ESCALON MEDICAL CORP
Form 10QSB
May 15, 2006

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

FORM 10-QSB

[X] Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended March 31, 2006.

[ ] Transition report pursuant to Section 13 or 15(d) of the securities Exchange Act of 1934 for the transitional period from _________ to __________.

Commission File Number 0-20127

ESCALON MEDICAL CORP.
(Exact name of small business issuer as specified in its charter)

PENNSYLVANIA	33-0272839
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

565 EAST SWEDESFORD ROAD, SUITE 200
WAYNE, PA 19087
(Address of principal executive offices)

(610) 688-6830
(Issuer's telephone number)

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

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

At April 28, 2006, 6,344,670 shares of common stock were outstanding.

Transitional Small Business Disclosure format. Yes [ ] No [X]

ESCALON MEDICAL CORP.
FORM 10-QSB QUARTERLY REPORT

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PART I. FINANCIAL STATEMENTS

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

ESCALON MEDICAL CORP. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

	MARCH 31, 2006 (UNAUDITED)	JUNE 30, 2005
ASSETS		
Current assets:		
Cash and cash equivalents	$ 3,154,427	$ 5,115,772
Available for sale securities	69,600	1,207,317
Accounts receivable, net	5,180,361	4,752,310

Inventory, net	6,576,841	5,856,285
Notes receivable	500,000	100,000
Other current assets	225,940	633,214
TOTAL CURRENT ASSETS	15,707,169	17,664,898
Furniture and equipment, net	990,800	911,700
Goodwill	21,253,187	20,166,450
Trademarks and trade names, net	620,106	616,906
Patents, net	337,718	402,814
Other intangibles	267,925	0
Other assets	369,152	286,568
TOTAL ASSETS	$ 39,546,057	$ 40,049,336
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term debt	$ 243,957	$ 230,344
Accounts payable	1,694,137	1,135,680
Accrued expenses	2,176,494	2,685,670
TOTAL CURRENT LIABILITIES	4,114,588	4,051,694
Long-term debt, net of current portion	224,729	391,793
Accrued post-retirement benefits	1,087,000	1,087,000
TOTAL LIABILITIES	5,426,317	5,530,487
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; 6,344,670 and 5,963,477 issued and outstanding at March 31, 2006 and June 30, 2005, respectively	6,345	5,964
Common stock warrants	1,601,346	1,601,346
Additional paid-in capital	65,699,370	63,898,190
Retained earnings	(32,980,166)	(32,136,487)
Accumulated other comprehensive (loss) income	(207,155)	1,149,836
TOTAL SHAREHOLDERS' EQUITY	34,119,740	34,518,849
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 39,546,057	$ 40,049,336

See notes to condensed consolidated financial statements

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

	THREE MONTHS ENDED MARCH 31,		NINE MONTHS ENDE MARCH 31,	
	2006	2005	2006	20

NET REVENUES:				
Product revenue	$7,286,704	$6,246,836	$20,895,553	$16,64
Other revenue	553,054	982,241	1,687,365	2,23
REVENUES, NET	7,839,758	7,229,077	22,582,918	18,88
COSTS AND EXPENSES:				
Cost of goods sold	4,382,268	2,998,745	12,010,652	9,01
Research and development	717,920	463,808	2,135,950	1,25
Marketing, general and administrative	3,283,722	2,938,673	10,395,612	8,05
TOTAL COSTS AND EXPENSES	8,383,910	6,401,226	24,542,214	18,32
(LOSS) INCOME FROM OPERATIONS	(544,152)	827,851	(1,959,296)	55
OTHER (EXPENSE) AND INCOME:				
Gain on sale of available for sale securities	0	0	1,157,336	
Equity in Ocular Telehealth Management, LLC	(18,508)	(13,632)	(69,972)	(4
Interest income	33,974	9,166	111,698	5
Interest expense	(27,515)	(15,915)	(47,421)	(4
TOTAL OTHER (EXPENSE) AND INCOME	(12,049)	(20,381)	1,151,641	(3
NET (LOSS) INCOME BEFORE TAXES	(556,201)	807,470	(807,655)	51
Provision for income taxes	20,024	63,912	36,024	8
NET (LOSS) INCOME	$ (576,225)	$ 743,558	$ (843,679)	$ 43
BASIC NET (LOSS) INCOME PER SHARE	$ (0.092)	$ 0.125	$ (0.138)	$
DILUTED NET (LOSS) INCOME PER SHARE	$ (0.092)	$ 0.119	$ (0.138)	$
WEIGHTED AVERAGE SHARES - BASIC	6,255,665	5,932,920	6,091,938	5,78
WEIGHTED AVERAGE SHARES - DILUTED	6,255,665	6,251,847	6,091,938	6,23

See notes to condensed consolidated financial statements

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

	NINE MONTHS ENDED MARCH 31,	
	2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net (loss) income	$ (843,679)	$ 432,408
Adjustments to reconcile net (loss) income to net cash (used in) operating activities:		
Depreciation and amortization	338,829	316,913
Abandonment of leashold improvement	0	11,057

Gain on sale of available for sale securities	(1,157,336)	0
Loss on Ocular Telehealth Management, LLC	69,972	49,942
Change in operating assets and liabilities:		
Accounts receivable, net	(428,051)	(750,816)
Inventory, net	(795,026)	(1,377,461)
Other current and long-term assets	38,087	(340,351)
Accounts payable, accrued and other liabilities	24,281	(826,531)
NET CASH (USED IN) OPERATING ACTIVITIES	(2,752,923)	(2,484,839)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of Drew, net of cash acquired	0	(936,238)
Purchase of MRP	(47,060)	0
Proceeds from the sale of available for sale securities	1,157,336	0
Investment in Ocular Telehealth Management, LLC	0	(256,000)
Purchase of distribution rights	(181,856)	0
Purchase of fixed assets	(295,027)	(98,990)
NET CASH PROVIDED BY/(USED IN) INVESTING ACTIVITIES	633,393	(1,291,228)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Line of credit borrowing	0	(1,907,948)
Line of credit repayment	0	(4,374,481)
Principal payments on term loans	(153,451)	0
Issuance of common stock - stock options	296,254	29,782
NET CASH PROVIDED BY/(USED IN) FINANCING ACTIVITIES	142,803	(6,252,647)
Effect of exchange rate changes on cash and cash equivalents	15,381	(58,465)
NET (DECREASE) IN CASH AND CASH EQUIVALENTS	(1,961,345)	(10,087,179)
Cash and cash equivalents, beginning of period	5,115,772	12,601,971
Cash and cash equivalents, end of period	$ 3,154,427	$ 2,514,792
SUPPLEMENTAL SCHEDULE OF CASH FLOW INFORMATION:		
Interest paid	$ 47,121	$ 234,781
Income taxes paid	$ 43,460	$ 394,469
Issuance of common stock for Drew acquisition	$ 0	$ 7,190,355
Issuance of common stock for MRP acquisition	$ 1,427,500	$ 0
(Decrease)/increase in unrealized appreciation on available for sale securities	$(1,137,717)	$ 4,227,436

See notes to condensed consolidated financial statements

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ESCALON MEDICAL CORP. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY
FOR THE NINE MONTHS ENDED MARCH 31, 2006
(UNAUDITED)

	COMMON STOCK SHARES	COMMON STOCK AMOUNT	COMMON STOCK WARRANTS	ADDITIONAL PAID-IN CAPITAL	ACCUMULATED DEFICIT
BALANCE AT JUNE 30, 2005	5,963,477	$5,964	$1,601,346	$63,898,190	$(32,136,487)
Net (loss)		0	0	0	(843,679)
Exercise of stock options	131,193	131	0	296,123	0
Purchase of assets of MRP	250,000	250		1,427,250	
Income tax benefit from exercise of stock options				77,807	
Change in unrealized gains on available for sale securities		0	0	0	0
Foreign currency translation		0	0	0	0
BALANCE AT MARCH 31, 2006	6,344,670	$6,345	$1,601,346	$65,699,370	$(32,980,166)

See notes to condensed consolidated financial statements

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

	THREE MONTHS ENDED MARCH 31,		NINE MONTHS ENDED MARCH 31,	
	2006	2005	2006	2005
Net income (loss)	$(576,225)	$ 743,558	$ (843,679)	$ 432,408
Change in unrealized gains on available for sale securities	16,110	(1,702,086)	(1,137,716)	4,227,436
Foreign currency translation	(127,340)	(28,480)	(219,324)	(83,683)
COMPREHENSIVE (LOSS) INCOME	$(687,455)	$ (987,008)	$(2,200,719)	$4,576,161

See notes to condensed consolidated financial statements

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

1. BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements include the accounts of Escalon Medical Corp. and its subsidiaries, collectively referred to as "Escalon" or the "Company." Escalon's subsidiaries include Sonomed, Inc. ("Sonomed"), Escalon Vascular Access, Inc. ("Vascular"), Escalon Medical Europe GmbH ("EME"), Escalon Digital Vision, Inc. ("EMI"), Escalon Pharmaceutical, Inc. ("Pharmaceutical"), Escalon Holdings, Inc. ("EHI") and Drew Scientific Group, Plc ("Drew"), including 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") or other regulatory authorities. The FDA requires extensive testing of new products prior to sale and has jurisdiction over the safety, efficacy and manufacture of products, as well as product labeling and marketing.

The accompanying condensed consolidated financial statements are unaudited and are presented pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC"). Accordingly, these consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto contained in the Company's 2005 Annual Report on Form 10-K under the Securities Exchange Act of 1934 (the "Exchange Act"). In the opinion of management, the accompanying consolidated financial statements reflect all adjustments (which are of a normal recurring nature) necessary for a fair presentation of the financial position, results of operations and cash flows for the interim periods presented. The results of operations are not necessarily indicative of the results that may be expected for the full year.

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

2. ACQUISITIONS

DREW ACQUISITION

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 since that date has acquired all of the Drew shares. 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.

