

E-Z-EM, Inc.  
Form 10-Q  
October 11, 2007

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-Q**

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

For the quarterly period ended September 1, 2007

**OR**

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 0-13003

**E-Z-EM, Inc.**

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of  
incorporation or organization)

11-1999504

(I.R.S. Employer  
Identification No.)

1111 Marcus Avenue, Lake Success, New York

(Address of principal executive offices)

11042

(Zip Code)

(516) 333-8230

Registrant's telephone number, including area code

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

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As of October 5, 2007, there were 10,976,549 shares of the issuer's common stock outstanding.

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## E-Z-EM, Inc. and Subsidiaries

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## E-Z-EM, Inc. and Subsidiaries

**CONSOLIDATED BALANCE SHEETS**

(in thousands)

| ASSETS   | September 1,<br>2007 | June 2,<br>2007 |
|--|----------------------|-----------------|
|  | (unaudited)          | (audited)       |
| <b>CURRENT ASSETS</b>  |                      |                 |
| Cash and cash equivalents  | \$ 7,919             | \$ 8,037        |
| Debt and equity securities, at fair value  | 36,509               | 36,163          |
| Accounts receivable, principally<br>trade, net of allowance for doubtful<br>accounts of \$904 and \$928 at September 1, 2007<br>and June 2, 2007, respectively | 21,536               | 23,460          |
| Inventories, net   | 34,928               | 29,799          |
| Refundable income taxes  | 857                  | 981             |
| Other current assets   | 5,721                | 5,788           |
|  | <u>107,470</u>       | <u>104,228</u>  |
| <b>PROPERTY, PLANT AND EQUIPMENT - AT COST,</b>  |                      |                 |
| less accumulated depreciation and<br>amortization of \$29,444 and \$28,574 at<br>September 1, 2007 and June 2, 2007,<br>respectively                           | 17,782               | 16,863          |
| <b>INTANGIBLE ASSETS, less accumulated</b>   |                      |                 |
| amortization of \$1,777 and \$1,591 at<br>September 1, 2007 and June 2, 2007,<br>respectively  | 3,194                | 3,380           |
| <b>DEBT AND EQUITY SECURITIES, at fair value</b>   |                      |                 |
|  | 599                  | 1,196           |
| <b>CASH SURRENDER VALUE OF LIFE INSURANCE</b>  |                      |                 |
|  | 6,605                | 6,471           |
| <b>OTHER ASSETS</b>  |                      |                 |
|  | 2,914                | 2,804           |
|  | <u>138,564</u>       | <u>134,942</u>  |
| Total assets   | \$ 138,564           | \$ 134,942      |

The accompanying notes are an integral part of these financial statements.

## E-Z-EM, Inc. and Subsidiaries

**CONSOLIDATED BALANCE SHEETS**  
(in thousands, except share and per share data)

| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>  | <b>September 1,<br/>2007</b> | <b>June 2,<br/>2007</b> |
|--|------------------------------|-------------------------|
|  | <b>(unaudited)</b>           | <b>(audited)</b>        |
| <b>CURRENT LIABILITIES</b>   |                              |                         |
| Accounts payable   | \$ 8,194                     | \$ 7,574                |
| Accrued liabilities  | 7,912                        | 8,435                   |
| Deferred revenue   | 3,585                        |                         |
| Accrued income taxes   | 507                          | 1,175                   |
|  | <u>          </u>            | <u>          </u>       |
| Total current liabilities  | 20,198                       | 17,184                  |
| <b>NONCURRENT LIABILITIES</b>  |                              |                         |
|  | 3,705                        | 3,721                   |
|  | <u>          </u>            | <u>          </u>       |
| Total liabilities  | 23,903                       | 20,905                  |
|  | <u>          </u>            | <u>          </u>       |
| <b>COMMITMENTS AND CONTINGENCIES</b>   |                              |                         |
| <b>STOCKHOLDERS' EQUITY</b>  |                              |                         |
| Preferred stock, par value \$.10 per share - authorized, 1,000,000 shares; issued, none  |                              |                         |
| Common stock, par value \$.10 per share - authorized, 16,000,000 shares; issued and outstanding 10,976,549 shares at September 1, 2007 and June 2, 2007 (excluding 89,205 shares held in treasury at September 1, 2007 and June 2, 2007) | 1,098                        | 1,098                   |
| Additional paid-in capital   | 31,857                       | 31,779                  |
| Retained earnings  | 73,451                       | 72,806                  |
| Accumulated other comprehensive income   | 8,255                        | 8,354                   |
|  | <u>          </u>            | <u>          </u>       |
| Total stockholders' equity   | 114,661                      | 114,037                 |
|  | <u>          </u>            | <u>          </u>       |
| Total liabilities and stockholders' equity   | \$ 138,564                   | \$ 134,942              |
|  | <u>          </u>            | <u>          </u>       |

The accompanying notes are an integral part of these financial statements.

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E-Z-EM, Inc. and Subsidiaries

**CONSOLIDATED STATEMENTS OF EARNINGS**

(unaudited)

(in thousands, except per share data)

|   | <b>Thirteen weeks ended</b>  |                              |
|---|------------------------------|------------------------------|
|   | <b>September 1,<br/>2007</b> | <b>September 2,<br/>2006</b> |
| Net sales   | \$ 32,967                    | \$ 33,440                    |
| Cost of goods sold  | 18,501                       | 18,849                       |
| <b>Gross profit</b>   | <b>14,466</b>                | <b>14,591</b>                |
| Operating expenses  |                              |                              |
| Selling, general and administrative   | 12,168                       | 11,141                       |
| Research and development  | 1,935                        | 1,376                        |
| <b>Total operating expenses</b>   | <b>14,103</b>                | <b>12,517</b>                |
| <b>Operating profit</b>   | <b>363</b>                   | <b>2,074</b>                 |
| Other income (expense)  |                              |                              |
| Interest income   | 420                          | 356                          |
| Interest expense  | (70)                         | (70)                         |
| Foreign currency exchange gains (losses)  | (56)                         | 219                          |
| Other, net  | 183                          | 55                           |
| <b>Earnings from continuing operations<br/>before income taxes</b>                      | <b>840</b>                   | <b>2,634</b>                 |
| <b>Income tax provision</b>   | <b>195</b>                   | <b>851</b>                   |
| <b>Earnings from continuing operations</b>  | <b>645</b>                   | <b>1,783</b>                 |
| <b>Loss from discontinued operation, net of<br/>income tax benefit of \$120 in 2006</b> |                              | <b>(221)</b>                 |
| <b>NET EARNINGS</b>   | <b>\$ 645</b>                | <b>\$ 1,562</b>              |
| Basic earnings (loss) per common share  |                              |                              |
| From continuing operations  | \$ 0.06                      | \$ 0.16                      |
| From discontinued operation,<br>net of income tax benefit                               |                              | (0.02)                       |
| <b>From total operations</b>  | <b>\$ 0.06</b>               | <b>\$ 0.14</b>               |

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Thirteen weeks ended

|   |    |                   |    |                   |
|---|----|-------------------|----|-------------------|
| Diluted earnings (loss) per common share                  |    |                   |    |                   |
| From continuing operations                                | \$ | 0.06              | \$ | 0.16              |
| From discontinued operation,<br>net of income tax benefit |    |                   |    | (0.02)            |
|   |    | <u>          </u> |    | <u>          </u> |
| From total operations                                     | \$ | 0.06              | \$ | 0.14              |
|   |    | <u>          </u> |    | <u>          </u> |

The accompanying notes are an integral part of these financial statements.

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E-Z-EM, Inc. and Subsidiaries

**CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY AND COMPREHENSIVE INCOME**

Thirteen weeks ended September 1, 2007  
(unaudited)  
(in thousands, except share data)

|  | Common stock |          | Additional<br>paid-in<br>capital | Retained<br>earnings | Accumulated<br>other<br>comprehensive<br>income | Total      | Compre-<br>hensive<br>income |
|--|--------------|----------|----------------------------------|----------------------|---|------------|------------------------------|
|  | Shares       | Amount   |                                  |                      |   |            |                              |
| Balance at June 2, 2007  | 10,976,549   | \$ 1,098 | \$ 31,779                        | \$ 72,806            | \$ 8,354  | \$ 114,037 |                              |
| Compensation related to<br>stock option plans                        |              |          | 78                               |                      |   | 78         |                              |
| Net earnings   |              |          |                                  | 645                  |   | 645        | \$ 645                       |
| Unrealized holding loss on debt<br>and equity securities             |              |          |                                  |                      |   |            |                              |
| Arising during the period  |              |          |                                  |                      | (268)   | (268)      | (268)                        |
| Reclassification adjustment<br>for gains included in net<br>earnings |              |          |                                  |                      | (82)  | (82)       | (82)                         |
| Foreign currency translation<br>adjustments                          |              |          |                                  |                      | 251   | 251        | 251                          |
| Comprehensive income   |              |          |                                  |                      |   |            | \$ 546                       |
| Balance at September 1, 2007   | 10,976,549   | \$ 1,098 | \$ 31,857                        | \$ 73,451            | \$ 8,255  | \$ 114,661 |                              |

The accompanying notes are an integral part of this financial statement.



