will expire in years eleven through twenty. Not included in the $31,856,000 federal net operating loss is approximately $8.2 million federal NOL carry forward at June 30, 2007 which represents amounts that were transferred to the Company as a result of the acquisition of Drew. Use of this transferred NOL could be limited under Section 382 and can only be used against future Drew taxable income. Any tax benefit realized from such use would first reduce acquired goodwill.

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

9. Commitments and Contingencies

Commitments

The Company leases its manufacturing, research and corporate office facilities and certain equipment under non-cancelable operating lease arrangements. The future amounts to be paid under these arrangements as of June 30, 2007 are as follows:

Twelve Months Ending	Lease Obligations
2008	$ 657,452
2009	497,722
2010	471,012
2011	410,021
2012	382,797
Thereafter	327,086
Total	$2,746,091

Rent expense charged to operations during the years ended June 30, 2007, 2006 and 2005 was approximately $866,000, $890,000 and $772,000, respectively.

Contingencies

Royalty Agreement: Clinical Diagnostics Solutions

Drew and Clinical Diagnostics Solutions, Inc. ("CDS") entered into a Private Label Manufacturing Agreement dated April 1, 2002 for the right to sell formulations or products of CDS including reagents, controls and calibrators ("CDS products") on a private label basis. The agreement term is 15 years and automatically renews year-to-year thereafter. Drew is obligated to pay CDS a royalty of 7.5% on all sales of CDS products produced from Drew's United Kingdom facility.

Intralase Corp. Legal Proceedings

In 1997, Intralase and the Company 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 the Company 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 the Company of $9,600,000 in exchange for which all pending litigation between the parties was dismissed, the parties exchanged general releases, the Company transferred to Intralase its ownership of all patents and intellectual property formerly licensed to Intralase by the Company, 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 the Company.

Institute of Child Health

Drew entered into a license agreement with the Institute of Child Health ("ICH") on May 10, 1993 to use ICH's intellectual property to manufacture, lease, sell, use and sublicense certain products and all related consumables used therein in the testing of blood and fluids. Under the license agreement Drew was to pay royalties to ICH on the products and consumables. On January 23, 2006, the Company received a letter from ICH alleging that Drew has failed to remit certain moneys due under the license agreement and has sought an accounting to determine such amount due.

Both parties continue to amicably negotiate a mutually agreeable solution to this matter. The Company does not believe that the ultimate disposition of this issue will have a material effect on the Company's financial statements.

Other Legal Proceedings

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

10. Retirement and Post-retirement Plans

The Company adopted a 401(k) retirement plan effective January 1, 1994. Escalon employees become eligible for the plan commencing on the date of employment. Company contributions are discretionary, and no Company contributions have been made since the plan's inception.

On January 14, 2000, Escalon acquired Sonomed. Sonomed adopted a 401(k) retirement plan effective on January 1, 1993. This plan has continued subsequent to the acquisition and is available only to Sonomed employees. The Company's contribution for the fiscal years ended June 30, 2007, 2006 and 2005 was $36,702, $35,034 and $24,928, respectively.

On July 23, 2004, the Company acquired Drew. Drew adopted a 401(k) retirement plan effective on July 1, 1995. This plan has continued subsequent to the acquisition and is available only to Drew's United States employees. Company contributions are discretionary, and no contributions have been made since Drew was acquired by the Company. Drew also has two defined contribution retirement plans which were effective November 24, 2002 and February 1, 1992. These plans have continued subsequent to the acquisition and are available only to Drew's United Kingdom Employees. Drew contributions for the fiscal years ended June 30, 2007, 2006 and 2005 was $29,794, $10,000 and $39,817, respectively.

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

- If the covered executive retires at age 65 or older, the Company would be obligated to pay the executive $8,000 per month for life, with payments commencing the month after retirement. If the covered executive were to die within a period of three years after such retirement, the Company would be obligated to continue making such payments until a minimum of 36 monthly payments have been made to the covered executive and his beneficiaries in the aggregate.
- If the covered executive dies before his retirement while employed by the Company, the Company would be obligated to make 36 monthly payments to his beneficiaries of $8,000 per month commencing in the month after his death.
- If the covered executive were to become disabled while employed by the Company, the Company would be obligated to pay the executive $8,000 per month for life, with payments commencing the month after he suffers such disability. If the covered executive were to die within three years after suffering such disability, the Company would be obligated to continue making such payments until a minimum of 36 monthly payments have been made to the covered executive and his beneficiaries in the aggregate.
- If the covered executive's employment with the Company is terminated by the Company, or if the executive terminates his employment with the Company for good reason, as defined in the agreement, the Company would be obligated to pay the executive $8,000 per month for life. If the covered executive were to die within a period of three years after such termination, the Company would be obligated to continue making such payments until a minimum of 36 monthly payments have been made to the covered executive and his beneficiaries in the aggregate.

In fiscal 2005 the Company accrued $1,087,000, which represents the present value of the supplemental retirement benefits awarded. This amount is accrued at June 30, 2007 and 2006.

11. Sale Of Silicone Oil Product Line, Licensing Of Laser Technology And Other Revenue

Sale of Silicone Oil Product Line

In the first quarter of fiscal 2000, Escalon received $2,117,000 from the sale to Bausch & Lomb of its license and distribution rights for the Silicone Oil product line. This sale resulted in a $1,864,000 gain after writing off the remaining net book value of license and distribution rights associated with that product line. The Company's contract to receive additional consideration based on sales of Silicone Oil by Bausch & Lomb expired on August 12, 2005.

The agreement with Bausch & Lomb, which commenced on August 13, 2000, was structured so that the Company received consideration from Bausch & Lomb based on its adjusted gross profit from its sales of Silicone Oil on a quarterly basis. The consideration was subject to a factor, which stepped down according to the following schedule:

From 8/13/00 to 8/12/01	100%
From 8/13/01 to 8/12/02	82%
From 8/13/02 to 8/12/03	72%
From 8/13/03 to 8/12/04	64%
From 8/13/04 to 8/12/05	45%

Royalties received from Silicone Oil during 2007, 2006 and 2005 were $0, $203,000 and $1,486,000, respectively.

Intralase: Licensing Of Laser Technology

In 1997, Intralase and the Company 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.

As part of the settlement agreement described in footnote 9 of these financial statements, on February 27, 2007 the Company transferred to Intralase its ownership of all patents and intellectual property formerly licensed to Intralase by the Company, and the license agreement was terminated. In addition, the settlement payment from Intralase satisfies all outstanding past, current and future royalties owed or alleged to be owed by Intralase to the Company.

Bio-Rad Laboratories, Inc. Royalty

The royalty received from Bio-Rad Laboratories, Inc. ("Bio-Rad") relates to a certain non-exclusive Eighth Amendment to an OEM Agreement ("OEM Agreement") between the Company's Drew subsidiary and Bio-Rad, dated July 19, 1994. Bio-Rad pays a royalty based on sales of certain of Drew's products in certain geographic regions.

The material terms of the OEM Agreement, provided:

- Drew receives an agreed royalty per test;
- Royalty payments will be made depending on the volume of tests provided by Bio-Rad. If less than 3,750 tests per month are provided by Bio-Rad, Bio-Rad will calculate the number of tests used on a quarterly basis in arrears and pay Drew within 45 days of the end of the quarter. If more than 3,750 tests per month are provided by Bio-Rad, Bio-Rad will pay an estimated monthly royalty and within 45 days of the end of the quarter will make final settlement upon the actual number of tests.

While the agreement, as amended by the Eighth Amendment, expired on May 15, 2005, the parties have continued to operate under the terms of the expired agreement pending negotiation of a potential extension and/or revision.

Other Revenue

Other revenue includes quarterly payments received from:

(1) Bausch & Lomb in connection with the sale of the Silicone Oil product line. This agreement expired August 12, 2005;

(2) Royalty payments received from Intralase relating to the licensing of the Company's intellectual laser technology; and the settlement payment from Intralase described in footnote 9 of these financial statements in the amount of $9,600,000

(3) Royalty payments received from Bio-Rad.

(4) Settlement payment from Intralase described in footnote 9 of these financial statements.

The following table presents other revenue received by the Company for the years ended June 30, 2007, 2006 and 2005:

	2007	2006	2005
Royalty Income:			
Bio-Rad royalty	$ 242,826	$ 283,000	$ 240,000
Baush and Lomb	0	203,000	1,486,000
IntraLase royalty	1,102,216	1,761,000	1,334,000
Settlement payment (see note 9)	9,600,000	0	0
Total	$10,945,042	$2,247,000	$3,060,000

12. Acquisition of Drew and MRP, and Pro Forma Results of Operations

On July 23, 2004, the Company acquired approximately 67% of the outstanding ordinary shares of Drew, a United Kingdom company, pursuant to the Company's exchange offer for all of the outstanding ordinary shares of Drew, and acquired all of the remaining Drew shares during fiscal year ended June 30, 2005. The results of Drew's operations have been included in the consolidated financial statements, and the Company has been operating Drew as an additional business unit since July 23, 2004.