	THREE MONTHS ENDED MARCH 31,		NINE MONTHS ENDED MARCH 31,	
	2006	2005	2006	2005
Revenues, net	$7,839,758	$7,229,077	$22,582,918	$18,882,726
Cost of goods sold	4,382,268	2,998,745	12,010,652	9,019,701

GROSS PROFIT	3,457,490	4,230,332	10,572,266	9,863,025
Operating expenses	4,001,642	3,402,481	12,531,562	9,307,810
Other (expense) and income	(12,049)	(20,381)	1,151,641	(38,869)
NET (LOSS) INCOME BEFORE TAXES	(556,201)	807,470	(807,655)	516,346
Provision for income taxes	20,024	63,912	36,024	83,938
NET (LOSS) INCOME	$ (576,225)	$ 743,558	$ (843,679)	$ 432,408
BASIC NET (LOSS) INCOME PER SHARE	$ (0.092)	$ 0.125	$ (0.138)	$ 0.075
DILUTED NET (LOSS) INCOME PER SHARE	$ (0.092)	$ 0.119	$ (0.138)	$ 0.069
WEIGHTED AVERAGE SHARES - BASIC	6,255,665	5,932,920	6,091,938	5,787,753
WEIGHTED AVERAGE SHARES - DILUTED	6,255,665	6,251,847	6,091,938	6,238,515

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 $1,086,737. 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.

3. STOCK-BASED COMPENSATION

The Company reports 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 effect on net income and earnings per share if the Company had applied the fair value recognition provisions of SFAS 123.

	THREE MONTHS ENDED MARCH 31,		NINE MONTHS ENDED MARCH 31,	
	2006	2005	2006	200
Net (loss) income, as reported	$(576,225)	$743,558	$ (843,679)	$ 432,
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(288,848)	(75,442)	(1,077,870)	(435,
PRO FORMA NET (LOSS) INCOME	$(865,073)	$668,116	$(1,921,549)	$ (3,3
(LOSS) EARNINGS PER SHARE:				
BASIC - AS REPORTED	$ (0.092)	$ 0.125	$ (0.138)	$ 0.
BASIC - PRO FORMA	$ (0.138)	$ 0.113	$ (0.315)	$ (0.
DILUTED - AS REPORTED	$ (0.092)	$ 0.119	$ (0.138)	$ 0.
DILUTED - PRO FORMA	$ (0.138)	$ 0.107	$ (0.315)	$ (0.

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 the 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 periods. No options were granted during the three-month period ending March 31, 2006.

In December 2004, the FASB issued SFAS No.123R ("SFAS No.123R") (revised 2004), "Share-Based Payments" SFAS No. 123R is a revision of SFAS No. 123 and supersedes ABP Opinion No. 25, which requires the Company to expense share-based payments, including employee stock options. With limited exceptions, the amount of compensation costs will be measured based on the grant date fair value of the equity or liability instrument issued. Compensation cost will be recognized over the period that the optionee provides service in exchange for the award. The Company is a small business issuer as defined in Item 10 of Regulation S-B. As a result, the Company will be required to adopt this standard in its fiscal year beginning July 1, 2006. The adoption of this standard for the expensing of stock options is expected to reduce pretax earnings in future periods. The impact of adoption of SFAS No. 123R cannot be predicted at this time because it will depend upon the level of share-based payments made in the future and the model the Company elects to utilize.

4. EARNINGS PER SHARE

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

	THREE MONTHS ENDED MARCH 31,		NINE MONTHS END MARCH 31,	
	2006	2005	2006	20
NUMERATOR:				
Numerator for basic and diluted earnings per share				
NET (LOSS) INCOME	$ (576,225)	$ 743,558	$ (843,679)	$ 43
DENOMINATOR:				
Denominator for basic earnings per share - weighted average shares	6,255,665	5,932,920	6,091,938	5,78
Effect of dilutive securities:				
Stock options and warrants	0	295,470	0	42
Shares reserved for future exchange	0	23,457	0	2
DENOMINATOR FOR DILUTED EARNINGS PER SHARE - WEIGHTED AVERAGE AND ASSUMED CONVERSION	6,255,665	6,251,847	6,091,938	6,23
BASIC (LOSS) EARNINGS PER SHARE	$ (0.092)	$ 0.125	$ (0.138)	$
DILUTED (LOSS) EARNINGS PER SHARE	$ (0.092)	$ 0.119	$ (0.138)	$

The impact of dilutive securities were omitted from the earnings per share calculation in 2006 as they would reduce the loss per share (anti-dilutive).

5. INVENTORY

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

	MARCH 31, 2006	JUNE 30, 2005
	(UNAUDITED)	
Raw materials	$4,000,651	$3,476,493
Work in process	805,877	473,252
Finished goods	2,061,981	2,073,208
	6,868,509	6,022,953

Valuation allowance	(291,668)	(166,668)
TOTAL INVENTORY	$6,576,841	$5,856,285

6. NOTES RECEIVABLE

Escalon entered into an agreement with an individual who was involved in the development of the Company's now discontinued Ocufit SR(R) drug delivery system. The Company holds a note receivable from the individual in the amount of $150,000 that was due in May 2005. The note was not paid when due, and the individual is currently in default. The Company intends to pursue collection, is currently evaluating collection alternatives and has recorded a $50,000 reserve based upon its current estimate of cost to pursue collection.

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 16). Anka is an early stage privately held company. Under the terms of this note, 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 note.

7. INTANGIBLE ASSETS

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 $237,754 and $188,649 at March 31, 2006 and June 30, 2005, respectively. Amortization expense for the three-month periods ended March 31, 2006 and 2005 was $25,652 and $26,478, respectively. Amortization expense for the nine-month periods ended March 31, 2006 and 2005 was $76,500 and $89,615, respectively.

The aggregate amortization expense for each of the next five years for patents is estimated to be approximately $70,000 per year for each of the next five fiscal years.

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 2). 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 $9,232 and $0 at March 31, 2006 and June 30, 2005, respectively. Amortization expense for the three and nine-month periods ended March 31, 2006 and 2005 was $9,232 and $0, respectively.

GOODWILL, TRADEMARKS AND TRADE NAMES

Goodwill, trademarks and trade names represent intangible assets obtained from Escalon Opthalmics ("EOI"), Endologix, Inc. ("Endologix"), Sonomed, MRP

(See note 2) and Drew acquisitions. Goodwill represents the excess of purchase price over the fair market value of net assets acquired.

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 unit. 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, will be recorded as a charge against income from operations.

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The following table presents unamortized intangible assets by business unit as of March 31, 2006 and June 30, 2005:

	MARCH 31, 2006 NET CARRYING AMOUNT	JUNE 30, 2005 NET CARRYING AMOUNT
	(UNAUDITED)	
GOODWILL		
Sonomed	$ 9,525,550	$ 9,525,550
Drew	9,574,655	9,574,655
Vascular	941,218	941,218
Medical/Trek/EMI	1,211,764	125,027
TOTAL	$21,253,187	$20,166,450

	MARCH 31, 2006 NET CARRYING AMOUNT	JUNE 30, 2005 NET CARRYING AMOUNT
	(UNAUDITED)	
UNAMORTIZED INTANGIBLE ASSETS		
Sonomed	$616,906	$616,906
Medical/Trek/EMI	3,200	0
TOTAL	$620,106	$616,906

The following table presents amortized intangible assets by business unit

as of March 31, 2006:

	GROSS CARRYING AMOUNT	IMPAIRMENT	ADJUSTED GROSS CARRYING AMOUNT	ACCUMULATED AMORTIZATION	NET
	(UNAUDITED)				
AMORTIZED INTANGIBLE ASSETS PATENTS					
Drew	$273,246	$0	$273,246	$ (74,936)	$1
Vascular	36,925	0	36,925	(13,843)	
Medical/Trek/EMI	265,301	0	265,301	(148,975)	1
TOTAL	$575,472	$0	$575,472	$(237,754)	$3
CUSTOMER LIST/COVENANT NOT TO COMPETE					
Medical/Trek/EMI	$277,157	$0	$277,157	$ (9,232)	$2
TOTAL	$277,157	$0	$277,157	$ (9,232)	$2

The following table presents amortized intangible assets by business unit as of June 30, 2005:

	GROSS CARRYING AMOUNT	IMPAIRMENT	ADJUSTED GROSS CARRYING AMOUNT	ACCUMULATED AMORTIZATION	NET CARRY VALUE
AMORTIZED INTANGIBLE ASSETS PATENTS					
Drew	$297,246	$0	$297,246	$ (55,908)	$241,33
Vascular (pending issuance)	36,916	0	36,916	0	36,91
Medical/Trek/EMI	257,301	0	257,301	(132,741)	124,56
TOTAL	$591,463	$0	$591,463	$(188,649)	$402,81

8. ACCRUED EXPENSES

The following table presents accrued expenses as of March 31, 2006 and June 30, 2005:

	MARCH 31, 2006	JUNE 30, 2005
	(UNAUDITED)	

Accrued compensation	$1,035,240	$1,276,639
Warranty accruals	321,244	201,413
Severance accruals	0	195,213
Legal accruals	221,369	251,000
Other accruals	598,641	761,355
TOTAL ACCRUED EXPENSES	$2,176,494	$2,685,620

Severance accruals as of March 31, 2006 and June 30, 2005 relate to certain former directors and officers of Drew who management had the intent to terminate as of the consummation date of the acquisition of Drew.

In addition to normal accruals, other accruals as of March 31, 2006 and June 30, 2005 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 March 31, 2006 and June 30, 2005 primarily relates to payroll, bonus and vacation accruals, and payroll tax liabilities.

9. LINE OF CREDIT AND 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 10.25% per annum and 8% per annum as of March 31, 2006 and June 30, 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 of the note was $318,683 and $405,471 as of March 31, 2006 and June 30, 2005, 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 $150,003 and $216,666 as of March 31, 2006 and June 30, 2005, respectively.

The schedule below presents principal amortization for the next five years under each of the Company's loan agreements as of March 31, 2006:

TWELVE MONTHS ENDING MARCH 31,	TEXAS MEZZANINE	SYMBIOTICS	TOTAL
			(UNAUDITED)
2006	$143,961	$ 99,996	243,957
2007	159,647	50,007	209,654
2008	15,075	0	15,075

2009	0	0	0
2010	0	0	0
TOTAL	$318,683	$150,003	468,686
	Current portion of long-term debt		243,957
	Long-term portion		$224,729

10. OTHER REVENUE

Other revenue includes quarterly payments received from:

(1) Bausch & Lomb in connection with the sale of the Silicone Oil product line, which contract expired on August 12, 2005 and from which the Company will not receive any additional royalties;

(2) Royalty payments received from IntraLase Corp. ("IntraLase") relating to the licensing of the Company's laser technology; and

(3) Royalty payments received from Bio-Rad Laboratories, Inc. ("Bio-Rad").

For the three-month periods ended March 31, 2006 and 2005, Silicone Oil revenue totaled $0 and $364,000, respectively, IntraLase royalties totaled $468,771 and $567,000, respectively, and the Bio-Rad royalties totaled $84,283 and $51,000, respectively. For the nine-month periods ended March 31, 2006 and 2005, Silicone Oil revenue totaled $203,124 and $1,119,000, respectively, IntraLase royalties totaled $1,255,865 and $970,000, respectively, and the Bio-Rad royalties totaled $228,376 and $144,000, respectively. Accounts receivable as of March 31, 2006 and June 30, 2005 related to other revenue was approximately $18,155 and $364,000, respectively.