## E-Z-EM, Inc. and Subsidiaries

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

(unaudited)

(in thousands)

**Thirteen weeks ended**

|  | <b>September 1,<br/>2007</b> | <b>September 2,<br/>2006</b> |
|--|------------------------------|------------------------------|
| <b>Cash flows from operating activities:</b>   |                              |                              |
| Net earnings   | \$ 645                       | \$ 1,562                     |
| Loss from discontinued operation,<br>net of tax  |                              | 221                          |
| Adjustments to reconcile net earnings<br>to net cash provided by (used in)<br>operating activities |                              |                              |
| Depreciation and amortization  | 963                          | 884                          |
| Gain on sale of investments  | (126)                        |                              |
| Provision for (reduction in)doubtful<br>accounts   | (24)                         | 23                           |
| Deferred income tax provision  | 17                           | 288                          |
| Stock option compensation cost   | 78                           | 21                           |
| Changes in operating assets and<br>liabilities, net of business divested                           |                              |                              |
| Accounts receivable  | 1,994                        | (726)                        |
| Inventories  | (4,997)                      | (2,109)                      |
| Other current assets   | 233                          | 1,522                        |
| Other assets   | (98)                         | 43                           |
| Accounts payable   | 599                          | (251)                        |
| Accrued liabilities  | (545)                        | (2,619)                      |
| Deferred revenue   | 3,579                        |                              |
| Accrued income taxes   | (675)                        | 157                          |
| Other noncurrent liabilities   | (20)                         | (12)                         |
| Net cash used in operating activities<br>of discontinued operation                                 |                              | (208)                        |
|  | <u>                    </u>  | <u>                    </u>  |
| Net cash provided by (used in)<br>operating activities   | 1,623                        | (1,204)                      |
|  | <u>                    </u>  | <u>                    </u>  |
| <b>Cash flows from investing activities:</b>   |                              |                              |
| Additions to property, plant and<br>equipment, net   | (1,639)                      | (1,190)                      |
| Available-for-sale securities  |                              |                              |
| Purchases  | (52,130)                     | (147,140)                    |
| Proceeds from sale   | 51,971                       | 151,764                      |
| Net cash provided by investing activities<br>of discontinued operation                             |                              | 2                            |
|  | <u>                    </u>  | <u>                    </u>  |
| Net cash provided by (used in) investing activities  | (1,798)                      | 3,436                        |
|  | <u>                    </u>  | <u>                    </u>  |

The accompanying notes are an integral part of these financial statements.



## E-Z-EM, Inc. and Subsidiaries

**CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)**(unaudited)  
(in thousands)**Thirteen weeks ended**

|  | <b>September 1,<br/>2007</b> | <b>September 2,<br/>2006</b> |
|--|------------------------------|------------------------------|
| <b>Cash flows from financing activities:</b>                                       |                              |                              |
| Repayments of debt   |                              | \$ (13)                      |
| Proceeds from exercise of stock options  |                              | 50                           |
| Tax benefit on exercise of stock options   |                              | 115                          |
| Net cash used in financing activities  |                              | (105)                        |
| of discontinued operation  |                              | (105)                        |
|  | <u>          </u>            | <u>          </u>            |
| Net cash provided by financing activities  | \$ —                         | 47                           |
|  | <u>          </u>            | <u>          </u>            |
| Effect of exchange rate changes on cash and cash equivalents                       | 57                           | (46)                         |
|  | <u>          </u>            | <u>          </u>            |
| INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS                                   | (118)                        | 2,233                        |
| Cash and cash equivalents Beginning of period                                      | 8,037                        | 6,749                        |
|  | <u>          </u>            | <u>          </u>            |
| End of period  | \$ 7,919                     | \$ 8,982                     |
|  | <u>          </u>            | <u>          </u>            |
| <b>Supplemental disclosures of cash flow information:</b>                          |                              |                              |
| Cash paid (refunded) during the period for:  |                              |                              |
| Interest   | \$ 50                        | \$ 34                        |
|  | <u>          </u>            | <u>          </u>            |
| Income taxes (net of refunds of \$ 468 and \$1,162 in 2007 and 2006, respectively) | \$ 719                       | \$ (858)                     |
|  | <u>          </u>            | <u>          </u>            |

The accompanying notes are an integral part of these financial statements.

E-Z-EM, Inc. and Subsidiaries

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

September 1, 2007 and September 2, 2006  
(unaudited)

**NOTE A – NATURE OF BUSINESS AND BASIS OF PRESENTATION**

**Nature of Business**

E-Z-EM, Inc. and its subsidiaries (“the Company” or “E-Z-EM”) is a leading provider of medical devices and contrast products used by radiologists, gastroenterologists and speech language pathologists primarily in screening for and diagnosing diseases and disorders of the gastrointestinal (“GI”) tract. Products are used for computed tomography (CT) and magnetic resonance (MR) imaging, colorectal cancer screening, evaluation of swallowing disorders (dysphagia), and testing for other diseases and disorders of the GI system. The Company is also the exclusive worldwide manufacturer and marketer of its RSDL skin decontaminant (“RSDL”) product for military services and first-responder organizations. RSDL is a patented, broad-spectrum liquid chemical warfare agent decontaminant that neutralizes or removes chemical agents from skin on contact, leaving a non-toxic residue that can be rinsed off with water. The Company also leverages its capacities in manufacturing, automation and quality control by providing contract manufacturing to third-parties.

**Basis of Presentation**

The consolidated balance sheet as of September 1, 2007, the consolidated statement of stockholders’ equity and comprehensive income for the thirteen weeks ended September 1, 2007, and the consolidated statements of earnings and cash flows for the thirteen weeks ended September 1, 2007 and September 2, 2006, have been prepared by the Company without audit. The consolidated balance sheet as of June 2, 2007 was derived from audited consolidated financial statements. In the opinion of management, all adjustments (which include normal recurring adjustments) necessary to present fairly the financial position, changes in stockholders’ equity and comprehensive income, results of operations and cash flows at September 1, 2007 (and for all periods presented) have been made.

Certain information and footnote disclosures, normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America, have been condensed or omitted. These consolidated financial statements should be read in conjunction with the financial statements and notes thereto included in the Annual Report on Form 10-K for the fiscal year ended June 2, 2007, filed by the Company on August 16, 2007. The results of operations for the periods ended September 1, 2007, and September 2, 2006, are not necessarily indicative of the operating results for the respective full years.

The consolidated financial statements include the accounts of E-Z-EM, Inc. and all wholly owned subsidiaries. Toho Kagaku Kenkyusho Co., Ltd. (“Toho”), the Company’s wholly owned Japanese subsidiary, is reported separately as a discontinued operation for the period ended September 2, 2006 within the consolidated financial statements (see Note B). All significant intercompany balances and transactions have been eliminated.

E-Z-EM, Inc. and Subsidiaries

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**September 1, 2007 and September 2, 2006  
(unaudited)**NOTE B – DISCONTINUED OPERATION**

In fiscal 2007, the Company completed the wind-down of Toho. The Company decided to close Toho and exit this market because it was unable to generate sufficient income from operations and grow the business due to a limited product offering and scope of operation. Also, a change in manufacturing location required a re-registration of Toho's principal products with Japanese regulatory authorities, resulting in a projected interruption of supply during the first quarter of fiscal 2007. Management planned a market withdrawal on a staged basis so that inventory could be sold, accounts receivable collected and the property sold in an organized fashion, while also satisfying all outstanding liabilities.

As a result of this exit, foreign currency translation losses of \$33,000 included in accumulated other comprehensive income have been charged to results of operations for the thirteen weeks ended September 2, 2006 in accordance with EITF Issue No. 01-5, "Application of FASB Statement No. 52 to an Investment Being Evaluated for Impairment That Will Be Disposed Of." EITF 01-5 requires that accumulated foreign currency translation adjustments be included as part of the carrying amount of a foreign investment being evaluated for impairment under a committed plan of disposal. For the period ended September 2, 2006, Toho is accounted for as a discontinued operation in the Company's financial statements in accordance with Statement of Financial Accounting Standards ("SFAS") No. 144, "Accounting for Impairment and Disposal of Long-Lived Assets."