The aggregate purchase price of Drew was $8,525,966, net of acquired cash of $151,996, consisting of direct acquisition costs of $1,246,376, primarily for investment banking, legal and accounting fees that were directly related to the acquisition of Drew, and 900,000 shares of Escalon common stock valued at $7,430,439. The value of the 900,000 shares issued was based on a five-day average of the market price of the stock (two days before through two days after the shares were exchanged).

The Company accounted for the purchase under FAS 141. Under FAS 141, the Company paid a premium (i.e., goodwill) over the fair value of the net tangible and identified intangible assets. The Company acquired Drew as part of its strategy to diversify its business into the diagnostic medical devices market. Drew afforded the Company a combined capital equipment product with a continuing revenue stream product in the form of disposables. The application of purchase accounting under FAS 141 requires that the total purchase price be allocated to the fair value of assets acquired and liabilities assumed based on their fair values at the acquisition date, with amounts exceeding the fair values being recorded as goodwill. The allocation process requires an analysis of acquired fixed assets, contracts, customer lists and relationships, trademarks, patented technology, service markets, contractual commitments, legal contingencies and brand value to identify and record the fair value of all assets acquired and liabilities assumed. The Company engaged a third-party to value the assets acquired and liabilities assumed. In valuing acquired assets and assumed liabilities, fair values were based on expected discounted cash flows, current replacement cost or other techniques as deemed appropriate.

The following table summarizes the purchase price allocation of estimated fair values of assets acquired and liabilities assumed as of the date of acquisition of Drew of July 23, 2004.

Current assets	$ 3,859,771
Furniture and equipment	868,839
Patents	297,246
Other long-term assets	7,406
Goodwill	9,574,655
Total assets acquired	$14,607,917
Line of credit	$ 1,617,208
Current liabilities	3,392,286
Long-term debt	1,072,457
Total liabilities assumed	$ 6,081,951
Net assets acquired	$ 8,525,966

The following pro forma results of operations information has been prepared to give effect to the purchase of Drew as if such transaction had occurred at the beginning of the period being presented. The information presented is not necessarily indicative of results of future operations of the combined companies.

	Fiscal Year Ended		
	2007	2006	2005
Revenues, net	$38,837,780	$29,790,698	$26,924,622
Cost of goods sold	15,771,254	16,003,904	13,158,061
Gross profit	23,066,526	13,786,794	13,766,561
Operating expenses	17,267,721	16,822,984	14,449,080
Other income and (expense)	166,852	1,081,559	3,362,294
Net (loss) income before taxes	5,965,657	(1,954,631)	2,679,775
Provision for income taxes	51,054	31,309	231,664
Net (loss) income	$ 5,914,603	$ (1,985,940)	$ 2,448,111
Basic net (loss) income per share	$ 0.928	$ (0.323)	$ 0.420
Diluted net (loss) income per share	$ 0.919	$ (0.323)	$ 0.393
Weighted average shares — basic	6,374,929	6,152,455	5,831,564
Weighted average shares — diluted	6,434,275	6,152,455	6,231,024

MRP Acquisition

On January 30, 2006 EMI acquired substantially all of the assets of MRP Group, Inc. ("MRP") in exchange for 250,000 shares of the Company's common stock and approximately $47,000 in cash. The MRP business consists of ophthalmic technology solutions offering two retinal imaging systems. Approximately 200 of these systems have been installed at leading medical and retinal care centers. The operating results of MRP are included as part of the Medical/Trek/EMI business unit as of January 30, 2006.

The Company accounted for the purchase under FAS 141. Under FAS 141, the Company paid a premium (i.e., goodwill) over the fair value of the net tangible and identified intangible assets acquired to obtain a leading

edge technology platform in the digital imaging marketplace. The application of purchase accounting under FAS 141 requires that the total purchase price be allocated to the fair value of assets acquired and liabilities assumed based on their fair values at the acquisition date, with amounts exceeding the fair values being recorded as goodwill in the amount of $905,807. The allocation process requires an analysis of acquired fixed assets, contracts, customer lists and relationships, trademarks, patented technology, service markets, contractual commitments, legal contingencies and brand value to identify and record the fair value of all assets acquired and liabilities assumed. The values of certain assets and liabilities are based on preliminary valuations and are subject to adjustment as additional information is obtained. The Company will have 12 months from the closing of the acquisition to finalize the valuation. Business unit disclosures and pro forma statement of operations data for 2006 and 2005 do not include MRP operations and assets as they are not material in relation to the consolidated financial statements.

The following table summarizes the purchase price allocation of estimated fair values of assets acquired and liabilities assumed as of the date of acquisition of MRP of January 30, 2006.

Current assets	$ 143,569
Furniture and equipment	50,000
Patents and Trademarks	11,200
Covenant not to compete	319,609
Customer list	123,360
Goodwill	905,807
Total assets acquired	$1,553,545
Current liabilities	78,984
Net assets acquired	$1,474,561

13. Segment Reporting

The Company's operations are classified into five principal reporting segments for 2007 and 2006 and four principal reporting segments in 2005. In 2005, Medical/Trek and EMI were combined.

Table amounts in thousands:

	Segment Statements of Operations					Twelve Months Ended June 30,			
	2007	Drew 2006	2005	2007	Sonomed 2006	2005	2007	Vascular 2006	2005
	(In thousands)								
Revenues, Net:									
Product revenue	$11,627	$14,253	$11,294	$ 9,823	$ 7,737	$ 7,663	$3,467	$3,640	$3,180
Other revenue	243	283	240	—	—	—	—	—	—
Total Revenue, Net	11,870	14,536	11,534	9,823	7,737	7,663	3,467	3,640	3,180
Costs And Expenses:									
Cost of goods sold	7,681	9,225	7,554	4,976	3,962	3,115	1,393	1,535	1,432
Operating expenses	7,830	7,740	5,211	3,779	3,670	3,593	2,108	2,112	1,747
Total Costs and Expenses	15,511	16,965	12,765	8,755	7,632	6,708	3,501	3,647	3,179
(Loss) Income From Operations	(3,641)	(2,429)	(1,231)	1,068	105	955	(34)	(7)	1
Other (Expense) and Income:									
Gain on sale of available for sale securities	—	—	—	—		—	—	—	—
Equity in OTM	—	—	—	—	—	—	—	—	—
Interest income	—	—	4.00	—	—	—	—	—	—
Interest expense	(28)	(63)	(83)	—	—	—	—	—	(1)
Total Other (Expense) and Income	(28)	(63)	(79)	—	—	—	—	—	(1)
(Loss) and Income Before Taxes	(3,669)	(2,492)	(1,310)	1,068	105	955	(34)	(7)	0
Income taxes	0	0	0	37	21	21	1	0	0
Net (Loss) Income	$ (3,669)	$ (2,492)	$ (1,310)	$ 1,031	$ 84	$ 934	$ (35)	$ (7)	$ 0
Depreciation and amortization	$ 320	$ 271	$ 213	$ 19	$ 22	$ 24	$ 70	$ 94	$ 45
Assets	$17,569	$17,205	$ 7,977	$14,073	$13,381	$13,472	$1,848	$3,838	$2,174
Expenditures for long-lived assets	$ 269	$ 167	$ 26	$ 0	$ 15	$ 23	$ 0	$ 14	$ 11

	Segment Statements of Operations					Twelve Months Ended June 30,			
	2007	EMI 2006	2005	2007	Medical/Trek 2006	2005	2007	Total 2006	2005
					(In thousands)				
Revenues, Net:									
Product revenue	$1,484	$ 434	$ 0	$ 1,492	$1,480	$ 1,727	$27,893	$27,544	$23,864
Other revenue	—	—	—	10,702	1,964	2,820	10,945	2,247	3,060
Total Revenue, Net	1,484	434	0	12,194	3,444	4,547	38,838	29,791	26,924
Costs and Expenses:									
Cost of goods sold	711	290	0	1,011	992	1,058	15,772	16,004	13,159
Operating expenses	830	635	0	2,722	2,668	3,897	17,269	16,825	14,448
Total Costs and Expenses	1,541	925	0	3,733	3,660	4,955	33,041	32,829	27,607
(Loss) Income From Operations	(57)	(491)	0	8,461	(216)	(408)	5,797	(3,038)	(683)
Other (Expense) and Income:									
Gain on sale of available for sale securities	—	—	—	75.00	1,157	3,412	75	1,157	3,412
Equity in OTM	—	—	—	(88)	(174)	(64)	(88)	(174)	(64)
Interest income	—	—	—	208	162	66	208	162	70
Interest expense	—	—	—	—	—	29.00	(28)	(63)	(55)
Total Other (Expense) and Income	0	0	0	195	1,145	3,443	167	1,082	3,363
(Loss) and Income Before Taxes	(57)	(491)	0	8,656	929	3,035	5,964	(1,956)	2,680
Income taxes	—	—	—	14	10	211	52	31	232
Net (Loss) Income	$ (57)	$ (491)	$ 0	$ 8,642	$ 919	$ 2,824	$ 5,912	$ (1,987)	$ 2,448
Depreciation and amortization	$ 107	$ 33	$ 0	$ 85	$ 63	$ 106	$ 601	483	388
Assets	$1,907	$1,750	$ 0	$ 9,619	$2,471	$16,426	$45,016	38,645	40,049
Expenditures for long-lived assets	$ 0	$ 56	$ 0	$ 9	$ 82	$ 44	$ 278	334	104