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BAUSCH & LOMB SILICONE OIL

The Company's 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 through the termination date (August 2005) 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%

INTRALASE: LICENSING OF LASER TECHNOLOGY

The material terms of the license of the Company's laser patents to IntraLase (the "License Agreement"), which expires in 2013, provide that the

Company will receive a 2.5% royalty on product sales that are based on the licensed laser patents, subject to deductions for third party royalties otherwise due and payable, and a 1.5% royalty on product sales that are not based on the licensed laser patents. The Company receives a minimum annual license fee of $15,000 per year during the remaining term of the license. The minimum annual License Agreement fee is offset against the royalty payments.

The material termination provisions of the License Agreement of the laser technology are as follows:

1. Termination by the Company if IntraLase defaults in the payment of any royalty;

2. Termination by the Company if IntraLase makes any false report;

3. Termination by the Company if IntraLase defaults in the making of any required report;

4. Termination by either party due to the commission of any material breach of any covenant or promise by the other party under the license agreement; or

5. Termination by IntraLase after 90 days notice (if IntraLase were to terminate, it would not be permitted to utilize the licensed technology necessary to manufacture its current products).

BIO-RAD ROYALTY

The royalty received from 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 diagnostic tests provided by Bio-Rad. If fewer 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 OEM 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.

11. 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 March 31, 2006 are as follows:

TWELVE MONTHS ENDING	LEASE OBLIGATIONS
	(UNAUDITED)
2006	$ 811,790
2007	466,051
2008	297,295
2009	290,686
2010	303,923
Thereafter	193,547
TOTAL	$2,363,292

Rent expense charged to operations during the three-month periods ended March 31, 2006 and 2005 was $234,557 and $231,608, respectively. Rent expense charged to operations during the nine-month periods ended March 31, 2006 and 2005 was $692,188 and $640,190, 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, as amended and restated on November 9, 2005, for the right to sell formulations or products of CDS, including reagents, controls and calibrators ("CDS products"), on a private label basis. The agreement has a term of 15 years, may be terminated by Drew at any time with 18 months written notice, and if not terminated 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 October 1997, the Company and IntraLase entered into a License Agreement wherein the Company granted IntraLase the exclusive right to use the Company's laser properties, including patented and non-patented technology, in exchange for shares of IntraLase common stock as well as royalties based on a percentage of net sales of future products. The shares of common stock were restricted for sale until April 6, 2005 and, according to a Fourth Amended Registration Right Agreement between the Company and IntraLase, were able to be sold. See Management's Discussion and Analysis of Financial Condition and Results of Operations and the Notes to Condensed Consolidated Financial Statements for discussions on the Company's sales of IntraLase common stock.

On June 10, 2004, the Company gave IntraLase notice of its intention to terminate the License Agreement due to IntraLase's failure to pay certain royalties that the Company believed were due under the License Agreement. On June 21, 2004, IntraLase sought a preliminary injunction and temporary restraining order with the United States District Court for the Central District of California, Southern District against the Company to prevent termination of the License Agreement. Contemporaneously, IntraLase filed an action for declaratory relief asking the court to validate its interpretation of certain terms of the License Agreement relating to the amount of royalties owed to the Company ("First Action"). The parties mutually agreed to the entry of a temporary restraining order, which was entered by the court

shortly thereafter. At the close of discovery, IntraLase and the Company filed cross-motions for summary judgment. On May 5, 2005, the District Court, having ruled on such motions, entered judgment in the First Action.

The court, in ruling on the parties' cross-motions for summary judgment, did not agree with IntraLase's interpretation of certain terms and declared that, under the terms of the License Agreement, IntraLase must pay the Company royalties on revenue from maintenance contracts and one-year warranties. Further, the court rejected IntraLase's argument that it is entitled to deduct the value of non-patented components of its ophthalmic products, which it sells as an integrated unit, from the royalties due the Company. Non-patented components of the products include computer monitors, joysticks, keyboards, universal power supplies, microscope assemblies, installation kits and syringes. In addition, the court rejected IntraLase's assertion that accounts receivable are not "consideration received" under the License Agreement and expressly ruled that IntraLase must pay the Company royalties on IntraLase's accounts receivable. The court also held that IntraLase must give the Company an accounting of third-party royalties. The court agreed with IntraLase that it is not required to pay royalties on research grants.

The court also agreed with the Company in finding that royalties are "monies" and the default in the payment of royalties must be remedied within 15 days of written notice of the default. The court rejected IntraLase's position concerning the effective date of the License Agreement holding that the effective date of the License Agreement was dated October 17, 2000. IntraLase has appealed the judgment to the Ninth Circuit Court of Appeals. The briefing schedule was extended, and briefing is now scheduled to occur during July and August, 2006.

IntraLase, after entry of the court's ruling, attempted to cure its default under the License Agreement, but underpaid the amounts due to the Company based upon a purported interpretation of "accounts receivable" that discounts the receivables recorded on the sales substantially, and in a manner that appears to directly contradict IntraLase's own published financial statements.

In May 2005, IntraLase filed a second suit against the Company in the Central District of California, case number SAVC 05-440-AHS ("Second Action"), again for declaratory relief as well as for reformation of the License Agreement. In this action, IntraLase has asked the court to, among other things, validate its interpretation of certain other terms of the License Agreement relating to the amount of royalties owed to the Company and a declaration concerning Escalon's audit rights under the License Agreement. On June 3, 2005, after having been served with the Company's Complaint filed in the Delaware Court of Chancery ("Delaware Action," described below), IntraLase filed an Amended Complaint in the Second Action. The Company not having been served with the Amended Complaint, filed a motion to dismiss the Complaint in the Second Action on jurisdictional and substantive grounds. On June 6, 2005, the Company filed a Motion to Dismiss the Amended Complaint on grounds virtually identical to its first motion to dismiss. On January 11, 2006, the California Court dismissed without prejudice the Second Action on the grounds that much of IntraLase's lawsuit sought a ruling on issues already raised by the Company in Escalon's Delaware Action. Accepting the Company's arguments for dismissal, the California Court held that retaining jurisdiction would likely result in duplicative litigation and an unnecessary entanglement between the federal and state court actions.

As noted above, on May 15, 2005, the Company not having been served with

IntraLase's Second Action, initiated the Delaware Action by filing a Complaint against IntraLase for, among other things, breach of contract, breach of fiduciary duty arising out of IntraLase's bad faith conduct under, and multiple breaches of, the License Agreement. In the Delaware Action, the Company seeks declaratory relief, specified damages, and specific performance of its rights under the License Agreement, including its express right under the License Agreement to have independent certified accountants audit the books and records of IntraLase to verify and compute payments due the Company.

On February 21, 2006, the Company again gave IntraLase notice of the Company's intention to terminate the License Agreement due to IntraLase's failure to pay certain royalties that the Company believed were due under the License Agreement as well as IntraLase's refusal to permit Escalon to inspect IntraLase's records and books of account in accordance with paragraph 5.3 of the License Agreement.

IntraLase has steadfastly refused to permit inspections reasonably requested by the Company to audit IntraLase's records and books of account and, instead, conditions any inspection by the Company's auditors on unreasonable and unnecessary confidentiality restrictions and unilateral limitations on the scope of records and books of account that would be made available for inspection to the Company. On the same day, the Company filed its First Amended Complaint in the Delaware Action adding to its pending claims a claim for declaratory relief wherein Escalon seeks a judgment declaring that the License Agreement terminated fifteen days after IntraLase received the Company's notice of defaults and intent to terminate and failed to cure those defaults.

On February 28, 2006, the Company agreed to suspend the cure periods applicable to the alleged breaches set out in its February 21, 2006 letter while the Company and IntraLase are engaged in mediation efforts. By order dated March 21, 2006, the Delaware Action was stayed while the Company and IntraLase prepared for mediation. On May 5, 2006, mediation took place before Vice Chancellor Donald F. Parsons, Jr. of the Delaware Court of Chancery, pursuant to Chancery Court Rule 174. The mediation was unsuccessful. The Delaware Action will proceed, and the applicable cure periods will begin to run, ten days after the Court of Chancery enters an order lifting the stay.

Separately, on April 22, 2005, the Company as beneficial record holder of common stock of IntraLase, made a formal written demand to inspect certain of IntraLase's books and records pursuant to Section 220 of the Delaware General Corporation Law. Shortly thereafter, EHI, as the record holder of common stock of IntraLase, made the same written demand. IntraLase rejected both demands. Thereafter, the Company and EHI filed an action in the Delaware Court of Chancery against IntraLase seeking to enforce their shareholder rights to inspect IntraLase's books and records ("220 Action"). The 220 Case is currently in the discovery stage. By order dated March 21, 2006, the 220 Case was stayed while the parties prepared for and proceeded to the unsuccessful mediation of the Delaware Action. The 220 Case will now proceed ten days after the Court of Chancery enters an order lifting the stay.

The Company is cognizant of the legal expenses and costs associated with the IntraLase matter. The Company, however, is taking all necessary and appropriate actions to protect its rights and interests under the License Agreement. The Company expects expenses associated with this litigation to adversely impact earnings in the near term. The Company believes that IntraLase has sufficient funds to support such payments based on its filings with the SEC and filings in connection with the First Action.

DREW LEGAL PROCEEDINGS

CARVER LITIGATION-CONNECTICUT ACTION

On December 17, 2002, Edward Carver, David DeCava and Diane Carver, former principal shareholders of CDC Technologies, Inc. ("CDC Technologies"), filed a complaint in the State of Connecticut, Superior Court, Judicial District of Waterbury against CDC Acquisition, IV Diagnostics and certain other principal shareholders of CDC Technologies seeking a total of approximately $420,000 for, among other things, repayment of loans made to CDC Technologies, payment of past wages and reimbursement of business expenses ("Connecticut Action"). The plaintiffs' claims arose out of a certain asset purchase for stock transaction in which CDC Acquisition, a wholly owned subsidiary of Drew, acquired the assets of CDC Technologies and IV Diagnostics. CDC Acquisition and IV Diagnostics, also a subsidiary of Drew, asserted counterclaims against the plaintiffs for, among other things, breach of fiduciary duty, unfair trade and conversion. In addition, CDC Acquisition and IV Diagnostics asserted cross-claims against the other principal shareholders of CDC Technologies for indemnification pursuant to the transaction agreements. A bench trial was held in June 2005. In August 2005 the court rendered a decision resulting in the court's award of only $76,000 to plaintiffs. CDC Acquisition and IV Diagnostics filed a motion for reconsideration of certain issues ruled upon by the court. The motion was denied. Plaintiffs' counsel filed a motion for attorneys' fees seeking over $181,000. The court granted such motion but awarded only $3,000 to plaintiffs' counsel. On November 1, 2005, CDC Acquisition and IV Diagnostics timely appealed the court's ruling that CDC Acquisitions and IV Diagnostics are liable to the plaintiffs. CDC Acquisitions and IV Diagnostics and the plaintiffs in the Connecticut Action have tentatively resolved their disputes. The Company will pay approximately $81,000 to plaintiffs. The

Company's claims against certain of the former principal shareholders of CDC Technologies, Inc. remain pending.