For the thirteen weeks ended September 2, 2006, project costs, primarily severance and the above-mentioned impairment, aggregated \$230,000. Changes in project costs are as follows:

|                   | <b>September 2,<br/>2006</b> |
|-------------------|------------------------------|
|                   | <b>(in thousands)</b>        |
| Beginning balance | \$ 333                       |
| Recorded          | 230                          |
| Paid              | (300)                        |
| Ending balance    | <u>\$ 263</u>                |

E-Z-EM, Inc. and Subsidiaries

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**September 1, 2007 and September 2, 2006  
(unaudited)**NOTE B – DISCONTINUED OPERATION (continued)**

Summarized results of operations for Toho as reported in loss from discontinued operation in the accompanying consolidated statements of earnings are as follows:

|                                  | <b>Thirteen<br/>weeks ended<br/>September 2,<br/>2006</b> |
|----------------------------------|---|
|                                  | <b>(in thousands)</b>                                     |
| Net sales                        |   |
| From unaffiliated customers      | \$ 194  |
| Total net sales                  | \$ 194  |
| Loss before income taxes         | \$ (341)  |
| Income tax benefit               | (120)   |
| Loss from discontinued operation | \$ (221)  |

**NOTE C - STOCK-BASED COMPENSATION**

Effective June 4, 2006, the Company adopted the provisions of SFAS No. 123(R), "Share-Based Payment," which revises SFAS No. 123, "Accounting for Stock-Based Compensation" and supersedes APB Opinion No. 25, "Accounting for Stock Issued to Employees." SFAS No. 123(R) requires that all stock-based compensation be recognized as an expense in the financial statements and that such cost be measured at the fair value of the award.

The Company adopted SFAS No. 123(R) using the modified prospective method, which requires the Company to recognize compensation expense on a prospective basis. Therefore, prior period financial statements have not been restated. Under this transition method, the Company applies the provisions of SFAS No. 123(R) to new awards and to awards modified, repurchased or cancelled on or after June 4, 2006. The provisions of SFAS No. 123(R) did not apply to any stock options outstanding as of June 4, 2006, since all such options were fully vested.

Prior to the adoption of SFAS No. 123(R), the Company accounted for stock-based compensation awards under its three stock-based compensation plans using the intrinsic value method of Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees" and related interpretations. Accordingly, no compensation expense had been recognized under these plans concerning stock options granted to employees and to members of the Board of Directors, as all such stock options granted had exercise prices equal to or greater than the market value of the underlying common stock on the dates of grant. No awards other than stock options have been granted under the Company's plans.

E-Z-EM, Inc. and Subsidiaries

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

September 1, 2007 and September 2, 2006  
(unaudited)

**NOTE C - STOCK-BASED COMPENSATION (continued)**

Additionally, in periods prior to June 4, 2006, the Company followed the disclosure-only requirements of SFAS No. 123, which allowed entities to continue to apply the provisions of APB No. 25 for transactions with employees and directors and provide pro forma net earnings and pro forma earnings per share disclosures for employee and director stock option grants made as if the fair value based method of accounting in SFAS No. 123 had been applied to these transactions.

For the thirteen weeks ended September 1, 2007, the Company recognized pre-tax share-based compensation expense of \$78,000 (\$51,000 after tax effects) for awards to members of the Board of Directors granted during the fourth quarter of fiscal 2007. For the thirteen weeks ended September 2, 2006, the Company recognized pre-tax share-based compensation expense of \$21,000 (\$13,000 after tax effects) for options granted in prior years to a former director serving as a consultant. These expenses are included in selling, general and administrative expense in the accompanying consolidated statements of earnings. The Company recognizes share-based compensation costs on a straight-line basis over the service period. At September 1, 2007, there was \$234,000 of total unrecognized compensation cost related to non-vested stock options granted under the Company's stock-based compensation plans, which will be recognized over a weighted-average remaining life of approximately three-quarters of one year.

In November 2005, the Financial Accounting Standards Board ("FASB") issued Staff Position No. FAS 123(R)-3, "Transition Election Related to Accounting for the Tax Effects of Share-Based Payment Awards" ("FSP 123R-3"). The Company has elected to adopt the alternative transition method provided in FSP 123R-3 for calculating the tax effects of stock-based compensation under SFAS 123R. The alternative transition method includes simplified methods to establish the beginning balance of the additional paid-in-capital pool ("APIC pool") related to the tax effects of stock-based compensation, and for determining the subsequent impact on the APIC pool and consolidated statements of cash flows of the tax effects of stock-based compensation awards that are outstanding upon adoption of SFAS No. 123(R).

Prior to the adoption of SFAS No. 123(R), the Company presented all tax benefits resulting from the exercise of stock options as operating cash flows in the consolidated statement of cash flows. SFAS No. 123(R) requires that cash flows from the exercise of stock options resulting from tax benefits in excess of recognized cumulative compensation cost (excess tax benefits) be classified as financing cash flows.

E-Z-EM, Inc. and Subsidiaries

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

September 1, 2007 and September 2, 2006  
(unaudited)

**NOTE C - STOCK-BASED COMPENSATION (continued)**

**2004 Stock and Incentive Award Plan**

In October 2004, the Company adopted the 2004 Stock and Incentive Award Plan (the "2004 Plan"). The 2004 Plan provides for the grant of incentive stock options to employees and for the grant of nonstatutory stock options, restricted stock, stock appreciation rights, performance units, performance shares and other incentive awards to employees, directors and other service providers. A total of 1,708,425 shares (including 700,000 shares authorized in October 2006) of the Company's common stock are available for issuance under the 2004 Plan, including 576,346 shares and 82,079 shares reallocated from the 1983 Stock Option Plan and 1984 Directors and Consultants Stock Option Plan, respectively. A committee of the board administers the 2004 Plan. The committee determines the vesting terms and exercise price of options granted under the 2004 Plan and the terms and conditions of any other awards made under the 2004 Plan. For all incentive stock options the exercise price must at least be equal to the fair market value of the Company's common stock on the date of grant. The term of an incentive stock option may not exceed ten years, and up to 800,000 shares of the Company's common stock may be issued upon exercise of incentive stock options. No awards may be granted under the 2004 Plan after October 26, 2014. At September 1, 2007, there were 696,175 shares available for grants of options and other awards under the 2004 Plan.

**1983 Stock Option Plan**

In 1983, the Company adopted the 1983 Stock Option Plan (the "1983 Plan"). The 1983 Plan provides for the grant to key employees of both nonqualified stock options and incentive stock options. A total of 2,041,628 shares (giving effect to the reallocation of 576,346 shares to the 2004 Plan) of the Company's common stock may be issued under the 1983 Plan pursuant to the exercise of options. All outstanding stock options have an exercise price of not less than the market value of the shares on the date of grant. Outstanding options are exercisable over a period of time designated by the administrators of the 1983 Plan (but not more than 10 years from the date of grant) and are subject to such other terms and conditions as the administrators have determined. No further options will be issued under the 1983 Plan.



E-Z-EM, Inc. and Subsidiaries

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

September 1, 2007 and September 2, 2006  
(unaudited)

**NOTE C - STOCK-BASED COMPENSATION (continued)**

**1984 Stock Option Plan**

In 1984, the Company adopted the 1984 Directors and Consultants Stock Option Plan (the "1984 Plan"). The 1984 Plan provides for the grant to members of the Board of Directors and consultants of nonqualified stock options. A total of 377,411 shares (giving effect to the reallocation of 82,079 shares to the 2004 Plan) of the Company's common stock may be issued under the 1984 Plan pursuant to the exercise of options. All outstanding stock options have an exercise price of not less than the market value of the shares on the date of grant. Outstanding options are exercisable over a period of time designated by the administrators of the 1984 Plan (but not more than 10 years from the date of grant) and are subject to such other terms and conditions as the administrators have determined. No further options will be issued under the 1984 Plan.

The fair value of options granted is estimated on the date of grant using the Black-Scholes option-pricing model based on weighted-average assumptions for all plans for expected life (years), expected volatility, risk-free interest rate, dividend yield and pre-vesting forfeitures. No options were granted during the thirteen weeks ended September 1, 2007 and September 2, 2006.

The expected life of the options represents the estimated period of time until exercise and is based on historical experience of similar awards, giving consideration to the contractual terms, vesting schedules and expectations of future behavior. The expected volatility is estimated using the historical volatility of the Company's stock. The risk-free interest rate is based on the U.S. Treasury rates at the date of grant with maturity dates approximately equal to the expected life at the grant date. The Company has not recently paid any dividends and does not expect to in the foreseeable future. The amount of stock-based compensation expense recognized during a period is based on the portion of the awards that are ultimately expected to vest. The Company estimates pre-vesting forfeitures at the time of grant by analyzing historical data and revises those estimates in subsequent periods if actual forfeitures differ significantly from those estimates. Ultimately, the total expense recognized over the vesting period will equal the fair value of awards that actually vest.