The Company operates in the healthcare market, specializing in the development manufacture and marketing of (1) ophthalmic medical devices and pharmaceuticals; (2) in-vitro diagnostic ("IVD") instrumentation and consumables for use in human and veterinary hematology; and (3) vascular access devices. The business segments reported above are the segments for which separate financial information is available and for which operating results are evaluated regularly by executive management in deciding how to allocate resources and assessing performance. The accounting policies of the business segments are the same as those described in the summary of significant accounting policies. For the purposes of this illustration, corporate expenses, which consist primarily of executive management and administrative support functions, are allocated across the business segments based upon a methodology that has been established by the Company, which includes a number of factors and estimates and that has been consistently applied across the business segments. These expenses are otherwise included in the Medical/Trek business unit.

During the fiscal year ended June 30, 2005, Drew derived its revenue from the sale of instrumentation and consumables for blood cell counting and blood analysis in the areas of diabetes, cardiovascular diseases and human and veterinary hematology. Sonomed derived its revenue from the sale of A-Scans, B-Scans and pachymeters. These products are used for diagnostic or biometric applications in ophthalmology. Vascular derived its revenue from the sale of PD Access™ and SmartNeedle™ monitors, needles and catheter products. These products are used by medical personnel to assist in gaining access to arteries and veins in difficult cases. Medical/Trek derived its revenue from the sale of ISPAN™ gas products, various disposable ophthalmic surgical products, revenue derived

from Bausch & Lomb's sale of Silicone Oil (the contract for which expired on August 12, 2005) and from royalty revenue related to Increase's licensing of the Company's intellectual laser technology. EMI derived its revenue CFA digital imaging systems and related products.

No customer represented more than 10% of consolidated revenue during the years ended June 30, 2007, 2006 and 2005. Of the external revenue reported above, the following amounts were derived internationally during the years ended June 30:

	2007	2006	2005
Drew	$ 5,177,708	$ 8,471,608	$5,616,000
Sonomed	5,901,532	4,316,856	3,818,000
Vascular	126,854	226,665	323,000
EMI	8,900	—	—
Medical/Trek	40,400	29,671	48,000
	$11,255,394	$13,044,800	$9,805,000

14. Related-party Transactions

Escalon and a member of the Company's Board of Directors are founding and equal members of Ocular Telehealth Management, LLC ("OTM"). OTM is a diagnostic telemedicine company providing remote examination, diagnosis and management of disorders affecting the human eye. OTM's initial solution focuses on the diagnosis of diabetic retinopathy by creating access and providing annual dilated retinal examinations for the diabetic population. OTM was founded to harness the latest advances in telecommunications, software and digital imaging in order to create greater access and a more successful disease management for populations that are susceptible to ocular disease. Through June 30, 2007, Escalon had invested $288,000 in OTM and owned 45% of OTM. The members of OTM have agreed to review the operations of OTM after 24 months of operations which began in April 2004, at which time the members each have the right to sell their membership back to OTM at fair market value. Such sale would be subject to OTM's ability to buy back the membership. The members met in May 2006 and decided to continue the operations of OTM, emphasizing that all additional funding will be provided pro-rata consistent with membership percentage ownership. The Company will provide administrative support functions to OTM. For the years ended 2007, 2006 and 2005 the Company recorded losses of $87,852, $173,844 and $63,613, respectively.

Two relatives of a senior executive officer have provided legal services as either an employee or a consultant to the Company. Richard DePiano, Jr. (son of the Chief Executive Officer ("CEO")) is Chief Operating Officer and General Counsel to the Company, Mr. DePiano's salary plus bonus for the years 2007, 2006 and 2005 were approximately $185,000, $180,000 and $165,000, respectively. Caryn Lindsey (daughter-in-law of the CEO) acted as a consultant and employee for the Company during 2006 and 2005. Ms. Lindsey in 2007, 2006 and 2005 received consulting fees and salary of $0, $110,939 and $118,000, respectively. Also, in 2005 3,000 options to purchase common stock of the Company at an exercise price of $4.97 per share were granted to Ms. Lindsey.

15. Intralase Initial Public Offering and Sale of Intralase Common Stock

In October 1997, Escalon licensed its intellectual laser properties to Intralase in exchange for an equity interest of 252,535 shares of Common Stock (as adjusted for splits), as well as royalties on future product sales. The Company has historically accounted for these shares a $0 basis because a readily determinable market value was previously not available. On October 7, 2004, Intralase announced the initial public offering of shares of its common stock at a price of $13.00 per share. The shares of common stock were restricted for a period of less than one year and were permitted to be sold after April 6, 2005 pursuant to a certain Fourth Amended Registration Rights Agreement between the Company and Intralase. During 2007, Intralase accepted a $25 per share tender offer for all

its outstanding shares, as such,, Escalon received $75,000 for its remaining holdings in Intralase of 3,000 shares.. The Company sold 58,355 shares of Intralase common stock in July 2005 at $19.8226 per share resulting in gross proceeds of $1,160,316. After paying broker commissions and other fees of $2,980, the Company received net proceeds of $1,157,335. The Company sold 191,000 shares of Intralase common stock in May 2005 at $17.9134 per share resulting in gross proceeds of $3,421,459. After paying broker commissions and other fees of $9,698, the Company received net proceeds of $3,411,761. During 2007, Intralase accepted a $25 per share tender offer for all of its outstanding shares. In April 2007, the Company received $75,000 for its remaining 3,000 shares of Intralase stock. The net proceeds from the sales were recorded in other income and expense. As of June 30, 2007 and 2006, the Company had -0- and 3,000 shares, respectively of Intralase that were classified as available-for-sale securities and had a market value of $-0- and $50,220.

16. Anka Co-Marketing Agreement

On October 11, 2005 the Company signed a non-exclusive co-marketing agreement with privately held Anka, a provider of web-based connectivity solutions for the ophthalmic physician. Anka's connectivity solutions are used in major eye healthcare centers and provide seamless integration of data from various clinical modalities commonly used in eye healthcare settings. The co-marketing agreement will enable the Company to jointly market its existing digital imaging hardware with Anka's connectivity solutions. By integrating the sales and marketing efforts, the alliance should provide economies of operation and a greater market reach. Anka is an early stage privately held company located in the Washington, D.C. area.

In connection with the co-marketing agreement, Company extended a $300,000 loan in October 2005 and an additional loan of $100,000 in January 2006, pursuant to demand notes, to Anka. Under the terms of these notes, repayment is due within six months after written demand or immediately upon an event of default. On February 16, 2006, the Company demanded repayment in accordance with the terms of the notes and expects timely repayment. The loan was paid in full in April 2006.

Item 9. ***Changes in and Disagreements with Accountants on Accounting and Financial Disclosure***

None

Item 9A. ***Controls and Procedures***

Evaluation of Disclosure Controls and Procedures

As of the end of the period covered by this Form 10-K annual report, the Company carried out an evaluation, under the supervision and with the participation of the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (the "Exchange Act")). Based upon that evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) are effective in recording, processing, summarizing and reporting, on a timely basis, information required to be disclosed by the Company in the reports that the Company files or submits under the Exchange Act and the Company's controls and procedures are also effective to ensure that information required to be disclosed in the reports the Company files or submit under the Exchange Act is accumulated and communicated to the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding disclosure.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting that occurred during our fourth fiscal quarter of 2007 that would have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Requirements of Section 404

Under the rules and regulations of the SEC, the Company is currently not required to comply with the requirements of Section 404 of the Sarbanes-Oxley Act of 2002 until the Company files its Annual Report on Form 10-K for the Company's fiscal year ending June 30, 2008, so long as the Company continues to meet the definition of a non-accelerated filer. In the Company's Annual Report on Form 10-K for the year ending June 30, 2008, the Company's management will be required to provide an assessment as to the effectiveness of the Company's internal control over financial reporting, which assessment will be deemed furnished to rather than filed with the SEC. In the Company's Annual Report on Form 10-K for the year ending June 30, 2009 and for each fiscal year thereafter, the Company's management will be required to provide an assessment as to the effectiveness of our internal control over financial reporting and the Company's independent registered public accounting firm will be required to provide an attestation as to the Company's management's assessment, which assessment and attestation will be filed with the SEC. The assessment and attestation processes required by Section 404 are relatively new to the Company. Accordingly, the Company may encounter problems or delays in completing the Company's obligations and receiving an unqualified report on the Company's internal control over financial reporting by the Company's independent registered public accounting firm.