CARVER LITIGATION-SOURCE ONE LITIGATION

On December 30, 2002, Source One, a distributor of CDC Technologies filed suit in state court in Minnesota ("Source One Litigation"), later removed to the United States District Court in Minnesota, against CDC Technologies, Edward Carver and CDC Acquisition, Inc. and IV Diagnostics, as successors in interest to CDC Technologies. CDC Acquisition and IV Diagnostics asserted cross-claims against Carver for indemnification of the amount of the judgment. The court granted summary judgment to the Source One against defendants and awarded Source One approximately $185,000 plus interest and costs. The court also found Carver liable to CDC Acquisition for indemnification of the amount of the judgment. Source One agreed to accept $140,000 from CDC Acquisition in settlement of its claims. CDC Acquisition settled its Source One Litigation indemnification claim against Carver for $75,000.

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. Drew is reviewing this matter with legal counsel and disputes the allegations for nonpayment.

DREW CORPORATE REORGANIZATION

During the reorganization of Drew's corporate structure, Drew had several bank accounts for $330,809 not immediately available for withdrawal from a bank in the United Kingdom. The Company anticipates that the funds will be available for release by the bank on May 19, 2006.

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.

12. SEGMENTAL INFORMATION

During the three- and nine-month periods ended March 31, 2006 and 2005, the Company operations were classified into four principal reportable business units that provide different products or services. Drew became a reportable business unit following its acquisition by the Company on July 23, 2004.

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

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

	DREW		SONOMED		VASCULAR		MEDICAL/TREK/E	
	2006	2005	2006	2005	2006	2005	2006	200
REVENUES, NET:								
Product revenue	$ 3,870	$3,006	$ 2,001	$ 1,977	$ 893	$ 830	$ 522	$ 4
Other revenue	84	51	0	0	0	0	469	9
TOTAL REVENUE, NET	3,954	3,057	2,001	1,977	893	830	991	1,3
COSTS AND EXPENSES:								
Cost of goods sold	2,622	1,700	966	662	447	379	348	2
Operating expenses	1,923	1,537	839	746	487	389	753	7
TOTAL COSTS AND EXPENSES	4,545	3,237	1,805	1,408	934	768	1,101	9
(LOSS) INCOME FROM OPERATIONS	(591)	(180)	196	569	(41)	62	(110)	3
OTHER (EXPENSE) AND INCOME:								
Gain on sale of available for								

sale securities	0	0	0	0	0	0	0	
Equity in OTM	0	0	0	0	0	0	(19)	(
Interest income	0	0	0	0	0	0	34	
Interest expense	(26)	(15)	0	(29)	0	0	0	
TOTAL OTHER (EXPENSE) AND INCOME	(26)	(15)	0	(29)	0	0	15	
(LOSS) AND INCOME BEFORE TAXES	(617)	(195)	196	540	(41)	62	(95)	4
Income taxes	0	0	14	0	0	0	6	
NET (LOSS) INCOME	$ (617)	$ (195)	$ 182	$ 540	$ (41)	$ 62	$ (101)	$ 3
Depreciation and amortization	$ 65	$ 0	$ 6	$ 5	$ 28	$ 11	$ 23	$
Assets	$17,592	$8,975	$13,802	$13,499	$3,850	$2,172	$4,302	$16,0
Expenditures for long-lived assets	$ 33	$ 18	$ 1	$ 0	$ (0)	$ 4	$ 35	$

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

	DREW		SONOMED		VASCULAR		MEDICAL/TREK	
	2006	2005	2006	2005	2006	2005	2006	2
REVENUES, NET:								
Product revenue	$11,071	$7,774	$ 5,802	$ 5,494	$2,703	$2,246	$1,319	$ 1
Other revenue	228	144	0	0	0	0	1,459	2
TOTAL REVENUE, NET	11,299	7,918	5,802	5,494	2,703	2,246	2,778	3
COSTS AND EXPENSES:								
Cost of goods sold	7,091	4,866	2,955	2,360	1,105	1,069	860	
Operating expenses	5,763	3,928	2,802	2,148	1,503	1,212	2,464	2
TOTAL COSTS AND EXPENSES	12,854	8,794	5,757	4,508	2,608	2,281	3,324	2
(LOSS) INCOME FROM OPERATIONS	(1,555)	(876)	45	986	95	(35)	(546)	
OTHER (EXPENSE) AND INCOME:								
Gain on sale of available for sale securities	0	0	0	0	0	0	1,157	
Equity in OTM	0	0	0	0	0	0	(70)	
Interest income	0	4	0	0	0	0	112	
Interest expense	(46)	(71)	0	0	0	(1)	0	
TOTAL OTHER (EXPENSE) AND INCOME	(46)	(67)	0	0	0	(1)	1,199	
(LOSS) AND INCOME BEFORE								

TAXES	(1,601)	(943)	45	986	95	(36)	653	
Income taxes	0	0	14	0	0	0	22	
NET (LOSS) INCOME	$(1,601)	$ (943)	$ 31	$ 986	$ 95	$ (36)	$ 631	$
Depreciation and amortization	$ 188	$ 97	$ 16	$ 19	$ 62	$ 34	$ 74	$
Assets	$17,592	$8,975	$13,802	$13,499	$3,850	$2,172	$4,302	$16
Expenditures for long-lived assets	$ 139	$ 26	$ 15	$ 23	$ 13	$ 11	$ 129	$

13. SHAREHOLDERS' EQUITY

WARRANTS TO PURCHASE COMMON STOCK

In connection with debt issued by a former lender to Escalon in November 2001, the Company issued the lender warrants to purchase 60,000 shares of the Company's common stock at $3.66 per share. The lender exercised the warrants on December 13, 2004, in a cashless exercise, receiving 32,855 shares of the Company's common stock in satisfaction of the warrants.

In connection with the private placement of the Company's common stock in March 2004, the Company issued to several accredited investors warrants to purchase 120,000 shares of the Company's common stock at $15.60 per share. The warrants are currently exercisable and expire in March 2009. The fair market value of the warrants was determined under the Black Scholes model and recorded to additional paid-in capital in accordance with Emerging Issues Task Force Issue Number 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock" ("EITF 00-19").

14. RELATED-PARTY TRANSACTIONS

The Company and a member of the Company's Board of Directors are founding and equal members of OTM. OTM is a diagnostic telemedicine company 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 March 31, 2006, the Company had invested $256,000 in OTM. As of March 31, 2006, Escalon owned 45% of OTM. The members of OTM have agreed to review the operations of OTM after 24 months, at which time the members each have the right to sell its membership

interest back to OTM at fair market value. The Company provides administrative support functions to OTM. From inception through March 31, 2006, OTM had revenue of approximately $16,200 and incurred expenses of approximately $213,500. This investment is accounted for under the equity method of accounting and is included in other assets.

Two relatives of a senior executive officer have provided legal services as either an employee or a consultant to the Company. Expenditures related to these individuals during the three-month periods ended March 31, 2006 and 2005, were approximately $95,000 and $94,000, respectively. For the nine-month periods

ended March 31, 2006 and 2005, these expenditures were $273,000 and $277,000, respectively.

15. INTRALASE INITIAL PUBLIC OFFERING

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 as having 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 held by the Company 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. The Company sold 191,000 shares of IntraLase common stock in May 2005 at $17.9134 per share resulting in net proceeds, after fees and commissions, of $3,411,761. As of June 30, 2005, the Company's remaining 61,535 shares of IntraLase were classified as available-for-sale securities and had a market value of $1,207,317.

On July 8, 2005, Company sold an additional 58,535 shares of IntraLase common stock 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 $1,157,336. The net proceeds from the sale were recorded in other income and expense. The Company's remaining 3,000 shares of IntraLase common stock at March 31, 2006 are classified as available-for-sale securities and had a market value of $69,600.

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.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

EXECUTIVE OVERVIEW - NINE-MONTH PERIOD ENDED MARCH 31, 2006

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

- On July 23, 2004, the Company acquired 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 since that date has acquired all of the Drew shares. The Company has been operating Drew as a separate business unit since its acquisition, and Drew's results of its operations are included in the "Management's Discussion and Analysis or Plan of Operation" for all periods since the acquisition in July 2004. Prior to the acquisition, Drew's ability to obtain raw materials and components was severely restricted due to prolonged liquidity constraints. These constraints were pervasive throughout all of Drew's locations and affected all aspects of Drew's operations. The Company's operational priorities with respect to Drew have been to stabilize and increase Drew's revenue base and to infuse Drew with working capital in the areas of manufacturing, sales and marketing and product development in an effort to remove the pre-acquisition liquidity constraints.

- In connection with the acquisition of Drew, the Company issued 900,000 shares of its common stock during the fiscal year ended June 30, 2005, of which 841,686 shares were issued in the six- month period ended December 31, 2004. The balance of the shares were issued in the six-month period ended June 30, 2005.

- Product revenue increased approximately 25.5% during the nine-month period ended March 31, 2006 as compared to the same period last fiscal year. The increase is primarily related to strong sales in the Company's Drew, Sonomed, Vascular and Medical/Trek/EMI business units. Sales at these business units increased approximately 42.4%, 5.6%, 20.4% and 16.2%, respectively, during the nine-month period ended March 31, 2006 when compared to the same period last fiscal year.

- During July 2005, the Company sold 58,555 shares of IntraLase common stock that had originally been received by the Company in connection with the license of its laser properties to IntraLase in 1997. (See note 15 of the notes to the condensed consolidated financial statements.) The stock was sold at $19.8226 per share and yielded net proceeds of $1,157,336 after the payment of brokers' commissions and other fees. The net proceeds were recorded as other income in the nine-month period ended March 31, 2006.