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E-Z-EM, Inc. and Subsidiaries

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

September 1, 2007 and September 2, 2006  
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**NOTE C - STOCK-BASED COMPENSATION (continued)**

The following is a summary of the stock option activity during the thirteen weeks ended September 1, 2007:

|  | Number of<br>Shares<br>(000) | Weighted<br>Average<br>Exercise<br>Price | Weighted<br>Average<br>Remaining<br>Contractual<br>Life in<br>Years | Aggregate<br>Intrinsic<br>Value<br>(000) |
|--|------------------------------|--|---|--|
| Outstanding at beginning of period             | 1,279                        | \$ 12.45                                 | 6.80  |  |
| Outstanding at end of period                   | 1,279                        | \$ 12.45                                 | 6.55  | \$ 3,068                                 |
| Vested or expected to vest at<br>end of period | 1,244                        | \$ 12.33                                 | 6.46  | \$ 3,132                                 |
| Exercisable at end of period                   | 1,244                        | \$ 12.33                                 | 6.46  | \$ 3,132                                 |

The following is a summary of the stock option activity during the thirteen weeks ended September 2, 2006:

|  | Number of<br>Shares<br>(000) | Weighted<br>Average<br>Exercise<br>Price | Weighted<br>Average<br>Remaining<br>Contractual<br>Life in<br>Years | Aggregate<br>Intrinsic<br>Value<br>(000) |
|--|------------------------------|--|---|--|
| Outstanding at beginning of period             | 1,358                        | \$ 12.23                                 | 7.65  |  |
| Exercised                                      | (7)                          | \$ 6.75                                  | 5.93  |  |
| Forfeited                                      | (6)                          | \$ 14.39                                 | 8.50  |  |
| Outstanding at end of period                   | 1,345                        | \$ 12.25                                 | 7.40  | \$ 3,608                                 |
| Vested or expected to vest at<br>end of period | 1,345                        | \$ 12.25                                 | 7.40  | \$ 3,608                                 |
| Exercisable at end of period                   | 1,345                        | \$ 12.25                                 | 7.40  | \$ 3,608                                 |

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The aggregate intrinsic value in the table above is before applicable income taxes and is based on the Company's closing stock price as of the last business day of the respective period. The total intrinsic value of stock options exercised during the thirteen weeks ended September 2, 2006 was \$51,000.

The Company received cash of \$50,000 from stock options exercised during the thirteen weeks ended September 2, 2006. These cash receipts are included in financing activities in the accompanying consolidated statements of cash flows. The Company realized tax benefits from the exercise of stock options during the thirteen weeks ended September 2, 2006 of \$115,000.

E-Z-EM, Inc. and Subsidiaries

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**September 1, 2007 and September 2, 2006  
(unaudited)**NOTE D - EARNINGS PER COMMON SHARE**

Basic earnings per share are based on the weighted average number of common shares outstanding without consideration of potential common stock. Diluted earnings per share are based on the weighted average number of common and potential dilutive common shares outstanding. The calculation takes into account the shares that may be issued upon exercise of stock options, reduced by the shares that may be repurchased with the funds received from the exercise, based on the average price during the period.

The following table sets forth the reconciliation of the weighted average number of common shares:

|  | <b>Thirteen weeks ended</b>  |                              |
|--|------------------------------|------------------------------|
|  | <b>September 1,<br/>2007</b> | <b>September 2,<br/>2006</b> |
|  | <b>(in thousands)</b>        |                              |
| Basic  | 10,977                       | 10,867                       |
| Effect of dilutive securities<br>(stock options) | 190                          | 192                          |
| Diluted  | 11,167                       | 11,059                       |

Excluded from the calculation of earnings per common share, are options to purchase 228,750 and 224,750 shares of common stock for the thirteen weeks ended September 1, 2007 and September 2, 2006, respectively, as their inclusion would be anti-dilutive. For the thirteen weeks ended September 1, 2007, the range of exercise prices on the excluded options was \$16.69 to \$17.49 per share and, for the thirteen weeks ended September 2, 2006, the range of exercise prices on the excluded options was \$15.64 to \$17.49 per share.

**NOTE E - EFFECTS OF RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS**

In June 2006, the FASB issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes," an interpretation of FASB Statement No. 109 ("FIN 48"). FIN 48 clarifies the accounting for uncertainties in income taxes recognized in an enterprise's financial statements. The interpretation requires that the Company determine whether it is more likely than not that a tax position will be sustained upon examination by the appropriate taxing authority. If a tax position meets the more likely than not recognition criteria, FIN 48 requires that the tax position be measured at the largest amount of benefit greater than 50 percent likely of being realized upon ultimate settlement. This accounting standard is effective for fiscal years beginning after December 15, 2006. The Company adopted FIN 48 as of June 3, 2007. The adoption of FIN 48 has not had a material effect on the Company's financial condition or results of operations.

E-Z-EM, Inc. and Subsidiaries

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

September 1, 2007 and September 2, 2006  
(unaudited)

**NOTE E - EFFECTS OF RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS (continued)**

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements." This statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. The standard applies whenever other standards require (or permit) assets or liabilities to be measured at fair value but does not expand the use of fair value in any new circumstances. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company does not believe that the adoption of SFAS No. 157 will have a material impact on its financial condition or results of operations.

In February 2007, the FASB issued SFAS No. 159, "*The Fair Value Option for Financial Assets and Financial Liabilities - Including an amendment of FASB Statement No. 115.*" SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. The objective of SFAS No. 159 is to provide opportunities to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply hedge accounting provisions. SFAS No. 159 also establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. The Company does not believe that the adoption of SFAS No. 159 will have a material impact on its financial condition or results of operations.

E-Z-EM, Inc. and Subsidiaries

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**September 1, 2007 and September 2, 2006  
(unaudited)**NOTE F - COMPREHENSIVE INCOME**

The components of comprehensive income, net of related tax, are as follows:

|  | <b>Thirteen weeks ended</b>  |                              |
|--|------------------------------|------------------------------|
|  | <b>September 1,<br/>2007</b> | <b>September 2,<br/>2006</b> |
|  | (in thousands)               |                              |
| Net earnings   | \$ 645                       | \$ 1,562                     |
| Unrealized holding gain (loss) on debt and equity securities:      |                              |                              |
| Arising during the period  | (268)                        | 100                          |
| Reclassification adjustment for gains included in net earnings     | (82)                         |                              |
| Foreign currency translation adjustments arising during the period | 251                          | (40)                         |
| Comprehensive income   | \$ 546                       | \$ 1,622                     |

The components of accumulated other comprehensive income, net of related tax, are as follows:

|   | <b>September 1,<br/>2007</b> | <b>June 2,<br/>2007</b> |
|---|------------------------------|-------------------------|
|   | (in thousands)               |                         |
| Unrealized holding gain on debt and equity securities | \$ 263                       | \$ 613                  |
| Cumulative translation adjustments                    | 7,992                        | 7,741                   |
| Accumulated other comprehensive income                | \$ 8,255                     | \$ 8,354                |

E-Z-EM, Inc. and Subsidiaries

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**September 1, 2007 and September 2, 2006  
(unaudited)**NOTE G - DEBT AND EQUITY SECURITIES**

Debt and equity securities at September 1, 2007 consisted of the following:

|  | <u>Amortized<br/>cost</u> | <u>Fair<br/>value</u> | <u>Unrealized<br/>holding<br/>gain</u> |
|--|---------------------------|-----------------------|--|
|  | (in thousands)            |                       |  |
| <b><u>Current</u></b>  |                           |                       |  |
| Available-for-sale securities<br>(carried on the balance sheet<br>at fair value) |                           |                       |  |
| Municipal bonds with maturities  |                           |                       |  |
| Due in one through 10 years  | \$ 6,000                  | \$ 6,000              |  |
| Due after 10 years and through<br>20 years                                       | 2,965                     | 2,965                 |  |
| Due after 20 years   | 15,100                    | 15,100                |  |
| Municipal funds  | 12,176                    | 12,176                |  |
| Other  | 268                       | 268                   |  |
|  | <u>\$ 36,509</u>          | <u>\$ 36,509</u>      |  |
| <b><u>Noncurrent</u></b>   |                           |                       |  |
| Available-for-sale securities<br>(carried on the balance sheet<br>at fair value) |                           |                       |  |
| Equity securities  | \$ 196                    | \$ 599                | \$ 403                                 |
|  | <u>\$ 196</u>             | <u>\$ 599</u>         | <u>\$ 403</u>                          |

E-Z-EM, Inc. and Subsidiaries

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**September 1, 2007 and September 2, 2006  
(unaudited)**NOTE G - DEBT AND EQUITY SECURITIES (continued)**

Debt and equity securities at June 2, 2007 consisted of the following:

|  | <u>Amortized<br/>cost</u> | <u>Fair<br/>value</u> | <u>Unrealized<br/>holding<br/>gain</u> |
|--|---------------------------|-----------------------|--|
|  | (in thousands)            |                       |  |
| <b><u>Current</u></b>  |                           |                       |  |
| Available-for-sale securities<br>(carried on the balance sheet<br>at fair value) |                           |                       |  |
| Municipal bonds with maturities  |                           |                       |  |
| Due after 10 years and through<br>20 years                                       | \$ 18,400                 | \$ 18,400             |  |
| Due after 20 years   | 17,575                    | 17,575                |  |
| Other  | 188                       | 188                   |  |
|  | <u>\$ 36,163</u>          | <u>\$ 36,163</u>      |  |
| <b><u>Noncurrent</u></b>   |                           |                       |  |
| Available-for-sale securities<br>(carried on the balance sheet<br>at fair value) |                           |                       |  |
| Equity securities  | \$ 257                    | \$ 1,196              | \$ 939                                 |
|  | <u>\$ 257</u>             | <u>\$ 1,196</u>       | <u>\$ 939</u>                          |

**NOTE H - INVENTORIES**

Inventories consist of the following:

|                 | <u>September 1,<br/>2007</u> | <u>June 2,<br/>2007</u> |
|-----------------|------------------------------|-------------------------|
|                 | (in thousands)               |                         |
| Finished goods  | \$ 15,700                    | \$ 15,016               |
| Work in process | 278                          | 247                     |
| Raw materials   | 18,950                       | 14,536                  |
|                 | <u>\$ 34,928</u>             | <u>\$ 29,799</u>        |



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**September 1,  
2007**

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**June 2,  
2007**

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E-Z-EM, Inc. and Subsidiaries

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

September 1, 2007 and September 2, 2006  
(unaudited)

**NOTE I - DEFERRED REVENUE**

In March 2007, the Company received its initial order for RSDL, for \$5.07 million, from the U.S. Army Space and Missile Command. The U.S. Department of Defense (DoD) inspected and accepted this product in May 2007 and paid for this product in July 2007. At the DoD's request, the Company is storing RSDL product with a carrying value of approximately \$1.2 million and a current sales value of approximately \$3.6 million relating to this order at its Canadian facility pending physical delivery. Such amount is included in finished goods inventory. The Company expects to make physical delivery in its second fiscal quarter, at which time it will recognize the revenue from this transaction.