While the Company believes that we will be able to timely meet our obligations under Section 404 and that the Company's management will be able to certify as to the effectiveness of the Company's internal control over financial reporting, there is no assurance that we will do so. If the Companyis unable to timely comply with Section 404, the Company's management is unable to certify as to the effectiveness of the Company's internal control over financial reporting or the Company's independent registered public accounting firm is unable to attest to that certification, the price of the Company's common stock may be adversely affected. Even if the Company timely meets the certification and attestation requirements of Section 404, it is possible that the Company's independent registered public accounting firm will advise the Company that they have identified significant deficiencies and/or material weaknesses.

Item 9B. ***Other Information***

None

PART III

Item 10. ***Directors, Executive Officers and Corporate Governance***

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

Item 11. ***Executive Compensation***

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

Item 12. ***Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters***

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

Item 13. ***Certain Relationships and Related Transactions, and Director Independence***

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

Item 14. ***Principal Accounting Fees and Services***

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

PART IV

Item 15. ***Exhibits, Financial Statement Schedules***

(a) Documents Filed as Part of This Annual Report on Form 10-K:

(1) Financial Statements

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

Reports of Independent Registered Public Accounting Firms

Consolidated Balance Sheets as of June 30, 2007 and 2006

Consolidated Statements of Operations for the years ended June 20, 2007, 2006 and 2005

Consolidated Statements of Shareholders' Equity for the years ended June 20, 2007, 2006 and 2005

Consolidated Statements of Cash Flows for the years ended June 20, 2007, 2006 and 2005

Notes to Consolidated Financial Statements

(2) Financial Statement Schedules

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

(3) Exhibits

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

3.1	(a) Restated Articles of Incorporation of Registrant.(8)
	(b) Agreement and Plan of Merger dated as of September 28, 2001 between Escalon Pennsylvania, Inc. and Escalon Medical Corp.(8)
3.2	Bylaws of Registrant.(8)
4.5	(a) Warrant Agreement between Registrant and U.S. Stock Transfer Corporation.(1)
	(b) Amendment to Warrant Agreement between the Registrant and U.S. Stock Transfer Corporation.(2)
	(c) Amendment to Warrant Agreement between the Registrant and American Stock Transfer Corporation.(3)
4.6	Securities Purchase Agreement, dated as of December 31, 1997 by and among the Registrant and Combination.(4)
4.7	Registration Rights Agreement, dated as of December 31, 1997 by and among the Registrant and Combination.(4)
4.8	Warrant to Purchase Common Stock issued December 31, 1997 to David Stefansky.(4)
4.9	Warrant to Purchase Common Stock issued December 31, 1997 to Combination.(4)
4.10	Warrant to Purchase Common Stock issued December 31, 1997 to Richard Rosenblum.(4)
4.11	Warrant to Purchase Common Stock issued December 31, 1997 to Trautman, Kramer & Company.(4)
10.6	Employment Agreement between the Registrant and Richard J. DePiano dated May 12, 1998.(6)**
10.7	Non-Exclusive Distributorship Agreement between Registrant and Scott Medical Products dated October 12, 2000.(9)
10.9	Assets Sale and Purchase Agreement between the Registrant and Endologix, Inc. dated January 21, 1999.(5)
10.13	Supply Agreement between the Registrant and Bausch & Lomb Surgical, Inc. dated August 13, 1999.(5)
10.15	Registrant's Amendment and Supplement Agreement and Release between the Registrant and Endologix, Inc. dated February 28, 2001.(10)
10.16	2003 Amendment to Loan Agreement.(12)
10.17	Allonge to the Amended and Restated Term/Time Note.(12)
10.18	Allonge to the Amended and Restated Line of Credit Note.(12)
10.20	PNC Bank, N.A. Letter Agreement dated November 16, 2001.(11)
10.21	PNC Bank, N.A. Amended and Restated Committed Line of Credit Note dated November 16, 2001.(11)
10.22	PNC Bank, N.A. Amended and Restated Time Note dated November 16, 2001.(11)
10.23	PNC Bank, N.A. Pledge Agreement dated November 16, 2001.(11)
10.24	PNC Bank, N.A. Amended and Restated Security Agreement dated November 16, 2001.(11)
10.29	Registrant's amended and restated 1999 Equity Incentive Plan.(13)**
10.30	Securities Purchase Agreement dated as of March 16, 2004 (the "Securities Purchase Agreement") between the Company and the Purchasers signatory thereto.(14)

10.31	Registration Rights Agreement dated as of March 16, 2004 between the Company and the Purchasers signatory thereto.(14)
10.32	Form of Warrant to Purchase Common Stock issued to each Purchaser under the Securities Purchase Agreement.(14)
10.33	Manufacturing Supply and Distribution Agreement between Sonomed, Inc. and Ophthalmic Technologies, Inc. dated as of March 11, 2004.(15)
10.34	Supplemental Executive Retirement Benefit Agreement for Richard DePiano dated June 23, 2005.(16)**
10.35	Settlement Agreement with Intralase Corp, dated February 27, 2007.(*)
21	Subsidiaries.(11)
23.1	Consent of Independent Registered Public Accounting Firm.(*)
31.1	Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes Oxley Act of 2002.(*)
31.2	Certification of the Chief Financial Officer Section 302 of the Sarbanes Oxley Act of 2002.(*)
32.1	Certification of the Chief Executive Officer pursuant to Section 906 of the Sarbanes Oxley Act of 2002.(*)
32.2	Certification of the Chief Financial Officer pursuant to Section 906 of the Sarbanes Oxley Act of 2002.(*)

* Filed herewith.

** Management contract of compensatory plan.

(1) Filed as an exhibit to Pre-Effective Amendment No. 2 to the Company's Registration Statement on Form S-1 dated November 9, 1993 (Registration No. 33-69360).

(2) Filed as an exhibit to the Company's Form 10-KSB for the year ended June 30, 1994.

(3) Filed as an exhibit to the Company's Form 10-KSB for the year ended June 30, 1995.

(4) Filed as an exhibit to the Company's Registration Statement on Form S-3 dated January 20, 1998 (Registration No. 333-44513).

(5) Filed as an exhibit to the Company's Form 10-KSB for the year ended June 30, 1999.

(6) Filed as an exhibit to the Company's Form 8-K/A, dated March 31, 2000.

(7) Filed as an exhibit to the Company's Registration Statement on Form s-* dated February 25, 2000 (Registration No. 333-31138).

(8) Filed as an exhibit to the Company's Proxy Statement on Schedule 14A, as filed by the Company with the SEC on September 21, 2001.

(9) Filed as an exhibit to the Company's Form 10-KSB for the year ended June 30, 2001.

(10) Filed as an exhibit to the Company's Form 10-Q for the quarter ended March 31, 2001.

(11) Filed as an exhibit to the Company's Form 10-KSB/A for the year ended June 30, 2002.

(12) Filed as an exhibit to the Company's Form 10-Q for the quarter ended December 31, 2002.

(13) Filed as an exhibit to the Company's Form 10-Q for the quarter ended December 31, 2003.

(14) Filed as an exhibit to the Company's Registration Statement on Form s-3 dated April 8, 2004 (Registration No. 333-114332).

(15) Filed as an exhibit to the Company's Form 10-Q for the quarter ended March 31, 2004.

(16) Filed as an exhibit to the Company's Form 8-K, dated June 23, 2005.

SIGNATURES

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

Escalon Medical Corp.
(Registrant)

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

Dated: September 28, 2007

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

By: /s/ Richard J. DePiano Richard J. DePiano	Chairman and Chief Executive Officer (Principal Executive Officer) and Director	September 28, 2007
By: /s/ Robert M. O'Connor Robert M. O'Connor	Chief Financial Officer (Principal Financial Officer)	September 28, 2007
By: /s/ Anthony Coppola Anthony Coppola	Director	September 28, 2007
By: /s/ Jay L. Federman Jay L. Federman	Director	September 28, 2007
By: /s/ William L.G. Kwan William L.G. Kwan	Director	September 28, 2007
By: /s/ Lisa Napolitano Lisa Napolitano	Director	September 28, 2007
By: /s/ Fred Choate Fred Choate	Director	September 28, 2007

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

Form 10-K/A
(Amendment No. 2)

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

For the fiscal year ended June 30, 2007

☐ **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

ESCALON MEDICAL CORP.