- Other revenue decreased approximately $547,000 or 24.5 % during the nine-month period ended March 31, 2006 as compared to the same period last fiscal year. The decrease primarily relates to a decrease in royalty payments received from Bauch & Lomb in connection with the Silicone Oil product line. During the nine-month periods ended March 31, 2006 and 2005, approximately .9% and 5.9%, respectively, of the Company's net revenue was received from the Bauch & Lomb contract, which expired in August 2005. Accordingly, the Company will receive no additional revenue related to this contract. The decrease in royalties from Bauch & Lomb was partially offset by increases in royalties from IntraLase and Bio Rad.

- Cost of goods sold as a percentage of product revenue increased to approximately 57.5% of revenues during the nine-month period ended March 31, 2006, as compared to approximately 54.2% of product revenue for the same period last fiscal year. Gross margins in the Drew business unit have historically been lower than those in the Company's other business units. The aggregate cost of goods sold as a percentage of product revenue of the Sonomed, Vascular and Medical/Trek/EMI business units during the nine-month period ended March 31, 2006 increased

slightly to approximately 50.0% of product revenue from approximately 46.8% in the same period last fiscal year.

- Operating expenses increased approximately 34.6% during the nine-month period ended March 31, 2006 as compared to the same period in the prior fiscal year. During the nine-month period ended March 31, 2006, the Company incurred higher personnel costs to support the growth in the Company's business operations, higher advertising, sales and marketing salaries, travel and trade show costs related to the higher sales volumes and higher expenses associated with the integration of the MRP and existing EMI product lines. (The MRP acquisition closed on January 30, 2006. See note 2 of the notes to the condensed consolidated financial statements.) Research and development costs also increased to support introductions and planned introductions of new and or enhanced products, especially in the Drew and Sonomed business units. In addition, the Company continues to experience a high amount of legal and accounting fees primarily related to IntraLase litigation costs, increased auditors fees in proportion to the increase in the Company's size due to the acquisition of Drew and costs related to compliance with the Sarbanes-Oxley Act of 2002. While the Company expects these legal, accounting and compliance expenses to impact earnings in the near term, it does not believe that all of these expenses will continue in the future at such high levels.

CAUTIONARY FACTORS THAT MAY AFFECT FUTURE RESULTS

Certain statements contained in, or incorporated by reference in, this report are forward-looking statements made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995, which provide current expectations or forecasts of future events. Such statements can be identified by the use of terminology such as "anticipate," "believe," "could," "estimate," "expect," "forecast," "intend," "may," "plan," "possible," "project," "should," "will," and similar words or expressions. The Company's forward-looking statements include certain information relating to general business strategy, growth strategies, financial results, liquidity, product development, the introduction of new products, the 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 and defending the Company in litigation matters. The reader must carefully consider forward-looking statements and understand that such statements involve a variety of risks and uncertainties, known and unknown, and may be affected by assumptions that fail to materialize as anticipated. Consequently, no forward-looking statement can be guaranteed, and actual results may vary materially. It is not possible to foresee or identify all factors affecting the Company's forward-looking statements, and the reader therefore should not consider the following list of such factors to be an exhaustive statement of all risks, uncertainties or potentially inaccurate assumptions.

The Company cautions the reader to consider carefully these factors as well as the specific factors discussed with each specific forward-looking statement in this quarterly report and in the Company's other filings with 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 most important 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, although such acquisitions or alliances may not occur. 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 is expected to negatively impact the Company's financial results in the short-term. As Drew is integrated into the Company, management will be working to reverse the situation, while at the same time seeking to strengthen Drew's market position. The Company loaned approximately $9,476,000 to Drew. The funds have been primarily used to procure components to build up inventory to support the manufacturing process, to pay off accounts payable and debt of Drew, 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 anticipates that further working capital will likely 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.

COSTS ASSOCIATED WITH INTRALASE LITIGATION MAY ADVERSELY IMPACT EARNINGS IN THE NEAR TERM.

The Company is cognizant of the escalating legal expenses and costs associated with the IntraLase matter. The Company, however, is taking all

necessary actions to protect its rights and interests under the License Agreement. The Company expects expenses associated with this litigation to adversely impact earnings in the near term.

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.

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

FAILURE OF THE MARKET TO ACCEPT THE COMPANY'S PRODUCTS COULD ADVERSELY IMPACT THE COMPANY'S BUSINESS AND FINANCIAL CONDITION.

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

- The price of the products;

- The 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 NO LONGER RECEIVES REVENUE FROM THE SALE OF SILICONE OIL BY BAUSCH & LOMB UNDER A CONTRACT THAT EXPIRED ON AUGUST 12, 2005.

The Company received approximately 1.4% and 6.5% of its net revenue during the nine-month periods ended March 31, 2006 and 2005, respectively, from Bausch & Lomb's sales of Silicone Oil. The Company was entitled to receive this revenue from Bausch & Lomb, in varying amounts, through August 12, 2005. The Company will not receive any future revenue related to the Silicone Oil royalty as the contract expired on August 12, 2005.

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 activity. 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 cannot be certain that the Company will not be subject to one or more claims for patent infringement, that the Company would prevail in any such action or that the Company's patents will 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;

- 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 Escalon, 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.

COMPANY OVERVIEW

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

The Company operates in the healthcare market specializing in the development, manufacture, marketing and distribution of medical devices and pharmaceuticals in the areas of ophthalmology, diabetes, hematology and vascular access. The Company and its products are subject to regulation and inspection by the FDA. The FDA requires extensive testing of new products prior to sale and has jurisdiction over the safety, efficacy and manufacture of products, as well as product labeling and marketing. The Company's Internet address is www.escalonmed.com.

In February 1996, the Company acquired substantially all of the assets and certain liabilities of EOI, a developer and distributor of ophthalmic surgical products. Prior to this acquisition, the Company devoted substantially all of its resources to the research and development of ultra fast laser systems designed for the treatment of ophthalmic disorders. As a result of the EOI acquisition, Escalon changed its market focus and ceased developing laser technology. In October 1997, the Company licensed its intellectual laser property to IntraLase, in return for an equity interest and future royalties on sales of products. IntraLase undertook responsibility for funding and developing the laser technology through to commercialization. IntraLase began selling products related to the laser technology during fiscal 2002 and announced its initial public offering of its common stock in October 2004. (See notes 10, 11 and 15 of the notes to the condensed consolidated financial statements for further information.) The Company is in dispute with IntraLase over royalty payments owed to the Company. (See note 11 of the notes to the condensed consolidated financial statements for further information.)

To further diversify its product portfolio, in January 1999, the Company's Vascular subsidiary acquired the vascular access product line from Endologix, formerly Radiance Medical Systems, Inc. Vascular's products use Doppler technology to aid medical personnel in locating arteries and veins in difficult circumstances. Currently, this product line is concentrated in the cardiac catheterization market. In January 2000, the Company purchased Sonomed, a privately held manufacturer of ophthalmic ultrasound diagnostic equipment.

On July 23, 2004, the Company acquired 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 since that date has acquired all of the Drew shares. 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.

CRITICAL ACCOUNTING POLICIES

The preparation of financial statements requires management to make

estimates and assumptions that impact amounts reported therein. The most significant of those involve the application for SFAS 142, discussed further in Note 7 of the notes to the condensed consolidated financial statements included in this report. The financial statements are prepared in conformity with accounting principles generally accepted in the United States of America, and, as such, include amounts based on informed estimates and judgments of management. For example, estimates are used in determining valuation allowances for deferred income taxes, uncollectible receivables, obsolete inventory, sales returns and rebates and purchased intangible assets. Actual results achieved in the future could differ from current estimates. The Company used what it believes are reasonable assumptions and, where applicable, established valuation techniques in making its estimates.

REVENUE RECOGNITION

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

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

- Persuasive evidence that an arrangement (purchase order and sales invoice) exists between a willing buyer (distributor) and the Company that outlines the terms of the sale (company information, quantity of goods, purchase price and payment terms). The buyer (distributor) does not have an immediate right of return.

- Shipping terms are ex-factory shipping point. At this point the buyer (distributor) takes title to the goods and is responsible for all risks and rewards of ownership, including insuring the goods as necessary.

- The Company's price to the buyer (distributor) is fixed and determinable as specifically outlined on the sales invoice. The sales arrangement does not have customer cancellation or termination clauses.

- The buyer (distributor) places a purchase order with the Company; the terms of the sale are cash, COD or credit. Customer credit is determined based on the Company's policies and procedures related to the buyer's (distributor's) creditworthiness. Based on this determination, the Company believes that collectibility is reasonably assured.

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

VALUATION OF INTANGIBLE ASSETS

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

INCOME/(LOSS) PER SHARE

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

Under the provisions of SFAS 128 and SAB 98, basic and diluted net income/(loss) per share 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 effect is anti-dilutive. Basic earnings per share are computed by dividing net income/(loss) by the weighted average number of shares of common stock outstanding during the period. Diluted earnings per share are determined in the same manner as basic earnings per share, except that the number of shares is increased by assuming exercise of dilutive stock options and warrants using the treasury stock method.

TAXES

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

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

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

Through March 31, 2006, the Company has recorded a full valuation allowance against the Company's net operating losses due to the uncertainty of their realization as a result of the Company's earnings history, the number of years

the Company's net operating losses and tax credits can be carried forward, the existence of taxable temporary differences and near-term earnings expectations. The amount of the valuation allowance could decrease if facts and circumstances change that materially increase taxable income prior to the expiration of the loss carry forwards. Any reduction would reduce (increase) the income tax expense (benefit) in the period such determination is made by the Company.

THREE- AND NINE-MONTH PERIODS ENDED MARCH 31, 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 three- and nine-month periods ended March 31, 2006 and 2005. Table amounts are in thousands:

	THREE-MONTH PERIOD ENDED MARCH 31,			NINE-MONTH PERIOD ENDED MARCH 31,		
	2006	2005	% CHANGE	2006	2005	% CHANGE
PRODUCT REVENUE:						
Drew	$3,870	$3,006	28.7%	$11,071	$ 7,774	42.4%
Sonomed	2,001	1,977	1.2%	5,802	5,494	5.6%
Vascular	893	830	7.6%	2,703	2,246	20.4%
Medical/Trek/EMI	522	434	20.3%	1,319	1,135	16.2%
TOTAL	$7,286	$6,247	16.6%	$20,895	$16,649	25.5%

Product revenue increased approximately $1,039,000, or 16.6%, to $7,286,000 during the three-month period ended March 31, 2006 as compared to the same period last fiscal year. In the Drew business unit, product revenue increased $864,000, or 28.7%, as compared to the same period last fiscal year. The increase is primarily due to additional sales in the domestic market of diabetics and hematology instruments, which offset a small decrease in international sales of instruments. Sales of instruments increased by approximately $600,000 in the three-month period ended March 31, 2006 as compared to the same period last prior year. Sales of spare parts and reagents and controls, which are used to operate the instruments, were both up slightly during the period.