**NOTE J - INCOME TAXES**

For the thirteen weeks ended September 1, 2007, the Company's effective tax rate of 23% differed from the Federal statutory tax rate of 34% due primarily to tax-exempt income, partially offset by non-deductible expenses. For the thirteen weeks ended September 2, 2006, the Company's effective tax rate of 32% differed from the Federal statutory tax rate of 34% due primarily to tax-exempt income, partially offset by non-deductible expenses.

The Company files a Federal income tax return and tax returns in various state jurisdictions. The Company's subsidiaries also file tax returns in their local jurisdictions of Canada, the United Kingdom and the Netherlands.

The U.S. Federal income tax returns of the Company through May 31, 2003 are closed by Internal Revenue Code regulations. The income tax returns filed by the Company's Canadian and Netherlands subsidiaries in their local tax jurisdictions through May 31, 2003 are closed by local statutes. The U.K. income tax returns filed by the Company's U.K. subsidiary through May 31, 2005 are closed by local statutes.

The Company's New York State tax returns for fiscal years 2003 through 2005 are currently under audit. The Company does not anticipate any material changes to the returns as filed.

The Company accounts for interest and penalties related to income tax matters in income tax provision.

E-Z-EM, Inc. and Subsidiaries

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

September 1, 2007 and September 2, 2006  
(unaudited)

**NOTE K – CONTINGENCIES**

**Litigation Matters**

On June 20, 2007, an action was filed against the Company entitled Tyco Healthcare Group LP, Mallinckrodt Inc. and Liebel-Flarsheim Company vs. E-Z-EM, Inc. Case no. 2-07CV-262 in the U.S. District Court for the Eastern District of Texas, Marshall Division. The complaint alleged that the Company willfully, deliberately and intentionally infringed and is continuing to infringe on U.S. patent no. 5,868,710 (the “710 patent”) by making, using, offering to sell, selling and/or importing certain injector systems, including but not limited to its Empower CT® and Empower CTA® injectors. The complaint alleged that the Company’s actions have caused, and will continue to cause, the plaintiffs to suffer substantial damage and irreparable injury. The complaint sought to prohibit the Company from continuing to market and sell these products and asked for compensatory and treble money damages, reasonable attorneys’ fees, costs and pre-judgment interest.

On August 30, 2007, the Company filed an answer denying the allegations in the complaint, pleading several affirmative defenses and bringing a counterclaim seeking a declaration that the claims of the 710 patent are invalid. The Company also moved to dismiss Tyco and Mallinckrodt as plaintiffs for lack of standing. The parties entered into a stipulation to remove Tyco as a plaintiff in the action and, on September 19, 2007, the court ordered the dismissal of Tyco with prejudice.

On September 18, 2007, Mallinckrodt and Liebel-Flarsheim filed a first amended complaint that substantially restated the claims alleged in the initial complaint. On October 1, 2007, the Company filed its answer denying the allegations in the first amended complaint, pleading several affirmative defenses and bringing a counterclaim seeking a declaration that the claims of the 710 patent are invalid. The Company believes that it has valid defenses to the infringement claims, including invalidity of certain claims of the 710 patent, and intends to defend the matter vigorously.

The Company is party to other claims, legal actions and complaints that arise in the ordinary course of business. The Company believes that any liability that may ultimately result from the resolution of these matters will not, individually or in the aggregate, have a material adverse effect on its financial position or results of operations.

**Concentration of Credit Risk**

For the thirteen weeks ended September 1, 2007 and September 2, 2006, sales of products to Merry X-Ray Corporation (“Merry X-Ray”) represented 31% and 35% of total sales, respectively. Approximately 36% and 35% of accounts receivable pertained to Merry X-Ray at September 1, 2007 and June 2, 2007, respectively. While the accounts receivable related to Merry X-Ray are significant, the Company does not believe the credit risk to be significant given the consistent payment history of this distributor.

E-Z-EM, Inc. and Subsidiaries

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

September 1, 2007 and September 2, 2006  
(unaudited)

**NOTE L - COMMON STOCK**

**Stock Repurchase Program**

In March 2003, the Board of Directors authorized the repurchase of up to 300,000 shares of the Company's common stock at an aggregate purchase price of up to \$3,000,000. During the thirteen weeks ended September 1, 2007 no shares were repurchased under this program. In aggregate, the Company has repurchased 74,234 shares of common stock for approximately \$716,000 under this program.

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Item 2. **Management's Discussion and Analysis of Financial Condition and Results of Operations**

The following information should be read together with the consolidated financial statements and the notes thereto and other information included elsewhere in this Quarterly Report on Form 10-Q.

**Forward-Looking Statements**

Our disclosure and analysis in this report, including but not limited to the information discussed in this Item 2, contain forward-looking information about our Company's financial results and estimates, business prospects and products in research that involve substantial risks and uncertainties. From time to time, we also may provide oral or written forward-looking statements in other materials we release to the public. Forward-looking statements give our current expectations or forecasts of future events. You can identify these statements by the fact that they do not relate strictly to historic or current facts. They use words such as "anticipate," "estimate," "expect," "project," "intend," "plan," "believe," "will," and other words and terms of similar meaning in connection with any discussion of future operations or financial performance. In particular, these include statements relating to future actions, prospective products or product approvals, future performance or results of current and anticipated products, sales efforts, expenses, interest rates, foreign exchange rates, intellectual property matters, the outcome of contingencies, such as legal proceedings, and financial results.

We cannot guarantee that any forward-looking statement will be realized, although we believe we have been prudent in our plans and assumptions. Achievement of future results is subject to risks, uncertainties and inaccurate assumptions. Should known or unknown risks or uncertainties materialize, or should underlying assumptions prove inaccurate, actual results could vary materially from past results and those anticipated, estimated or projected. As a result, investors are cautioned not to place undue reliance on any of our forward-looking statements. Investors should bear this in mind as they consider forward-looking statements.

We do not assume any obligation to update or revise any forward-looking statement that we make, even if new information becomes available or other events occur in the future. We are also affected by other factors that may be identified from time to time in our filings with the Securities and Exchange Commission, some of which are set forth in Item 1A – "Risk Factors" in our Form 10-K filing for the 2007 fiscal year. You are advised to consult any further disclosures we make on related subjects in our Forms 10-Q, 8-K and 10-K reports to the Securities and Exchange Commission. Although we have attempted to provide a list of important factors which may affect our business, investors are cautioned that other factors may prove to be important in the future and could affect our operating results. You should understand that it is not possible to predict or identify all such factors or to assess the impact of each factor or combination of factors on our business. Consequently, you should not consider any such list to be a complete set of all potential risks or uncertainties.

**Overview**

We are a leading provider of medical diagnostic contrast agents and devices used in the diagnosis of abdominal disease. Our customers include radiologists, gastroenterologists and speech language pathologists. We are focused on becoming a worldwide CT solutions company for the computed tomography (CT) market. This focus is driven by the trend away from older fluoroscopic procedures (e.g., barium enema) to CT-based applications for imaging the entire abdominal tract because of the enhanced benefits of Multi-detector CT technology.

We have pioneered solutions for the emerging area of Virtual Colonography, which may offer unique capabilities for the early detection of colorectal cancer, and have also developed new imaging contrast agents, for example VoLumen, that allow enhanced images from CT and CT Angiography applications utilizing Multi-detector CT technology. We also manufacture and market a line of CT power injectors that deliver injectable CT contrast agents.