(Name of small business issuer in its charter)

Pennsylvania	**33-0272839**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*

565 East Swedesford Road,
Suite 200,
Wayne, PA 19087
(Address of principal executive office's including zip code)

610 688-6830
(Issuer's telephone number)
Securities registered pursuant to section 12(b) of the Act:
None
Securities registered pursuant to section 12(g) of the Act:
Common Stock, $0.001 Par Value Per Share

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

Check whether the issuer is not required to file reports pursuant to Section 13 or 15(d) of the Exchange Act ☐

Check whether the issuer: (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 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 ☐

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-K contained in this form, and no discloser will be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☐

Indicate by check mark whether registrant is a shell company (as defined in Rule 12b-2 of the Securities Exchange Act of 1934). Yes ☐ No ☑

The revenues for the fiscal year ended June 30, 2007, the most recent fiscal year, were $38,838,000.

The aggregate market value of the common voting stock held by non-affiliates of the Registrant was approximately $25,228,000 as of September 20, 2007, based upon the closing sale price of the Common Stock as quoted on the NASDAQ Capital Market.

The number of shares of the Registrant's Common Stock outstanding as of September 20, 2007 is 6,386,857.

PART III.

Item 10. ***Directors and Executive Officers of the Registrant.***

EXECUTIVE OFFICERS OF THE COMPANY

Our executive officers are as follows:

Name	Age	Position
Richard J. DePiano	66	Chairman and Chief Executive Officer
Richard J. DePiano, Jr.	41	Chief Operating Officer and General Counsel
Robert M. O'Connor	46	Chief Financial Officer

Mr. DePiano has been a director of the Company since February 1996 and has served as Chairman and Chief Executive Officer of the Company since March 1997. Mr. DePiano has been the Chief Executive Officer of the Sandhurst Company, L.P. and Managing Director of the Sandhurst Venture Fund since 1986. Mr. DePiano also serves Chairman of the Board of Directors of PhotoMedex, Inc.

Mr. DePiano, Jr. was appointed Chief Operating Officer and General Counsel of the Company December 28, 2006. Mr. DePiano, Jr. joined the Company in November of 2000 as Vice President Corporate and Legal Affairs. Prior to joining Escalon, Mr. DePiano, Jr. worked with Forceno & Arangio, L.L.P., from September 1998 until November 2000 as a Senior Associate representing individual and business clients in various areas of the law including mergers and acquisitions, automotive dealership representation, family, small and emerging businesses, securities law, venture capital financing, consumer finance and general corporate and commercial matters. Prior to this Mr. DePiano, Jr. was in private law practice since 1992. He currently serves as 1st Vice President and as a member of the Board of Directors of the Delaware Valley Corporate Counsel Association ("DELVACCA"). Mr. DePiano, Jr. also serves as the Chairman of the Nominations Committee, Chairman of the Law School Initiative Committee and member of the Pro-Bono Committee of DELVACCA. He also is Vice Chairman of the Board of Directors of the Montgomery County Industrial Development Authority and is also a member of the Pennsylvania Bar Association.

Mr. O'Connor was appointed Chief Financial Officer of the Company on June 30, 2006. Mr. O'Connor joined Escalon Medical Corporation from BDO Seidman, LLP where he served as a senior manager from 2004. His prior experience includes both public and private accounting roles as a manager at PricewaterhouseCoopers, L.L.P. where he served in the middle market advisory services group from 1998 until 2000, and positions of controller and chief financial officer of Science Dynamics a manufacturer of high tech telecom equipment from 2000 until 2002 and Ianieri & Giampapa, LLC a certified public accounting firm from 2002 until 2004. Mr. O'Connor holds an MBA from Rutgers University — Graduate School of Management and a B.S. from Kean University. He is a certified public accountant and a member of the American Institute of Certified Public Accountants (AICPA).

DIRECTORS OF THE COMPANY

The election of our directors by our shareholders is governed by the Pennsylvania Business Corporation Law and our Bylaws. The following discussion summarizes these provisions and describes the process our Governance and Nominating Committee will follow in connection with the nomination of candidates for election as directors by the holders of our common stock.

GOVERNANCE AND NOMINATING PROCEDURES

Our Governance and Nominating Committee is responsible for recommending to the Board of Directors candidates to stand for election to the Board of Directors at the annual meeting. Our Governance and Nominating Committee will also consider director candidates recommended by shareholders in accordance with the advance notice procedures in Section 2.3 of our Bylaws. These procedures are described under "Shareholder Proposals" in this proxy statement. The Governance and Nominating Committee may also consider director candidates proposed by our management. We have not utilized third-party executive search firms to identify candidates for director.

With the exception of applicable rules of the SEC and the Nasdaq Stock MarketSM ("Nasdaq"), our Governance and Nominating Committee does not have any specific, minimum qualifications for candidates for election to our Board of Directors, and our Governance and Nominating Committee may take into account such factors as it deems appropriate. Our Governance and Nominating Committee examines the specific attributes of candidates for election to our Board of Directors and also considers the judgment, skill, diversity, business experience, the interplay of the candidate's experience with the experience of the other members of our Board of Directors and the extent to which the candidate would contribute to the overall effectiveness of our Board of Directors.

Our Governance and Nominating Committee will utilize the following process in identifying and evaluating candidates for election as members of our Board of Directors:

- Evaluation of the performance and qualifications of the members of our Board of Directors whose term of office will expire at the forthcoming annual meeting of shareholders and determination of whether they should be nominated for re-election.
- Consideration of the suitability of the candidates for election, including incumbent directors.
- Review of the qualifications of any candidates proposed by shareholders in accordance with our Bylaws, candidates proposed by management and candidates proposed by individual members of our Board of Directors.
- After such review and consideration, propose to the Board of Directors a slate of candidates for election at the forthcoming annual meeting of shareholders.

Nominees for Class I Name of Director	Director Since	Year Term Will Expire	Age	Principal Occupation During Past Five Years and Certain Directorships
William L.G. Kwan	1999	2009	66	Retired; Vice President of Business Development of Alcon Laboratories, Inc. a medical products company, from October 1996 to 1999, and Vice President of International Surgical Instruments from November 1989 to October 1999.
Anthony J. Coppola	2000	2009	70	Principal and operator of The Historic Town of Smithville, Inc., a real estate and commercial property company from 1988 to present; Retired Division President of SKF Industries, a manufacturing company, from 1963 to 1986.

Class II Name of Director	Director Since	Year Term Will Expire	Age	Principal Occupation During Past Five Years and Certain Directorships
Lisa A. Napolitano	2003	2007*	44	Tax Manager, Global Tax Management, Inc., a provider of compliance support services for both federal and state taxes, since 1998. Ms. Napolitano is a Certified Public Accountant in Pennsylvania.
Fred G. Choate	2005	2007*	61	Managing Member of Atlantic Capital Funding LLC from 2003 to present, Managing Member of Atlantic Capital Management LLC from 2004 to present; Baltic-American Enterprise Fund, Chief Investment Officer from 2003 to present; Managing Member of Greater Philadelphia Venture Capital Corp from 1992 to present. Mr. Choate has been a director of Parke Bank since 2003. Mr. Choate was formerly a director of Escalon Medical from 1998 to 2003.

Class III Name of Director	Director Since	Year Term Will Expire	Age	Principal Occupation During Past Five Years and Certain Directorships
Richard J. DePiano	1996	2008	66	Chairman and CEO of Escalon Medical Corp. since March 1997. CEO of the Sandhurst Company, L.P. and Managing Director of the Sandhurst Venture Fund since 1986; Chairman of the Board of Directors of PhotoMedex, Inc.
Jay L. Federman, M.D.	1996	2008	69	Dr. Federman is an ophthalmologist subspecialing in the management of vitro-retinal diseases. Dr. Federman's Directorships include the Research Department Wills Eye Hospital from 1987 to 1995. Chief of Department Ophthalmology of the Medical College of Pennsylvania from 1994 to 2004, Co-Director of Retina Service of Wills Eye Hospital from 1991 to 1999 and a Director of the Vitro-Retinal Research Foundation of Philadelphia. Chairman of the Board of Directors, of the Company from February 1996 to March 1997.

CORPORATE GOVERNANCE

The SEC and Nasdaq have adopted regulations and listing requirements that relate to our corporate governance. Our Board of Directors has adopted standards and practices in order to comply with those regulations that apply to us. The Company has adopted a Code of Ethics, which can be accessed on the Company's web site at www.escalonmed.com. Our independent directors meet at regularly scheduled meetings at which only independent directors are present.

Audit Committee

Our Audit Committee consists of Anthony J. Coppola, William L.G. Kwan and Lisa A. Napolitano, the audit committee's financial expert. The Committee met four times in 2007. Each member of the Audit Committee is independent within the meaning of the rules of Nasdaq and of the SEC. Consistent with the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley"), the Audit Committee has responsibility for:

- the selection of our independent public accountants;
- reviewing the scope and results of the audit;
- reviewing related-party transactions; and
- reviewing the adequacy of our accounting, financial, internal and operating controls.

Our Audit Committee operates pursuant to a written charter, the full text of which was attached to our proxy statement for our 2004 annual meeting and is available on our website.

SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the Securities Exchange Act of 1934 (the "Exchange Act") requires that our officers and directors, as well as persons who own 10% or more of a class of our equity securities, file reports of their ownership of our securities, as well as statements of changes in such ownership, with us and the Securities Exchange Commission (the "SEC"). Based upon written representations received by us from our officers, directors and 10% or greater shareholders, and our review of the statements of beneficial ownership changes filed with us by our officers, directors and 10% or greater shareholders during fiscal 2007, all filing requirements applicable to our officers and directors were complied with.

Item 11. *Executive Compensation*

Compensation Discussion and Analysis

Introduction

The compensation committee of our board of directors, or our compensation committee, oversees our compensation and policies, our compensation levels, including reviewing and approving equity awards to our executive officers, and reviews and recommends annually for approval by our board of directors all compensation decisions relating to our executive officers.

Our compensation committee believes that the primary objectives of our compensation programs for our executive officers are to:

- attract and retain talented and dedicated executive officers who contribute to our growth, development and profitability and to encourage them to remain with us for many years;
- motivate our executive officers to achieve our strategic business objectives and to reward them when they achieve those objectives; and
- provide long-term compensation to our executive officers that rewards our executive officers for sustained financial and operating performance and leadership excellence.

To achieve these objectives, we compensate our executive officers through a combination of base salary, annual cash bonuses, car allowance and long-term equity compensation.

Our compensation committee is comprised entirely of independent directors in accordance with NASDAQ standards and the director independence criteria established by our corporate governance guidelines.

Our compensation committee's charter reflects these responsibilities, and the compensation committee and our board of directors reviews the charter annually.

Our Compensation Philosophy and Objectives

The most significant component of the compensation policy administered by our compensation committee is that a substantial portion of the aggregate annual compensation of our named executive officers should be based on our annual financial results, our overall sales, growth and our profitability. Our compensation committee also evaluates the achievement of our other corporate objectives and the contribution of each named executive officer to those achievements.

We rely on our judgment in making compensation decisions after reviewing our performance and the performance of our executives based on financial and operational objectives. We do not retain the services of any compensation consultants. Our named executive officers, Richard DePiano, Sr. and Robert O'Connor, do have employment, severance and change-of-control agreements. (See Employment Agreement below)

For a number of years, we have maintained a cash incentive compensation program for our officers, including our named executive officers. The amount of the bonus is dependent upon several factors listed below including our financial results, sales growth and our profitability. Our compensation committee does not assign specific weights to these factors.

The Compensation of Our Officers

Our officers receive the following types of compensation:

- *Base Salary.* The base salaries of our officers, including our named executive officers, are established based on the scope of their responsibilities and the recommendation of our chief executive officer to our compensation committee for other than his own compensation. Our compensation committee reviews the base salaries of our named executive officers annually, including our chief executive officer, and adjusts those salaries annually after taking into account individual responsibilities, performance, length of service with us, current salary, experience and compensation history as well as our results of operations.

- *Annual Cash Bonus.* Our officers, including our named executive officers, receive annual cash bonuses based on our financial results, overall sales growth and profitability. Our compensation committee then recommends to our board of directors the percentage of the maximum amount to be allocated among our officers, including our named executive officers, on a discretionary basis. Our chief executive officer submits recommended bonus allocations for our officers, including our named executive officers other than himself, to our compensation committee, which reviews his recommendations and then establishes the annual bonus allocations for our officers and reports its decisions to our board of directors. The annual cash bonuses approved by our compensation committee are paid in a single installment following the completion of a particular fiscal year.

- *Long-Term Equity Incentives.* We believe that we can maximize our long-term performance best when the performance of our officers is motivated by equity-based awards that provide value based on our long-term performance. We have designed our long-term equity compensation plans to provide all of the members of our management, including our named executive officers, with equity incentives to foster the alignment of the interests of our officers with the interests of our stockholders. Our equity-based compensation plans provide the principal method by which our officers can acquire ownership of our common stock.

The primary form of equity compensation that we have historically awarded to our officers, including our named executive officers, is stock options. Our compensation committee receives preliminary recommendations for periodic stock option grants from our chief executive officer for our officers other than himself. Our compensation committee then recommends stock option grants for all of our officers, including our chief executive officer, for approval by our board of directors.

We have stock option plans that authorize us to grant options to purchase shares of our common stock to our employees, officers and directors. We have consistently followed the practice of granting stock options at an exercise price of the closing price of our common stock on NASDAQ on the date of grant.

The Operation of Our Compensation Process

Our compensation committee recommends all compensation and equity awards to our executive officers for final discretionary action by our board of directors. Our compensation committee, in recommending the annual compensation of our officers, including our named executive officers, to be established by our board of directors, reviews the performance and compensation of our officers. In assessing the performance of our named executive officers in relation to the objectives established by our board of directors, our compensation committee reviews specific achievements associated with attainment of the objectives, the degree of difficulty of the objectives and the extent to which significant unforeseen obstacles or favorable circumstances affected their performance.

Our compensation committee recommends to our board of directors the base salaries, annual aggregate bonus amount and stock option grants to the members of our management. As part of its oversight of the compensation of

our named executive officers, our compensation committee recommended the following compensation adjustments for 2007 for our named executive officers:

- increases in base salaries of our named executive officers in 2007 that averaged 2.7% which our compensation committee considered an adjustment consistent with published information about CPI increases in the United States in 2007;
- increases in individual bonus represented an increase which our compensation committee regarded as appropriate recognition of our named executives performance across a combination of qualitative and quantitative objectives during the performance period, and
- continued grants of stock options at exercise prices at which we would be prepared to sell our common stock in the event we were to determine to raise additional capital because our compensation committee believes that our history of stock option grants has in fact been successful in motivating our named executive officers to achieve superior performance.

Insert Tax Matters

EXECUTIVE COMPENSATION

The following table shows the compensation paid during each of the three fiscal years ended June 30, 2007 for services rendered in all capacities to our Chief Executive Officer, our Chief Financial Officer and our other most highly compensated executive officer whose compensation exceeded $100,000 in the fiscal year ended June 30, 2007.

SUMMARY COMPENSATION TABLE

Name and Principal Position	Year	Salary	Bonus	Stock Awards	Option Awards	Non-Equity Incentive Plan Compensation	Change in Pension Value and Nonqualified Deferred Compensation Earnings	all Other Compensation	Total
Richard J. Depiano . . . . . Chairman and Chief Executive Officer	2007	$317,700	$250,000	$—	$23,207	$—	$—	$9200(1)	590,907
Richard J. Depiano, Jr . . . . . Chief Operating Officer and General Counsel	2007	$127,200	$ 80,000	$—	$ 7,425	$—	$—	$ —	$214,625
Robert M. O'connor . . . . . Chief Financial Officer	2007	$200,000	$ 25,000	$—	$ —	$—	$—	$ —	$225,000

1) Includes payment by the Company of (i) in the case of Mr. DePiano, (a) an automobile allowance and (b) insurance premiums paid for life insurance.

The following table shows information with respect to options exercised during the year ended June 30, 2007 and held on June 30, 2007 by the persons named in the Summary Compensation Table and the status of their options at June 30, 2007.

OPTION EXERCISES AND STOCK VESTED

	Option Awards		Stock Awards	
Name	Number of Shares Acquired on Exercise	Value Realized Upon Exercise	Number of Shares Acquired on Exercise	Value Realized Upon Exercise
Richard J. Depiano . . . . . Chairman and Chief Executive Officer	—	$—	—	$—
Richard J. Depiano, Jr. . . . . Chief Operating Officer and General Counsel	—	$—	—	$—
Robert M. O'connor . . . . . Chief Financial Officer	—	$—	—	$—

No awards were made to any named executive officer during such fiscal year under any long-term incentive plan. The Company does not currently sponsor any defined benefit or actuarial plans.

Employment Agreement

On May 12, 1998, the Company entered into an employment agreement with Richard J. DePiano as the Chairman and Chief Executive Officer of the Company. The initial term of the employment agreement commenced on May 12, 1998 and continued through June 30, 2001. The employment agreement renews on July 1 of each year for successive terms of three years unless either party notifies the other party at least 30 days prior to such date of the notifying party's determination not to renew the agreement. The current base salary provided under the agreement, as adjusted for yearly cost of living adjustments, is $300,000 per year, and the agreement provides for additional incentive compensation in the form of a cash bonus to be paid by the Company to Mr. DePiano at the discretion of the Board of Directors. The agreement also provides for health and long-term disability insurance and other fringe benefits as well as an automobile allowance of $800 per month.