Product revenue increased $24,000, or 1.2%, at the Sonomed business unit as compared to the same period last fiscal year. The increase in product revenue was primarily caused by an increase in sales of the Company's EZ AB scan ultrasound systems 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 in the prior fiscal year 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 2005 due to market saturation and increased price competition within the marketplace.

Product revenue increased $63,000, or 7.6%, to $893,000 in the Vascular

business unit during the three-month period ended March 31, 2006 as compared to the same period last fiscal year. The increase in product revenue in the Vascular business unit was primarily caused by an increase in direct sales to end users by the Company's domestic sales team. These increases were partially offset by decreases in revenue from the Company's distributor network and a slight decrease in international sales. The Company terminated its relationship with several of its distributors during the prior fiscal year. In the Medical/Trek/EMI business unit, product revenue increased $88,000, or 20.3%, to $522,000 during the three-month period ended March 31, 2006 as compared to the same period last fiscal year. The increase in Medical/Trek/EMI product revenue is primarily attributed to an increase in the Trek business unit revenue from Bausch & Lomb and an increase in EMI sales of digital imaging systems.

Product revenue increased approximately $4,226,000, or 25.5%, to $20,895,000 during the nine-month period ended March 31, 2006 as compared to the same period last fiscal year. In the Drew business unit, product revenue increased $3,297,000, or 42.4 %, as compared to the same period last fiscal year. The increase is primarily due to additional sales in the domestic and international markets of diabetics and hematology instruments. Sales of instruments increased by approximately $2,300,000 in the nine-month period ended March 31, 2006 as compared to the same period last prior year. 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 $308,000, or 5.6%, at the Sonomed business unit as compared to the same period last fiscal year. The increase in product revenue was primarily caused by an increase in sales of the Company's EZ AB scan ultrasound systems 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 $457,000, or 20.4%, to $2,246,000 at the Vasuclar business unit during the nine-month period ended March 31, 2006 as compared to the same period last fiscal year. The increase in product revenue in the Vascular business unit was primarily caused by an increase in direct sales to end users by the Company's domestic sales team. These increases were partially offset by decreases in revenue from the Company's distributor network. The Company terminated its relationship with several of its distributors during the prior fiscal year. In the Medical/Trek/EMI business unit, product revenue increased $184,000 or 16.2% to $1,319,000 during the nine-month period ended March 31, 2006 as compared to the same period last fiscal year. The increase in Medical/Trek/EMI product revenue is primarily attributed to an increase in the Trek business unit revenue from Bausch & Lomb and an increase in EMI sales of digital imaging systems.

Other revenue decreased by approximately $429,000, or 43.7 %, to $553,000 during the three-month period ended March 31, 2006 as compared to the same period last fiscal year. The decrease is primarily due to an approximately $364,000 decrease in royalties received from Bausch & Lomb in connection with their 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 in the three-month period ended March 31, 2006 and will receive no future royalties under this agreement. (See note 10 of the notes to the condensed 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 $33,000 to $84,000 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. Also contributing to the decrease in other revenue was a $98,000 reduction in royalty payments received from IntraLase related to the licensing of the Company's intellectual laser technology. Royalties decreased due to the method of calculating its royalty payments to the Company by Intralase and is the subject of litigation. (See notes 10 and 11 of the notes to the condensed consolidated financial statements.)

Other revenue decreased by approximately $547,000, or 24.5%, to $1,687,000 during the nine-month period ended March 31, 2006 as compared to the same period last fiscal year. The decrease is primarily due to an approximately $916,000 decrease in royalties received from Bausch & Lomb in connection with their 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 will receive no future royalties under this agreement. (See note 10 of the notes to the condensed consolidated financial statements.) The decrease in royalties from Bausch & Lomb was partially offset by an approximately $286,000 increase in royalty payments received from IntraLase related to the licensing of the Company's intellectual laser technology. IntraLase royalties increased partially due to a court order amending IntraLase's method of calculating its royalty payments to the Company and revenue growth by IntraLase. (See notes 10 and 11 of the notes to the condensed consolidated financial statements.) Also

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offsetting the decrease in Bausch & Lomb royalties was an $85,000 increase from Bio-Rad related to an OEM agreement between Bio-Rad and Drew.

The following table presents consolidated cost of goods sold by reportable business unit and as a percentage of related unit product revenues for the three and nine-month periods ended March 31, 2006 and 2005. Table amounts are in thousands:

	THREE-MONTH PERIOD ENDED MARCH 31,				NINE-MONTH PERIOD ENDED MARCH 31,			
	2006	%	2005	%	2006	%	2005	%
COST OF GOODS SOLD:								
Drew	$2,622	67.8%	$1,700	56.6%	$ 7,091	64.1%	$4,866	62.6%
Sonomed	966	48.3%	662	33.5%	2,955	50.9%	2,360	43.0%
Vascular	447	50.1%	379	45.7%	1,105	40.9%	1,069	47.6%
Medical/Trek/EMI	348	66.7%	258	59.5%	860	65.2%	725	63.9%

TOTAL	$4,383	60.2%	$2,999	48.0%	$12,011	57.5%	$9,020	54.2%

Cost of goods sold totaled approximately $4,383,000, or 60.2% of product revenue, for the three-month period ended March 31, 2006 as compared to $2,999,000, or 48.0% of product revenue, for the same period last fiscal year. Cost of goods sold in the Drew business unit totaled $2,622,000, or 67.8% of product revenue, for the three-month period ended March 31, 2006 as compared to $1,700,000, or 56.6% of product revenue, for the same period last fiscal year. The increase 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 the prior fiscal year. Instrument and OEM sales were a higher percentage of total revenues than in the same period last fiscal year. 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 $966,000, or 48.3% of product revenue, for the three-month period ended March 31, 2006 as compared to $662,000, or 33.5% of product revenue, for the same period last fiscal year. The primary reason for the increase was an increase in the percentage of sales during the period that were international sales. The Company historically experiences a lower selling price per unit on its international product sales. 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 2005. Cost of goods sold in the Vascular business unit totaled $447,000, or 50.1% of product revenue, for the three-month period ended March 31, 2006 as compared to $379,000, or 45.7% of product revenue, for the same period last fiscal year. The Company experienced higher overtime and lower production efficiencies in the current period as compared to the prior period. Cost of goods sold in the Medical/Trek/EMI business unit totaled $348,000, or 66.7% of product revenue, during the three-month period ended March 31, 2006 as compared to $258,000, or 59.5% of product revenue, during the same period last fiscal year. 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.

Cost of goods sold totaled approximately $12,011,000, or 57.5 % of product revenue, for the nine-month period ended March 31, 2006 as compared to $9,020,000, or 54.2% of product revenue, for the same period last fiscal year. Cost of goods sold in the Drew business unit totaled $7,091,000, or 64.1% of product revenue, for the nine-month period ended March 31, 2006 as compared to $4,866,000, or 62.6% of product revenue, for the same period last fiscal year. The increase 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 the prior fiscal year. Instrument sales were a higher percentage of total revenues than in the same period last fiscal year. Instrument sales historically have lower margins than the sales of reagents and controls which are used to operate the instruments. These increases were partially offset by a decrease in material costs resulting from the easing of pre-acquisition liquidity constraints at Drew following its acquisition by

the Company and operating efficiencies gained through both manufacturing changes implemented post-acquisition and higher production volumes during the nine-month period ended March 31, 2006 as compared to the same period last fiscal year.

Cost of goods sold in the Sonomed business unit totaled $2,955,000, or 50.9% of product revenue, for the nine-month period ended March 31, 2006 as compared to $2,360,000, or 43.0% of product revenue, for the same period last fiscal year. The primary reason for the increase was an increase in the percentage of sales during the period that were international sales. The Company historically experiences a lower selling price per unit on its international product sales. In addition, the Company experienced a significantly higher margin in prior year on pachymeters sales due to market demand. Cost of goods sold in the Vascular business unit totaled $1,105,000, or 45.7% of product revenue, for the nine-month period ended March 31, 2006 as compared to $1,069,000, or 47.6% of product revenue, for the same period last fiscal year. The primary factor affecting the decrease in cost of goods sold as a percentage of product revenue was the increase in direct sales to end users and corresponding decrease in sales through the Company's distributor network where the Company generally experiences lower price per unit on its products. The percentage was slightly offset by an increase in overtime and lower production efficiencies. Cost of goods sold in the Medical/Trek/EMI business unit totaled $850,000, or 64.4% of product revenue, during the nine-month period ended March 31, 2006 as compared to $725,000, or 63.9% of product revenue, during the same period last fiscal year. 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 three and nine-month periods ended March 31, 2006 and 2005. Table amounts are in thousands:

	THREE-MONTH PERIOD ENDED MARCH 31,			NINE-MONTH PERIOD ENDED MARCH 31,		
	2006	2005	% CHANGE	2006	2005	% CHANGE
MARKETING, GENERAL AND ADMINISTRATIVE:						
Drew	$1,434	$1,184	21.1%	$ 4,440	$3,129	41.9%
Sonomed	466	405	15.1%	1,597	1,068	49.5%
Vascular	365	327	11.9%	1,186	981	20.8%
Medical/Trek/EMI	1,018	1,020	-0.1%	3,173	2,871	10.5%
TOTAL	$3,284	$2,935	11.9%	$10,396	$8,050	29.1%

Marketing, general and administrative expenses increased $349,000, or 11.9%, to $3,284,000 during the three-month period ended March 31, 2006 as compared to the same period last fiscal year. Marketing, general and administrative expenses in the Drew business unit increased $250,000, or 21.1%, to $1,434,000 as compared to the same period last fiscal year. The increase is primarily due to higher personnel (approximately $331,000) 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 28.7% increase in product revenue when compared to the corresponding prior year period. Slightly offsetting these expenses was a decrease in travel and trade show expenses by $64,000 due to less travel between Company locations.

Marketing, general and administrative expenses in the Sonomed business unit increased by $61,000, or 15.1%, to $466,000 as compared to the same period last fiscal year. Marketing and sales salaries, and travel expenses related to additional sales personnel, increased by approximately $40,000 as part of the Company's focus on increasing domestic and foreign revenues. Advertising expenses increased by approximately $30,000 related to exhibits and brochures advertising the Company's Ultrasound Biomicrosopes instrument ("UBM"). Offsetting these increases were rent and utilities expense, which decreased by $11,000 as the Company relocated to lower cost facilities in 2005.