In addition to our products for the radiology market, we also market a unique healthcare decontaminant product. RSDL skin decontaminant ("RSDL") is a liquid skin decontaminant that neutralizes or removes a broad spectrum of chemical warfare and T-2 toxic agents. In April 2005, we purchased from our strategic partner, O'Dell Engineering, all its assets related to the RSDL technology. We now have exclusive, worldwide rights to the RSDL technology for the military and first-responder markets. Prior to the acquisition, we were the exclusive manufacturer of RSDL under an agreement between O'Dell Engineering and our Canadian subsidiary. In March 2007, the U.S. Department of Defense (DoD) determined that RSDL had satisfied all final configuration testing criteria, and was approved for initial procurements by the individual service branches. The decision, known as Milestone C, cleared the way for deployment of RSDL to war-fighters as the DoD's next generation skin decontaminant for protection against chemical warfare agents. In March 2007, we received an initial order for \$5.07 million for RSDL from the U.S. Army Space and Missile Command. At the DoD's request, we are currently storing RSDL product at our facilities, with a carrying value of approximately \$1.2 million and a current sales value of approximately \$3.6 million, relating to this initial order. The DoD inspected and formally accepted this product in May 2007 and paid for this product in July 2007. The product is currently pending physical delivery, which we expect to occur in our second fiscal quarter, at which time we will recognize the revenue from this transaction. We have subsequently received several additional orders from the U.S. Army Space and Missile Command with a combined value of approximately \$12.5 million for RSDL and its training variant. We expect to ship these orders by the end of our fiscal year. Revenues will be recognized when the product is shipped.

In fiscal 2007, we completed the wind-down of Toho Kagaku Kenkyusho Co., Ltd. ("Toho"), our wholly owned Japanese subsidiary. We decided to close Toho and exit this market because we were unable to generate sufficient income from operations to grow the business due to a limited product offering and the scope of Toho's operations. Also, a recent change in manufacturing location required us to re-register Toho's principal products with the Japanese regulatory authorities, which we projected would cause an interruption of supply during the first quarter of 2007. We planned a staged market withdrawal to allow us to sell inventory, collect accounts receivable and sell the property in an organized fashion, while also satisfying all outstanding liabilities. For the quarter ended September 2, 2006, Toho is accounted for as a discontinued operation in our financial statements in

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accordance with SFAS No. 144, "Accounting for Impairment and Disposal of Long-Lived Assets."

Our pricing flexibility is constrained under our agreements with large group purchasing organizations ("GPO" or "GPOs") - groups of hospitals and other large customers formed to combine purchasing power. Due to the multi-year terms of typical GPO contracts, our ability to pass along base cost increases through increased prices is limited. Consolidation in the healthcare industry has also resulted in a broader product range in typical GPO contracts. Transactions with GPOs are often larger, more complex, and involve more long-term contracts than in the past. GPOs' enhanced purchasing power may continue to increase the pressure on product pricing in the market as a whole. Additionally, some of our competitors have, and may in the future enter into other, agreements with GPOs. In the past, some of these GPOs have not strictly enforced these contracts against their members, and, by lowering our prices, we have been able to continue to sell our products directly to their members. However, should these GPOs determine to enforce this contractual obligation against their members, it could have a material adverse effect on our sales, and thus our operating results, in future periods.

The CT imaging market in calendar 2007 has been hindered by the Deficit Reduction Act of 2005 (DRA), which took effect on January 1, 2007. The DRA effectively reduced the Medicare and Medicaid reimbursement rates for MR, CT and PET/CT procedures performed at outpatient imaging centers. The impact of DRA is being felt in the market and remains to be quantified. Some of our customers have advised us that they have delayed plans to purchase imaging equipment, at least in the near term, in order to assess the impact of DRA on their businesses.

### Results of Operations

Our quarters ended September 1, 2007 and September 2, 2006 both represent thirteen weeks.

### Consolidated Results of Operations

For the quarter ended September 1, 2007, we reported net earnings of \$645,000, or \$.06 per common share on both a basic and diluted basis, as compared to net earnings of \$1,562,000, or \$.14 per common share on both a basic and diluted basis, for the comparable period of last year.

The following table sets forth earnings from continuing operations and loss from discontinued operation for the quarters ended September 1, 2007 and September 2, 2006:

|                                     | <u>2007</u>    | <u>2006</u>  |
|-------------------------------------|----------------|--------------|
|                                     | (in thousands) |              |
| Earnings from continuing operations | \$ 645         | \$ 1,783     |
| Loss from discontinued operation    |                | (221)        |
|                                     | <u>645</u>     | <u>1,562</u> |
| Net earnings                        | \$ 645         | \$ 1,562     |

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Our results are expressed as a percentage of net sales for the quarters ended September 1, 2007 and September 2, 2006 in the following table:

|  | <u>2007</u> | <u>2006</u>  |
|--|-------------|--------------|
| Net sales  | 100.0%      | 100.0%       |
| Cost of goods sold   | 56.1        | 56.4         |
| <b>Gross profit</b>  | <b>43.9</b> | <b>43.6</b>  |
| Operating expenses   |             |              |
| Selling, general and administrative                                | 36.9        | 33.3         |
| Research and development   | 5.9         | 4.1          |
| <b>Total operating expenses</b>                                    | <b>42.8</b> | <b>37.4</b>  |
| <b>Operating profit</b>  | <b>1.1</b>  | <b>6.2</b>   |
| Other income (expense)   |             |              |
| Interest income  | 1.3         | 1.1          |
| Interest expense   | (0.2)       | (0.2)        |
| Foreign currency exchange gains (losses)                           | (0.2)       | 0.7          |
| Other, net   | 0.6         | 0.1          |
| <b>Earnings from continuing operations before income taxes</b>     | <b>2.6</b>  | <b>7.9</b>   |
| <b>Income tax provision</b>  | <b>0.6</b>  | <b>2.5</b>   |
| <b>Earnings from continuing operations</b>                         | <b>2.0</b>  | <b>5.4</b>   |
| <b>Loss from discontinued operation, net of income tax benefit</b> |             | <b>(0.7)</b> |
| <b>NET EARNINGS</b>  | <b>2.0%</b> | <b>4.7%</b>  |

**Continuing Operations**

Operating profit for the current quarter declined by \$1,711,000 due to decreased sales and increased operating expenses.

Net sales for the quarter ended September 1, 2007 decreased 1%, or \$473,000, as compared to the quarter ended September 2, 2006, due to lower sales volumes, partially offset by price increases and foreign currency exchange fluctuations, which increased the translated amounts of foreign subsidiaries' sales to U.S. dollars for financial reporting purposes by \$448,000. Price increases accounted for approximately 3% of net sales for the current quarter, as a significant portion of our domestic products are sold under fixed pricing, long-term group purchasing organization contracts. On a product line basis, the net sales decline resulted primarily from decreased sales of CT imaging contrast products of \$1,060,000, X-ray fluoroscopy products of \$542,000, healthcare decontaminants of \$253,000 and accessory medical devices of \$195,000, partially offset by increased sales of CT injector systems of \$1,696,000.



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The CT imaging market in calendar 2007 has been hindered by the Deficit Reduction Act of 2005 (DRA), which took effect on January 1, 2007. The DRA effectively reduced the Medicare and Medicaid reimbursement rates for MR, CT and PET/CT procedures performed at outpatient imaging centers. The impact of

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DRA is being felt in the market and remains to be quantified. Some of our customers have advised us that they have delayed plans to purchase imaging equipment, at least in the near term, in order to assess the impact of DRA on their businesses. We believe that this has reduced sales of our CT imaging products in the current quarter and may continue to adversely affect these sales in future quarters.

Net sales in international markets, including direct exports from the United States, increased 2%, or \$162,000, for the current quarter from the prior year's quarter due to foreign currency exchange fluctuations, which increased the translated amounts of foreign subsidiaries' sales to U.S. dollars for financial reporting purposes by \$403,000, and price increases, which accounted for approximately 2% of net sales in international markets for the current quarter, partially offset by lower sales volumes. On a product line basis, the net sales increase resulted from increased sales of CT imaging products of \$429,000, contract manufacturing products of \$164,000 and other products of \$93,000, partially offset by decreased sales of healthcare decontaminants of \$305,000 and X-ray fluoroscopy products of \$219,000.

The following table sets forth net sales by product category for the quarters ended September 1, 2007 and September 2, 2006:

|                           | 2007      |       | 2006      |       |
|---------------------------|-----------|-------|-----------|-------|
|                           | \$        | %     | \$        | %     |
| (dollars in thousands)    |           |       |           |       |
| CT Imaging Contrast       | \$ 8,188  | 24.8  | \$ 9,248  | 27.6  |
| CT Injector Systems       | 8,241     | 25.0  | 6,545     | 19.6  |
| <hr/>                     |           |       |           |       |
| Total CT Imaging          | 16,429    | 49.8  | 15,793    | 47.2  |
| X-Ray Fluoroscopy         | 10,316    | 31.3  | 10,858    | 32.5  |
| Contract Manufacturing    | 1,685     | 5.1   | 1,684     | 5.0   |
| Accessory Medical Devices | 1,258     | 3.8   | 1,453     | 4.3   |
| Gastroenterology          | 1,098     | 3.3   | 1,135     | 3.4   |
| Virtual Colonoscopy       | 1,073     | 3.3   | 1,188     | 3.6   |
| Healthcare Decontaminants | 244       | 0.8   | 497       | 1.5   |
| Other                     | 864       | 2.6   | 832       | 2.5   |
| <hr/>                     |           |       |           |       |
|                           | \$ 32,967 | 100.0 | \$ 33,440 | 100.0 |
| <hr/>                     |           |       |           |       |

Gross profit, expressed as a percentage of net sales, was 44% for both the current quarter and the comparable quarter of the prior year. Sales price increases offset increased costs for finished products purchased from our Canadian subsidiary, which were more expensive due to the continued weakening of the U.S. dollar against the Canadian dollar.