On June 23, 2005, the Company entered into a Supplemental Executive Retirement Benefit Agreement with Mr. DePiano. The agreement provides for the payment of supplemental retirement benefits to Mr. DePiano in the event of his termination of service Mr. DePiano with the Company under the following circumstances:

- If Mr. DePiano retires at age 65 or older, the Company is obligated to pay the executive $8,000 per month for life, with payments commencing the month after retirement. If Mr. DePiano were to die within a period of three years after such retirement, the Company would be obligated to continue making such payments until a minimum of 36 monthly payments have been made to the covered executive and his beneficiaries in the aggregate.
- If Mr. DePiano dies before his retirement, while employed by the Company, the Company would be obligated to make 36 monthly payments to his beneficiaries of $8,000 per month commencing in the month after his death.
- If Mr. DePiano were to become permanently disabled while employed by the Company, the Company would be obligated to pay the executive $8,000 per month for life, with payments commencing the month after he suffers such disability. If Mr. DePiano were to die within three years after suffering such disability, the Company would be obligated to continue making such payments until a minimum of 36 monthly payments have been made to the covered executive and his beneficiaries in the aggregate.
- If Mr. DePiano's employment with the Company is terminated by the Company, prior to him attaining age 65 or if he terminates his employment with the Company for good reason, as defined in the agreement, the Company would be obligated to pay him $8,000 per month for life. If Mr. DePiano were to die within a period of three years after such termination, the Company would be obligated to continue making such

payments until a minimum of 36 monthly payments have been made to him and his beneficiaries in the aggregate.

During the fourth quarter of fiscal 2005, we recorded as an expense in our Consolidated Statement of Income, $1,087,000, which represents the present value of the supplemental retirement benefits awarded.

As Chief Operating Officer and General Counsel, Mr. DePiano, Jr. received an annual salary of $127,300.

As Chief Financial Officer, Mr. O'Connor's annual base salary is $200,000. Mr. O'Connor has been granted stock options to purchase 60,000 shares of the Company's common stock, which are exercisable in full as of the June 30, 2006 grant date. The exercise price of these options is $5.05 per share. Mr. O'Connor pursuant to his offer letter will be entitled to a severance payment equal to his annual base salary and an increase of his annual base salary to $250,000 in connection with a change of control.

Section 162(m) of the Code generally does not allow us a deduction for federal income tax purposes to the extent that we pay annual compensation to any of our executive officers named in the Summary Compensation Table in this proxy statement that is in excess of $1 million. However, compensation paid to such an executive officer that is paid pursuant to a performance-based plan is generally not subject to the Section 162(m) limitation. Although our compensation committee is aware of the Section 162(m) limitation, our compensation committee believes that it is equally important to maintain flexibility and the competitive effectiveness of the compensation of our named executive officers. Our compensation committee may, therefore, from time to time, authorize compensation that is not deductible for federal income tax purposes if our compensation committee believes it is in our best interests and the best interests of our stockholders to do so.

DISCUSSION OF ELEMENTS OF COMPENSATION

Salary. Salaries for named executive officers are determined based on a variety of factors, including the executive's scope of responsibilities. Salaries are reviewed for our named executive officers once each year, and may be adjusted after considering the below factors and the named executive officer's performance.

Annual Cash Bonus. In fiscal year 2007, named executive officers had the opportunity to earn a cash bonus. Bonuses are provided to reward achieving business results against individual annual performance commitments and to deliver cash as part of an overall compensation package that is competitive in the marketplace.

The Compensation Committee determines bonuses in its discretion based on performance across a combination of qualitative and quantitative objectives during the performance period. Working with our chief executive officer, each named executive officer establishes these objectives annually. The chief executive officer establishes his goals in consultation with the Board. The goals used to determine bonuses vary for each executive based on his responsibilities and may include financial or strategic measures, including:

- revenue,
- profitability,
- innovation,
- product development and implementation,
- quality,
- customer satisfaction,
- customer acceptance,
- organizational and leadership,
- strategic planning and development,
- operations excellence, and
- efficiency and productivity.

For named executive officers other than the chief executive officer, the chief executive officer recommends individual bonus payments based on the executive's performance against his goals for the year. The Compensation Committee considers the recommendations and makes a final decision on the bonus payments.

For Mr. DePiano, the Compensation Committee recommends a bonus payment to the independent members of the Board. In making this recommendation, the Compensation Committee considers the performance evaluation of Mr. DePiano. The Board considers the Committee's recommendation and Mr. DePiano's performance evaluation in determining the bonus for Mr. DePiano.

Report of Our Compensation Committee

The following report of our compensation committee does not constitute proxy solicitation material and shall not be deemed filed or incorporated by reference into any of our filings under the Securities Act or the Exchange Act, except to the extent that we specifically incorporate this compensation committee report by reference therein.

Our compensation committee held a joint meeting with the board of directors of the company. The committee reviewed and discussed the compensation discussion and analysis that appears under the caption "Executive Compensation" with management.

Based on the review and discussion by our compensation committee with management, the members of our compensation committee then held a meeting at which they recommended to our board of directors that our board of directors approve the inclusion of the compensation disclosure and analysis set forth in this 10-K/A under the caption "Executive Compensation" for filing with the SEC report on Form 10-K/A for the year ended June 30, 2007 for filing with the SEC.

Lisa A. Napolitano
William L.G. Kwan
Anthony J. Coppola

October 29, 2007

COMPENSATION OF DIRECTORS

None of the Company's directors were paid any directors fees by the Company during the fiscal year ended June 30, 2007. Historically each non-employee director was issued stock options to purchase 10,000 shares of the Company's common stock. This year the Board discussed various alternatives to the issuance of stock options and has charged the Compensation Committee to present a report concerning directors' fees. Directors are reimbursed for expenses incurred in connection with attending meetings of the Board and Board Committees.

DIRECTOR COMPENSATION

Name	Fees Earned or Paid in Cash	Stock Awards	Option Awards	Non-Stock Incentive Plan Compensation	Change in Pension Value and Nonqualified Deferred Compensation Earnings	All Other Compensation	Total
William L.G. Kwan	$—	$—	$24,754	$—	$—	$—	$24,754
Anthony J. Coppola	$—	$—	$24,754	$—	$—	$—	$24,754
Lisa A. Napolitano	$—	$—	$24,754	$—	$—	$—	$24,754
Fred G. Choate	$—	$—	$24,754	$—	$—	$—	$24,754
Richard J. Depiano	$—	$—	$ —	$—	$—	$—	$ —
Jay L. Federman, M.D.	$—	$—	$24,754	$—	$—	$—	$24,754

The following table details grants of plan based awards for the fiscal year ended June 30, 2007:

GRANTS OF PLAN-BASED AWARDS

Name	Grant Date	Estimated Future Payouts Under Non-Equity Incentive Plan Awards: Thresold	Target	Maximum	Estimated Future Payouts Under Non-Equity Incentive Plan Awards: Thresold	Target	Maximum	All Other Stock Awards: Number of Shares of Stock or Units	All Other Options Awards: Number of Securities Underlying Options	Exercise or Base Price of Option Awards	Grant Date Fair Value of Stock and Option Awards
Richard J. Depiano. . . . . Chairman and Chief Executive Officer	2007	$—	$—	$—	$—	$—	$—	—	25,000	$2.65	$61,886
Richard J. Depiano, Jr. . . . . Chief Operating Officer and General Counsel	2007	$—	$—	$—	$—	$—	$—	—	20,000	$2.65	$49,509
Robert M. O'connor . . . . . Chief Financial Officer	2007	$—	$—	$—	$—	$—	$—	—	—	$ —	$ —

The following table the outstanding equity awards as of June 30, 2007:

OUTSTANDING EQUITY AWARDS AT FISCAL YEAR-END TABLE

	Option Awards					Stock Awards			
Name	Number of Securities Underlying Unexercised Options: Exercisable	Unexercisable	Plan Incentive Plan Awards: Number of Securities Underlying Unexercised Unearned Options	Option Exercise Price	Option Expiration Date	Number of Stock Shares or Units of Stock that have not Vested	Market Value of Shares or Units of Stock that have not Vested	Equity Incentive Plan Awards: Number of Unearned Shares, Units or Other Rights that have not Vested	Equity Incentive Plan Awards: Market or Payout Value of Unearned Shares, Units or Other Rights that have not Vested
Richard J. Depiano.	41,480	—	—	$2.13	8/12/2008	—	—	—	—
Chairman and Chief	45,000	—	—	$2.38	11/1/2010	—	—	—	—
Executive Officer	50,000	—	—	$2.77	11/1/2011	—	—	—	—
	10,417	—	—	$1.45	8/13/2012	—	—	—	—
	25,000	—	—	$6.94	11/10/2013	—	—	—	—
	25,000	—	—	$6.19	8/17/2014	—	—	—	—
	40,000	—	—	$8.06	8/16/2015	—	—	—	—
	7,600	12,400	12,400	$2.65	11/9/2016	—	—	—	—
Richard J. Depiano, Jr.	700	—	—	$2.38	11/2/2010	—	—	—	—
Chief Operating Officer	1,100	—	—	$2.77	11/1/2011	—	—	—	—
and General Counsel	3,567	—	—	$1.45	8/13/2012	—	—	—	—
	10,000	—	—	$6.94	11/10/2013	—	—	—	—
	25,000	—	—	$6.19	8/17/2014	—	—	—	—
	20,000	—	—	$8.06	8/16/2015	—	—	—	—
	3,000	17,000	17,000	$2.65	11/9/2016	—	—	—	—
Robert M. O'Connor . . . . . Chief Financial Officer	60,000	—	—	$5.05	6/29/2016	—	—	—	—

Item 12. ***Security Ownership of Certain Beneficial Owners and Management and Related Shareholder Matters***

SECURITIES AUTHORIZED FOR ISSUANCE UNDER EQUITY COMPENSATION PLANS

STOCK OWNERSHIP

The following table shows the amount and percentage of our outstanding common stock beneficially owned by each director, each nominee for director, each executive officer named in the Summary Compensation Table, persons or groups who beneficially own more than 5% of our outstanding common stock and all of our executive officers and directors as a group as of September 30, 2007.