Marketing, general and administrative expenses in the Vascular business unit increased $39,000, or 11.9%, to $365,000 as compared to the same period last fiscal year. Salaries and other personnel-related expenses increased approximately $21,000 and travel related expenses increased by approximately $10,000 when compared to the prior fiscal period. Both increases were related to supporting a higher volume of business during the current period as compared to the same period in the prior fiscal year.

Marketing, general and administrative expenses in the Medical/Trek/EMI business unit slightly decreased $1,000, or .1%, to $1,018,000 as compared to the same period last fiscal year. Accounting fees and sales and marketing expenses related to the MRP product line increased by $54,000 and $77,000, respectively. Accounting fees were higher due to audit fees related to Sarbanes-Oxley compliance and higher third party consulting fees for tax and temporary services. Sales and marketing expenses increased due to costs related to the integration of the MRP with the EMI product lines, and the joint marketing and integration of the Company's product line with Anka Systems as part of a co-marketing agreement. (See notes 2 and 6 of the notes to the condensed consolidated financial statements.) Offsetting these expenses were a reduction in legal expenses and corporate salaries and benefits of $70,000 and $43,000, respectively. Legal fees decreased as there has been less activity related to the IntraLase litigation. The Company still anticipates these litigation costs will continue to impact earnings in the near term. (See note 11 of the notes to the condensed consolidated financial statements for a description of legal proceedings.) The remaining decrease was due to lower period over period expenses in investor relations and insurance.

Marketing, general and administrative expenses increased $2,346,000, or 29.1%, to $10,396,000 during the nine-month period ended March 31, 2006 as compared to the same period last fiscal year. Marketing, general and administrative expenses in the Drew business unit increased $1,311,000, or 41.9%, to $4,440,000 as compared to the same period last fiscal year. The increase is primarily due to higher personnel (approximately $609,000) and travel, trade show and advertising costs (approximately $338,000) 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 42.4% increase in product revenue when compared to the corresponding prior year period.

Marketing, general and administrative expenses in the Sonomed business unit increased $529,000, or 49.5%, to $1,597,000 as compared to the same period last fiscal year. Marketing and sales salaries, commissions and other personnel-related expenses, including amounts paid to independent agents utilized primarily in Europe, increased approximately $233,000 as a result of increased headcount related primarily to the Company's goal of increasing domestic and international revenues. Sales, meeting and trade show expenses, travel and lodging, and advertising increased by a combined amount of approximately $243,000 related primarily to the focus on growing sales and the

introduction of the Company's new UMB, which was introduced at the American Academy of Ophthalmology meeting in October 2005. Legal expenses increased by $28,000 primarily due to fees incurred to resolve a dispute with a supplier and fees related to researching intellectual property ownership issues currently being evaluated for licensing for use in potential new products.

Marketing, general and administrative expenses in the Vascular business unit increased $204,000, or 20.8%, to $1,186,000 as compared to the same period last fiscal year. Sales salaries and other personnel-related expenses increased approximately $89,000, travel related expenses for sales personnel increased by approximately $41,000, advertising increased by approximately $11,000 and the expense for customer samples increased by approximately $13,000 when compared to the prior fiscal period. All of the increases were related to supporting a higher volume of business during the current period as compared to the same period in the prior fiscal year. Legal expenses increased $39,000 over the prior period due to additional patent maintenance fees.

Marketing, general and administrative expenses in the Medical/Trek/EMI business unit increased $302,000, or 10.5%, to $3,173,000 as compared to the same period last fiscal year. Legal, accounting, sales and marketing expenses and personnel related costs increased by approximately $130,000, $40,000 and $200,000, respectively. Legal fees increased due to litigation costs with IntraLase. The Company expects these litigation costs will continue to impact earnings in the near term. (See note 11 of the notes to

the condensed consolidated financial statements for a description of legal proceedings.) Sales and marketing expenses increased due to costs related to the integration of the MRP with the EMI product lines, and the joint marketing and integration of the Company's product line with Anka Systems as part of a co-marketing agreement. (See notes 2 and 6 of the notes to the condensed consolidated financial statements.) Accounting fees were higher due to audit fees related to Sarbanes-Oxley compliance and higher third party consulting fees for tax and temporary services. Slightly offsetting these increases were decreases in investor relations and insurance expenses over the prior period.

Research and development expenses increased $251,000, or 53.9%, to $718,000 during the three-month period ended March 31, 2006 as compared to the same period last fiscal year. Research and development expenses were primarily expenses associated with the planned introduction of new and or enhanced products in the Drew and EMI business units. Research and development expenses in the Drew business unit increased $136,000, or 38.5%, to $489,000 as compared to the same period last fiscal year. The increase is primarily due to additional salaries and benefits and consulting fees associated with the development of several new hematology and diabetic instruments. Research and development expenses in the Medical/Trek/EMI business unit increased $128,000 to $133,000 as compared to the same period last fiscal year. The increase is primarily due to higher consulting (approximately $12,000), prototype (approximately $41,000) and salary expenses (approximately $50,000) for the development of the Company's new digital ophthalmic platform.

Research and development expenses increased $878,000, or 69.8%, to $2,136,000 during the nine-month period ended March 31, 2006 as compared to the same period last fiscal year. Research and development expenses were primarily expenses associated with the planned introduction of new and or enhanced products in the Drew, Sonomed and EMI business units. Research and development expenses in the Drew business unit increased $524,000, or 65.6%, to $1,323,000 as compared to the same period last fiscal year. The increase is primarily due

to additional salaries and benefits and consulting fees associated with the development of several new hematology and diabetic instruments. Research and development expenses in the Medical/Trek/EMI business unit increased $293,000 to $313,000 as compared to the same period last fiscal year. The increase is primarily due to higher consulting (approximately $31,000), prototype (approximately $48,000) and salary expenses (approximately $170,000) for the development of the Company's new digital ophthalmic platform. Research and development expenses in the Sonomed business unit increased $116,000 to $387,000 as compared to the same period last fiscal year. The increase is primarily due to higher consulting (approximately $158,000) offset by lower salaries (approximately $40,000) for development of the Company's new UMB machines and enhancements to it current product line.

Gain on sale of available for sale securities was approximately $1,157,000 in the nine-month period ended March 31, 2006. The increase was due to the sale of 58,585 shares of IntraLase common stock in July 2005. (See note 15 of the notes to the condensed consolidated financial statements.) There were no sales of available for sale securities during the three-month period ended March 31, 2006.

The Company recognized a loss of $18,000 and $13,000 related to its investment in OTM during the three-month periods ended March 31, 2006 and 2005, respectively, and $70,000 and $50,000 for the nine-month periods ended March 31, 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 14 of the notes to the condensed consolidated financial statements.)

Interest income was $34,000 and $9,000 for the three-month periods ended March 31, 2006 and 2005, respectively. The increase was due to a combination of higher effective yields on investments and higher investable balances.

Interest income was $70,000 and $50,000 for the nine-month periods ended March 31, 2006 and 2005, respectively. The increase was due to a combination of higher effective yields on investments in the

current nine period. The higher yields were offset by lower average investable balances due to the repayment of approximately $6,348,000 of debt in the second quarter of fiscal 2005.

Interest expense was $28,000 and $16,000 for the three-month periods ended March 31, 2006 and 2005, respectively, and $47,000 and $42,000 for the nine-month periods ended March 31, 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. The increase in interest expense during the three-month period ended March 31, 2006 when compared to the same prior year period is due to the non recurring reversal of loan commitment fees in the prior fiscal period.

LIQUIDITY AND CAPITAL RESOURCES

Changes in overall liquidity and capital resources from continuing operations during the three-month period ended March 31, 2006 are reflected in the following table (in thousands):

	MARCH 31, 2006	JUNE 30, 2005
CURRENT RATIO:		
Current assets	$ 15,707	$ 17,665
Less: Current liabilities	4,115	4,052
WORKING CAPITAL	$ 11,592	$ 13,613
CURRENT RATIO	3.8 TO 1	4.4 TO 1
DEBT TO TOTAL CAPITAL RATIO:		
Notes payable and current maturities	$ 244	$ 230
Long-term debt	225	392
Total debt	$ 469	$ 622
Total equity	34,120	34,519
TOTAL CAPITAL	$ 34,589	$ 35,141
TOTAL DEBT TO TOTAL CAPITAL	1.4%	1.8%

WORKING CAPITAL POSITION

Working capital decreased approximately $2,021,000 as of March 31, 2006 and the current ratio decreased to 3.8 to 1 from 4.4 to 1 when compared to June 30, 2005. The decrease in working capital was caused primarily by the loss from operations of approximately $1,959,000 and cash used to fund fixed asset additions of approximately $295,000, a deposit on a license for the right to distribute a new instrument for the Drew business unit of approximately $182,000, the pay off of several loans and the purchase of MRP during the nine-month period ended March 31, 2006. Partially offsetting these uses of working capital were proceeds of approximately $296,000 realized by the Company for the exercise of employee stock options.

CASH USED IN OPERATING ACTIVITIES

During the nine-month periods ended March 31, 2006 and 2005, the Company used approximately $2,753,000 and $2,485,000 of cash for operating activities. The net increase in cash used for operating activities of approximately $268,000 for the nine-month period ended March 31, 2006 as compared to the same period in the prior fiscal year is due primarily to the following factors:

- The Company employed significantly less cash to fund working capital requirements during the nine months ended March 31, 2006 than it employed in the same period in the prior fiscal year. Total working capital employed was approximately $1,161,000 and $3,295,000, respectively, during the

nine-month periods ended March 31, 2006 and 2005, respectively. The decrease is due to the fact that in the prior year period, the Company utilized cash to begin to alleviate the liquidity constraints that Drew was experiencing prior to its acquisition by the Company. The cash was utilized to support increases in inventory and receivables and reduce payables and outstanding draws on Drew's line of credit.

- The reduction in cash utilized to fund working capital was partially offset by a reduction in income of approximately $1,275,000 for the nine-month period ended March 31, 2006 when compared to the same prior year period.