Selling, general and administrative ("SG&A") expenses were \$12,168,000 for the quarter ended September 1, 2007 compared to \$11,141,000 for the quarter ended September 2, 2006. This increase of \$1,027,000, or 9%, was due to costs of \$384,000 associated with an increase in the size of our North American sales force, legal fees of \$262,000 incurred in the defense of the Tyco lawsuit, severance costs of \$216,000, and unfavorable foreign currency exchange fluctuations, which increased the translated amounts of foreign subsidiaries' SG&A expenses to U.S. dollars for financial reporting purposes by \$186,000. We expect to continue to incur legal fees associated with the defense of the Tyco lawsuit until this matter is settled.

Research and development ("R&D") expenditures increased 41% for the current quarter to \$1,935,000, or 6% of net sales, from \$1,376,000, or 4% of net sales, for the comparable quarter of the prior year due primarily to

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increased general regulatory costs of \$278,000, resulting from additional personnel to support planned increases in international product registrations, and increased costs of \$247,000 for CT imaging and X-ray fluoroscopy projects. Of the R&D expenditures for the current quarter, approximately 53% related to CT imaging and X-ray fluoroscopy projects, 32% to general regulatory costs, 7% to gastroenterology projects, 3% to virtual colonoscopy projects, 2% to healthcare decontaminant projects and 3% to other projects. R&D expenditures are expected to be 5% of net sales for the remainder of this fiscal year.

Other income (expense) totaled \$477,000 of income for the current quarter compared to income of \$560,000 for the comparable period of last year. This decline is due primarily to unfavorable changes in foreign currency exchange gains and losses of \$275,000, resulting from the weakening of the U.S. dollar in the current quarter, partially offset by gains of \$126,000 on the sale of non-core equity securities in the current quarter and increased interest income of \$64,000.

For the quarter ended September 1, 2007, our effective tax rate of 23% differed from the Federal statutory tax rate of 34% due primarily to tax-exempt income, partially offset by non-deductible expenses. For the quarter ended September 2, 2006, our effective tax rate of 32% differed from the Federal statutory tax rate of 34% due primarily to tax-exempt income, partially offset by non-deductible expenses.

### Discontinued Operation

We have consolidated the financial statements of Toho and reported its results as a discontinued operation. Summarized results of operations for Toho as reported in loss from discontinued operation in the accompanying consolidated statement of earnings for the quarter ended September 2, 2006 are as follows:

|                                  | (in thousands) |
|----------------------------------|----------------|
| Net sales                        |                |
| From unaffiliated customers      | \$ 194         |
| Total net sales                  | \$ 194         |
| Loss before income taxes         | \$ (341)       |
| Income tax benefit               | (120)          |
| Loss from discontinued operation | \$ (221)       |

### Liquidity and Capital Resources

For the quarter ended September 1, 2007, operations and capital expenditures were funded by working capital and cash reserves. Our policy has generally been to fund operations and capital requirements without incurring significant debt. At September 1, 2007 and June 2, 2007, we had no outstanding indebtedness for borrowed money. We have available \$1,894,000 under a bank line of credit, of which no amounts were outstanding at September 1, 2007.

Our contractual obligations and their effect on liquidity and cash flows as of September 1, 2007 are set forth in the table below. We have no variable interest entities or other off-balance sheet arrangements.

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Payments Due By Period as of September 1, 2007

|   | Total            | Less than<br>1 year | 1-3<br>years    | 3-5<br>years  | More than<br>5 years |
|---|------------------|---------------------|-----------------|---------------|----------------------|
| (in thousands)  |                  |                     |                 |               |                      |
| Contractual Obligations:                                      |                  |                     |                 |               |                      |
| Operating leases <sup>(1)</sup>                               | \$ 6,443         | \$ 1,908            | \$ 3,470        | \$ 428        | \$ 637               |
| Purchase obligations <sup>(1)</sup>                           | 6,340            | 6,218               | 122             |               |                      |
| Employment contract <sup>(1)</sup>                            | 720              | 720                 |                 |               |                      |
| Other liabilities reflected on the consolidated balance sheet |                  |                     |                 |               |                      |
| Deferred compensation <sup>(2)</sup>                          | 2,755            | 99                  | 232             | 265           | 2,159                |
| License arrangements  | 36               | 36                  |                 |               |                      |
| Accrued severance benefits                                    | 420              | 420                 |                 |               |                      |
| <b>Total</b>  | <b>\$ 16,714</b> | <b>\$ 9,401</b>     | <b>\$ 3,824</b> | <b>\$ 693</b> | <b>\$ 2,796</b>      |

<sup>(1)</sup> The non-cancelable operating leases, purchase obligations, and employment contract are not reflected on the consolidated balance sheet under accounting principles generally accepted in the United States of America. The purchase obligations consist of finished product and component parts.

<sup>(2)</sup> Deferred compensation costs covering active employees are assumed payable after five years, although certain circumstances, such as termination, would require earlier payment.

At September 1, 2007, approximately \$44,428,000, or 32%, of our assets consisted of cash and cash equivalents and short-term debt and equity securities. The current ratio was 5.32 to 1, with net working capital of \$87,272,000, at September 1, 2007, compared to the current ratio of 6.07 to 1, with net working capital of \$87,044,000, at June 2, 2007. We believe that our cash reserves, cash provided from operations and existing bank line of credit will provide sufficient liquidity to meet our cash requirements for the next 12 months.

In March 2003, the Board of Directors authorized the repurchase of up to 300,000 shares of our common stock at an aggregate purchase price of up to \$3,000,000. During the quarter ended September 1, 2007, no shares were repurchased under this program. In aggregate, we have repurchased 74,234 shares of common stock for approximately \$716,000 under this program.

**Critical Accounting Policies**

Our significant accounting policies are summarized in Note A to the Consolidated Financial Statements included in our Annual Report on Form 10-K for our fiscal year ended June 2, 2007. While all these significant accounting policies affect the reporting of our financial condition and results of operations, we view certain of these policies as critical. Policies determined to be critical are those policies that have the most significant impact on our financial statements and require us to use a greater degree of judgment and/or estimates. Actual results may differ from those estimates.

We believe that given current facts and circumstances, it is unlikely that applying any other reasonable judgment or estimate methodologies would cause a material effect on our consolidated results of operations, financial position or liquidity for the periods presented in this report. The accounting policies identified as critical are as follows:

**Revenue Recognition**

We recognize revenues in accordance with generally accepted accounting principles as outlined in Staff Accounting Bulletin No. 104, "Revenue Recognition in Financial Statements," which requires that four basic criteria be met before revenue can be recognized: (1) persuasive evidence of an arrangement exists; (2) the price is fixed or determinable; (3) collectibility is reasonably assured; and (4) product delivery has occurred or services have been rendered. Decisions relative to criterion (3) regarding collectibility are based upon our judgments, as discussed under "Accounts Receivable" below. Should conditions change in the future and cause us to determine this criterion is not met, our results of operations may be affected. We recognize revenue on the date the product is shipped or when the product is delivered, depending on when title passes to the customer. Shipping and credit terms are negotiated on a customer-by-customer basis. Products are shipped primarily to distributors at agreed upon list prices. The distributor then resells the products primarily to hospitals and, depending upon contracts between us, the distributor and the hospital, the distributor may be entitled to a rebate. We deduct all rebates from sales and have a provision for rebates based on historical information for all rebates that have not yet been submitted to us by the distributors.

Changes in our rebate allowance for the quarters ended September 1, 2007 and September 2, 2006 are as follows:

|                       | <u>2007</u>       | <u>2006</u>       |
|-----------------------|-------------------|-------------------|
|                       | (in thousands)    |                   |
| Beginning balance     | \$ 2,082          | \$ 1,866          |
| Provision for rebates | 7,829             | 6,691             |
| Rebate credits issued | (7,797)           | (6,418)           |
|                       | <u>          </u> | <u>          </u> |
| Ending balance        | \$ 2,114          | \$ 2,139          |
|                       | <u>          </u> | <u>          </u> |

The rebate allowance is comprised of three components:

- actual rebate requests received from distributors prior to the closing of our financial statements;
- an estimate, compiled by distributor, of rebate requests not yet received based on historical submissions, adjusted for any material changes in purchasing patterns or market conditions; and
- an estimate of distributors' inventory-on-hand available for future sale pursuant to group purchasing organization ("GPO") contracts. We do not know the specific inventory levels held by our distributors. However, based on discussions with our customers, who uniformly attempt to maintain just-in-time purchasing programs, and our knowledge of their ordering patterns, we estimate a one-week wholesale inventory level. Since most of our product sales are subject to GPO contracts, most distributor inventory-on-hand will be subject to rebate. This portion of the rebate estimate is derived by first determining the total quantity of each product sold by us during the last week of the fiscal period multiplied by two factors, (a) and (b), where (a) is the percentage of the product rebated during the prior six-month period based on historical sales and (b) is the average rebate paid on the product during that period.