BENEFICIAL OWNERSHIP TABLE

Name and Address of 5% Beneficial Owners and Officers, Directors and Group	Amount of Beneficial Ownership of Outstanding Shares(1)	Percent of Class	Amount of Beneficial Ownership of Shares Underlying Options	Amount of Aggregate Beneficial Ownership	Aggregate Percent of Class
Richard J. DePiano	144,278	2.27%	236,897	381,175	5.87%
Fidelity Management & Research Co.	585,100	9.16%	—	585,100	9.16%
Barclays Global Investors, N.A.	383,072	6.0%			
Richard J. DePiano, Jr.	206	—	60,367	60,573	.95%
Robert O'Connor	—		60,000	60,000	.94%
Jay L. Federman, MD	12,072	0.19%	45,000	57,072	0.89%
William L. Kwan	—	0.00%	50,000	50,000	0.78%
Fred G. Choate	—	0.00%	10,000	10,000	0.16%
Anthony J. Coppola	—	0.00%	25,000	25,000	0.39%
Lisa A. Napolitano	—	0.00%	22,000	22,000	0.34%
All Directors and executive officers As a group (7 persons)	144,484	2.26%	557,264	701,748	10.99%

* Less than 1%

(1) Information furnished by each individual named. This table includes shares that are owned jointly, in whole or in part with the person's spouse, or individually by his or her spouse.

No shares held by the board of directors or named executive officers are pledged.

The following table shows Securities authorized for issuance under equity compensation plans.

EQUITY COMPENSATION PLAN INFORMATION

Plan Category	Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights (a)	Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights (b)	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected N Column (a)) (c)
Equity compensation plans approved by security holders	920,685	$5.728	360,667
Equity compensation plans not approved by security holders	120,000	$15.60	-0-
Total	1,040,685		360,667

Item 13. ***Certain Relationships and Related Transactions, and Director Independence.***

Related Person Transactions

We recognize that related person transactions present a heightened risk of conflicts of interest and can create the appearance of a conflict of interest. Therefore, all proposed related person transactions are disclosed to the board of directors before we enter into the transaction, and, if the transaction continues for more than one year, the continuation is reviewed annually by the board of directors.

Escalon and a member of the Company's Board of Directors are founding and equal members of Ocular Telehealth Management, LLC ("OTM"). OTM is a diagnostic telemedicine company providing remote examination, diagnosis and management of disorders affecting the human eye. OTM's initial solution focuses on the diagnosis of diabetic retinopathy by creating access and providing annual dilated retinal examinations for the diabetic population. OTM was founded to harness the latest advances in telecommunications, software and digital imaging in order to create greater access and a more successful disease management for populations that are susceptible to ocular disease. Through June 30, 2007, Escalon had invested $288,000 in OTM and owned 45% of OTM. The members of OTM have agreed to review the operations of OTM after 24 months of operations which began in April 2004, at which time the members each have the right to sell their membership back to OTM at fair market value. Such sale would be subject to OTM's ability to buy back the membership. The members met in May 2006 and decided to continue the operations of OTM, emphasizing that all additional funding will be provided pro-rata consistent with membership percentage ownership. The Company will provide administrative support functions to OTM. For the years ended 2007, 2006 and 2005 the Company recorded losses of $87,852, $173,844 and $63,613, respectively.

Two relatives of a senior executive officer have provided legal services as either an employee or a consultant to the Company. Richard DePiano, Jr. (son of the Chief Executive Officer ("CEO")) is Chief Operating Officer and General Counsel to the Company, Mr. DePiano's salary plus bonus for the years 2007, 2006 and 2005 were approximately $185,000, $180,000 and $165,000, respectively. Caryn Lindsey (daughter-in-law of the CEO) acted as a consultant and employee for the Company during 2006 and 2005. Ms. Lindsey in 2007, 2006 and 2005 received consulting fees and salary of $0, $110,939 and $118,000, respectively. Also, in 2005 3,000 options to purchase common stock of the Company at an exercise price of $4.97 per share were granted to Ms. Lindsey.

Item 14. ***Principal Accounting Fees and Services.***

Audit Fees. Mayer Hoffman McCann, our independent public accountants, billed us $147,500 and $106,300 in total for the fiscal years ended June 30, 2007 and 2006, respectively in connection with the audit of our annual consolidated financial statements.

Audit Related Fees. We did not pay any audit related fees to Mayer Hoffman McCann during fiscal years ended June 30, 2007 and 2006.

Tax Fees. We did not pay any fees to Mayer Hoffman McCann for tax services during the fiscal years ended June 30, 2007 and 2006.

All Other Fees. We did not pay any fees to Mayer Hoffman McCann for all other services during the fiscal years ended June 30, 2007 and 2006.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this Amendment No. 1 to be signed on its behalf by the undersigned, thereunto duly authorized.

Escalon Medical Corp.
(Registrant)

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

Dated: October 29, 2007

INVESTOR INFORMATION

CORPORATE OFFICE

Headquarters
Escalon Medical Corp.
565 East Swedesford Road
Suite 200
Wayne, Pennsylvania 19087
(610) 688-6830

Manufacturing Operations
Escalon Medical Corp.
2440 South 179th Street
New Berlin, WI 53146
(262) 821-9182

Sonomed, Inc.
1979 Marcus Avenue
Suite C105
Lake Success, NY 11042
(516) 354-0900

Drew Scientific Inc.
Unit 4
Peter Green Way
Furness Enterprise Park
Barrow in Furness
Cumbria LA14 2PE
United Kingdom
1229 432089

4230 Shilling Way
Dallas, TX 75237
(214) 210-4900

2056 Thomaston Avenue
Oxford, CT 06478
(203) 267-7022

STOCK LISTING

Nasdaq Capital Market
Market System
Trading Symbol: ESMC

INDEPENDENT AUDITORS

Mayer, Hoffman Mc Cann, P.C.
Plymouth Meeting, Pennsylvania

GENERAL COUNSEL

Duane Morris LLP
Philadelphia, Pennsylvania

TRANSFER AGENT AND REGISTRAR

American Stock Transfer and Trust Company
Brooklyn, New York
(800) 937-5449

ANNUAL MEETING

November 28, 2008, 9:00 am
Duane Morris LLP
30 South 17th Street
Philadelphia, Pennsylvania

FORM 10-K and 10-K/A No. 2

The Form 10-K and 10-K/A No. 2 contained herein, for the Company's fiscal year ended June 30, 2007, is not accompanied by the exhibits, which were filed with the Securities and Exchange Commission. The Company will furnish any exhibits to those shareholders who request the same upon payment to the Company of its reasonable expenses in furnishing such exhibits. Requests for any such exhibits should be made in writing to the Company's Secretary at its corporate office.

DIRECTORS AND OFFICERS

DIRECTORS

Richard J. DePiano
Chairman and
Chief Executive Officer
Escalon Medical Corp.

Jay L. Federman, M.D.
Associated Retinal
Consultants
Bala Cynwyd Pennsylvania

Fred G. Choate
Atlantic Capital Funding LLC
Wayne, Pennsylvania

William L. G. Kwan
Fort Worth, Texas

Anthony J. Coppola
Town of Historic Smithville, LLC
Smithville, New Jersey

Lisa A. Napolitano
Global Tax Management
Newtown Square, Pennsylvania

CORPORATE OFFICERS

Richard J. DePiano
Chairman and
Chief Executive Officer

Robert M. O'Connor
Chief Financial Officer

Richard J. DePiano, Jr.
Chief Operating Officer

The Company has adopted a code of ethics which can be viewed at www.escalonmed.com

SAFE HARBOR STATEMENT

This report includes forward-looking statements about the Company's future growth, product development, regulatory filings, potential joint venture arrangements, potential markets and competitive position. Any such statements are subject to risks and uncertainties that could cause the actual results to vary materially. Such risks are discussed in the Company's report on Form 10-K and 10-K/A No. 2 for its 2007 fiscal year.

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DREW

Escalon Medical Corp.
565 East Swedesford Road Suite 200
Wayne, PA 19087
Voice: 610.688.6830
Fax: 610.688.3641
www.escalonmed.com