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

Cash flows generated by investing activities were approximately $633,000 during the nine-month period ended March 31, 2006 and relate primarily to the net proceeds of approximately $1,157,000 realized from the sale of a majority of the remaining shares of the IntraLase securities held by the Company as available for sale securities. (See note 15 of the notes to the condensed consolidated financial statements.) Partially offsetting the cash realized from the securities sale was cash utilized for fixed asset additions of approximately $295,000, a deposit on a license for the right to distribute a new instrument for the Drew business unit of approximately $182,000 and cash outlays of approximately $47,000 for the purchase of MRP. (See note 2 of the notes to the condensed consolidated financial statements.) Any necessary capital expenditures have generally been funded out of cash from financing activities, and the Company is not aware of any factors that would cause historical capital expenditure levels to not be indicative of capital expenditures in the future and, accordingly, does not believe that the Company will have to commit material resources to capital investment for the foreseeable future.

Cash flows provided by financing activities were approximately $143,000 during the nine-month period ended March 31, 2006. During the period, the Company made scheduled long-term debt repayments of approximately $153,000. Offsetting the debt repayments was approximately $296,000 received by the Company from the exercise of stock options by directors and employees of the Company.

DEBT HISTORY

On December 23, 2002, a lender acquired the Company's bank debt, which consisted of term debt of $5,850,000 and $1,475,000 outstanding on a $2,000,000 available line of credit. On February 13, 2003, the Company entered into an amended agreement with the lender. The primary amendments of the amended loan agreement were to reduce quarterly principal payments, extend the term of the repayments and to alter the covenants of the original bank agreement. On September 30, 2004, the Company paid off and terminated both the remaining term debt and the outstanding balance on the line of credit. In November 2001, the Company issued 60,000 warrants to purchase the Company's common stock at $3.66 per share in connection with this debt. The warrants were exercised in December 2004.

On January 21, 1999, the Company's Vascular subsidiary and Endologix entered into an Assets Sale and Purchase Agreement. Pursuant to this agreement, the Company acquired for cash the assets of Endologix's vascular access business in exchange and also agreed to pay royalties to Endologix based on future sales of the vascular access business for a period of five years following the close of the sale, with a guaranteed minimum of $300,000 per year. On February 1, 2001, the parties amended the agreement to

eliminate any future royalty payments to Endologix. Pursuant to this amendment, the Company paid $17,558 in cash to Endologix, delivered a short-term note in the amount of $64,884 that was satisfied in January 2002, delivered a note in the amount of $717,558 payable in eleven quarterly installments that commenced on April 15, 2002, and issued 50,000 shares of its common stock to Endologix. On September 30, 2004, the Company paid off the balance of the term debt.

At the time of the acquisition of Drew by the Company, Drew had two lines of credit aggregating approximately $2,700,000, one of which was with a domestic financial institution, and one with a United Kingdom financial institution. At the time of the acquisition, outstanding draws on the lines aggregated approximately $1,643,000. The lines were paid off and terminated during the quarter ended December 31, 2004.

Drew has long-term debt facilities through the Texas Mezzanine Fund and through Symbiotics, Inc. The Texas Mezzanine Fund debt provides 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 March 31, 2006 and June 30, 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 March 31, 2006 was approximately $319,000. The Symbiotics, Inc. term debt, which originated from the acquisition of a product line from Symbiotics, Inc., is payable in monthly principal installments of $8,333 plus interest at a fixed rate of 5.00% per annum. The outstanding balance as of March 31, 2006 was approximately $150,000.

BALANCE SHEET

The components of the balance sheet of the Company were increased as of July 23, 2004 by the acquisition of Drew as follows:

Cash	$ 150,849
Accounts receivable	1,439,120
Inventory	2,069,146
Other current assets	351,505
Furniture and equipment	868,839
Goodwill	9,574,655
Patents	297,246
Other long-term assets	7,406
Line of credit	1,617,208
Current liabilities	3,392,286
Long-term debt	1,072,457
Exchange of common stock	7,430,439

These amounts represents approximately a $113,000 net difference from the amounts reported in the Company's Form 10-Q for the quarter ended December 31, 2004, which has been recorded as an increase in goodwill. The difference is the result of additional facts obtained since the acquisition which impacted the valuation of the assets acquired and liabilities assumed.

OFF-BALANCE SHEET ARRANGEMENTS AND CONTRACTUAL OBLIGATIONS

The Company was not a party to any off-balance sheet arrangements during

the three-and nine-month periods ended March 31, 2006 and 2005.

The following table presents the Company's contractual obligations as of March 31, 2006 (interest is not included in the table as it is immaterial):

	TOTAL	LESS THAN 1 YEAR	1-3 YEARS	5-MAR YEARS	MORE THAN 5 YEARS
Long-term debt	$ 468,686	$ 243,957	$ 224,729	$ 0	$ 0
Operating lease agreements	2,363,292	811,790	1,054,032	497,470	0
TOTAL	$2,831,978	$1,055,747	$1,278,761	$497,470	$ 0

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 since that date has acquired all of the Drew shares. 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 will be working to reverse the situation, while at the same time seeking to strengthen Drew's market position. As of March 31, 2006, the Company has loaned approximately $9,476,000 to Drew. The funds have been primarily used to procure components to build up inventory to support the manufacturing process, to pay off accounts payable and debt of Drew, to fund new product development and underwrite operating losses incurred since acquisition. The Company anticipates that further working capital will likely be required by Drew.

The Company realized approximately 0.0% and 5.0%, of its net revenue during the three-month periods ended March 31, 2006 and 2005, and approximately 0.9% and 5.9%, of its net revenue during the nine-month periods ended March 31, 2006 and 2005, respectively, from Bausch & Lomb's sale of Silicone Oil. This agreement expired in August 2005 and the Company will not receive any future royalties from this contract. Silicone Oil revenue was based on sale of the product by Bausch & Lomb multiplied by a contractual factor that declines on an annual basis due to a contractual step-down provision through its expiration date which was August 12, 2005. As there were no costs associated with this revenue, the expiration of the agreement will negatively impact gross margins, operating income and cash flows in future periods. The Company has incurred and anticipates continuing to incur higher than normal legal expenses related primarily to protecting its rights and interests in intellectual property licensed to IntraLase. (See note 11 of the notes to the condensed consolidated financial statements.) These higher costs are likely to unfavorably impact operating income and cash flows in future periods.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

INTEREST RATE RISK

The table below provides information about the Company's financial

instruments consisting of both variable and fixed interest rate debt obligations. For debt obligations, the table represents principal cash flows and related interest rates by expected maturity dates. Interest rates as of March 31, 2006 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 9 of the notes to the condensed consolidated financial statements for further information regarding the Company's debt obligations.)

	2006	2007	2008	THEREAFTER	TOTAL
Texas Mezzanine Fund Note	$143,961	$159,647	$15,075	$ 0	$318,683
Interest rate	10.25%	Prime Plus 4%	Prime Plus 4%	0.00%	
Symbiotics, Inc. Note	$ 99,996	$ 50,007	$ 0	$ 0	$150,003
Interest rate	5.00%	5.00%	5.00%	0.00%	
TOTAL	$243,957	$209,654	$15,075	$ 0	$468,686

EXCHANGE RATE RISK

During the three-month periods ended March 31, 2006 and 2005, approximately 35% and 36%, respectively, of the Company's consolidated net revenue was derived from international sales. During the nine-month periods ended March 31, 2006 and 2005, approximately 35% and 36% of the Company's consolidated net revenue was derived from international sales. Prior to the acquisition of Drew, the price of all product sold overseas was denominated in United States Dollars and consequently the Company incurred no exchange rate risk on revenue. However, a portion of Drew's product revenue is denominated in United Kingdom Pounds and Euros. During the three-month periods ended March 31, 2006 and 2005, Drew recorded approximately $334,000 and $535,000 respectively, of revenue denominated in United Kingdom Pounds and $26,000 and $3,000 in Euros, respectively. During the nine-month periods ended March 31, 2006 and 2005, Drew recorded approximately $1,187,000 and $1,885,000, respectively, of revenue denominated in United Kingdom Pounds and $244,000 and $23,000 in Euros, respectively.

Drew incurs a portion of its expenses denominated in United Kingdom Pounds. During the three-month periods ended March 31, 2006 and 2005, Drew incurred approximately $1,042,000 and $1,017,000, respectively, of expense denominated in United Kingdom Pounds. For the nine-month periods ended March 31, 2006 and 2005, these expenses totaled approximately $3,471,000 and $2,990,000, respectively. The Company's Sonomed business unit incurs a portion of its marketing expenses in the European market, the majority of which are transacted in Euros. For the three-month periods ended March 31, 2006 and 2005, these expenses totaled approximately $21,000 and $34,000, respectively. For the nine-month periods ended March 31, 2006 and 2005, these expenses totaled approximately $160,000 and $117,000, respectively. The Company's Vascular business unit began incurring marketing expenses in the European market during the second quarter of fiscal 2004, the majority of which are transacted in Euros. For the three-month periods ended March 31, 2006 and 2005, these expenses totaled approximately $34,000 and $39,000, respectively. For the nine-month periods ended March 31, 2006 and 2005, these expenses totaled approximately $111,000 and $124,000, respectively.

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

ITEM 3. CONTROLS AND PROCEDURES

(A) EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

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

Based on their evaluation of the effectiveness of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act,) as of March 31, 2006, the Chief Executive Officer and Principal Financial and Accounting Officer of the Company have concluded that such disclosure controls and procedures are effective to ensure that the information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, and that information required to be disclosed in the reports that the Company files or submits under the Exchange Act is accumulated and communicated to the Company's management, including its Chief Executive Officer and Principal Financial and Accounting Officer, to allow timely decisions regarding required disclosure.

(B) INTERNAL CONTROL OVER FINANCIAL REPORTING

There have not been any changes in the Company's internal control over financial reporting (as such term is defined in Rule 13a-15(f) under the Exchange Act, during the first fiscal quarter ended March 31, 2006 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

See note 11 of the notes to the condensed consolidated financial statements for further information regarding the Company's legal proceedings.

ITEM 2. UNREGISTERED SALES OF SECURITIES AND USE OF PROCEEDS

As reported in note 2 of the notes to the condensed consolidated financial statements, on January 30, 2006, the Company, through its subsidiary EMI, acquired substantially all of the assets of MRP in exchange for 250,000 shares of the Company's common stock and approximately $47,000 in cash. These shares were issued pursuant to the private offering exemption afforded under Section 4(2) of the Securities Act of 1933.

ITEM 6. EXHIBITS

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

31.2 Certificate of Principal Financial and Accounting Officer under Rule

13a-14(a).

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

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

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

ESCALON MEDICAL CORP.
(Registrant)

Date: May 15, 2006 By: /s/ Richard J. DePiano

Richard J. DePiano
Chairman and Chief
Executive Officer

Date: May 15, 2006 By: /s/ David S. Berkowitz

David S. Berkowitz
Principal Financial and Accounting
Officer