All product returns must be pre-approved by us and may be subject to a 20% restocking charge. To be accepted, a returned product must be unadulterated,

undamaged and have at least 12 months remaining on its stated expiration date.

We record revenue on warranties and extended warranties on a straight-line basis over the term of the related warranty contracts, which generally cover one year. Deferred revenues related to warranties and extended warranties were \$1,042,000 and \$1,003,000 at September 1, 2007 and June 2, 2007, respectively. Service costs are expensed as incurred.

### Accounts Receivable

Accounts receivable are generally due within 30 to 90 days and are stated at amounts due from customers, net of an allowance for doubtful accounts. We perform ongoing credit evaluations and adjust credit limits based upon payment histories and customers' current creditworthiness, as determined by a review of their current credit information. We continuously monitor aging reports, collections and payments from customers, and maintain a provision for estimated credit losses based upon historical experience and any specific customer collection issues we identify. While such credit losses have historically been within expectations and the provisions established, we cannot guarantee the same credit loss rates will be experienced in the future. We write off accounts receivable when they become uncollectible. Concentration risk exists relative to our accounts receivable, as 36% and 35% of our total accounts receivable balances at September 1, 2007 and June 2, 2007, respectively, were concentrated in one distributor. While the accounts receivable related to this distributor are significant, we do not believe the credit risk to be significant given the distributor's consistent payment history.

Changes in our allowance for doubtful accounts for the quarters ended September 1, 2007 and September 2, 2006 are as follows:

|  | <u>2007</u>    | <u>2006</u>   |
|--|----------------|---------------|
|  | (in thousands) |               |
| Beginning balance                              | \$ 928         | \$ 888        |
| Provision for (reduction in) doubtful accounts | (24)           | 23            |
| Ending balance                                 | <u>\$ 904</u>  | <u>\$ 911</u> |

### Income Taxes

In preparing our financial statements, income tax expense is calculated for each jurisdiction in which we operate. This involves estimating actual current taxes due plus assessing temporary differences arising from differing treatment for tax and accounting purposes that are recorded as deferred tax assets and liabilities. Deferred tax assets are periodically evaluated to determine their recoverability, based primarily on our ability to generate future taxable income. Where their recovery is not likely, we establish a valuation allowance and record a corresponding additional tax expense in our statement of earnings. If actual results differ from our estimates due to changes in assumptions, the provision for income taxes could be materially affected.

As of June 3, 2007, we adopted Financial Accounting Standards Board ("FASB") Interpretation No. 48, "Accounting for Uncertainty in Income Taxes," an interpretation of FASB Statement No. 109 ("FIN 48"). The interpretation requires that we determine whether it is more likely than not that a tax position will be sustained upon examination by the appropriate taxing

authority. If a tax position meets the more likely than not recognition criteria, FIN 48 requires that the tax position be measured at the largest amount of benefit greater than 50 percent likely of being realized upon ultimate settlement. The adoption of FIN 48 has not had a material effect on our financial condition or results of operations.

### **Inventories**

We value inventories at the lower of cost (on the first-in, first-out method) or market. On a quarterly basis, we review inventory quantities on hand and analyze the provision for excess and obsolete inventory based primarily on product expiration dating and our estimated sales forecast, which is based on sales history and anticipated future demand. Our estimates of future product demand may not be accurate and we may understate or overstate the provision required for excess and obsolete inventory. Accordingly, any significant unanticipated changes in demand could have a significant impact on the value of our inventory and results of operations. At September 1, 2007 and June 2, 2007, our reserve for excess and obsolete inventory was \$1,346,000 and \$1,243,000, respectively.

### **Effects of Recently Issued Accounting Pronouncements**

In June 2006, the FASB issued FIN 48. FIN 48 clarifies the accounting for uncertainties in income taxes recognized in an enterprise's financial statements. The interpretation requires that we determine whether it is more likely than not that a tax position will be sustained upon examination by the appropriate taxing authority. If a tax position meets the more likely than not recognition criteria, FIN 48 requires that the tax position be measured at the largest amount of benefit greater than 50 percent likely of being realized upon ultimate settlement. This accounting standard is effective for fiscal years beginning after December 15, 2006. We adopted FIN 48 as of June 3, 2007. The adoption of FIN 48 has not had a material effect on our financial condition or results of operations.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements." This statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. The standard applies whenever other standards require (or permit) assets or liabilities to be measured at fair value but does not expand the use of fair value in any new circumstances. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. We do not believe the adoption of SFAS No. 157 will have a material impact on our financial condition or results of operations.

In February 2007, the FASB issued SFAS No. 159, "*The Fair Value Option for Financial Assets and Financial Liabilities - Including an amendment of FASB Statement No. 115.*" SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. The objective of SFAS No. 159 is to provide opportunities to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply hedge accounting provisions. SFAS No. 159 also establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. We do not believe the adoption of SFAS No. 159 will have a material impact on our financial condition or results of operations.

Item 3. **Quantitative and Qualitative Disclosures About Market Risk**

We are exposed to market risk from changes in foreign currency exchange rates and, to a much lesser extent, interest rates on investments and financing, that could impact our results of operations and financial position. We do not currently engage in any hedging or market risk management tools. There have been no material changes with respect to market risk previously disclosed in our Annual Report on Form 10-K for our 2007 fiscal year.

**Foreign Currency Exchange Rate Risk**

The financial reporting of our non-U.S. subsidiaries is denominated in currencies other than the U.S. dollar. Since the functional currency of our non-U.S. subsidiaries is the local currency, foreign currency translation adjustments are accumulated as a component of accumulated other comprehensive income in stockholders' equity. Assuming a hypothetical aggregate change of 10% in the exchange rates of foreign currencies against the U.S. dollar at September 1, 2007, our assets and liabilities would increase or decrease by \$4,823,000 and \$1,015,000, respectively, and our net sales and net earnings would increase or decrease by \$2,912,000 and \$340,000, respectively, on an annual basis.

We also maintain intercompany balances and loans receivable with subsidiaries with different local currencies. These amounts are at risk of foreign exchange losses if exchange rates fluctuate. Assuming a hypothetical aggregate change of 10% in the exchange rates of foreign currencies against the U.S. dollar at September 1, 2007, our pre-tax earnings would be favorably or unfavorably impacted by approximately \$1,002,000 on an annual basis.

**Interest Rate Risk**

Our excess cash is invested in highly liquid, short-term, investment grade securities with maturities of less than one year. These investments are not held for speculative or trading purposes. Changes in interest rates may affect the investment income we earn on cash, cash equivalents and debt securities and therefore affect our cash flows and results of operations. As of September 1, 2007, we were exposed to interest rate change market risk with respect to our investments in tax-free municipal bonds in the principal amount of \$24,065,000. The bonds bear interest at a floating rate established between seven and 35 days. For the quarter ended September 1, 2007, the after-tax interest rate on the bonds approximated 4.0%. Each 100 basis point (or 1%) fluctuation in interest rates will increase or decrease interest income on the bonds by approximately \$241,000 on an annual basis.

As of September 1, 2007, we did not maintain any fixed or variable interest rate financing.

As of September 1, 2007, we have available \$1,894,000 under a working capital bank line of credit, of which no amounts were outstanding. Advances under this line of credit will bear interest at an annual rate indexed to the Canadian prime rate. We will thus be exposed to interest rate risk with respect to this credit facility to the extent that interest rates rise when there are amounts outstanding under this facility.



Item 4. **Controls and Procedures**

**Evaluation of Disclosure Controls and Procedures**

As required by Rule 13a-15(e) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), we conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures as of September 1, 2007. This evaluation was carried out under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer. There are inherent limitations to the effectiveness of any system of disclosure controls and procedures. Therefore, effective disclosure controls and procedures can only provide reasonable assurance of achieving their control objectives. Based upon our evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective as of September 1, 2007, to provide reasonable assurance that information required to be disclosed in the reports that we file under the Exchange Act is recorded, processed, summarized and reported in a timely manner and is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

**Changes in Internal Control over Financial Reporting**

There was no change in our internal control over financial reporting during our fiscal quarter ended September 1, 2007 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**E-Z-EM, Inc. and Subsidiaries**

**Part II: Other Information**

**Item 1. Legal Proceedings**

On June 20, 2007, an action was filed against us entitled Tyco Healthcare Group LP, Mallinckrodt Inc. and Liebel-Flarsheim Company vs. E-Z-EM, Inc. Case no. 2-07CV-262 in the U.S. District Court for the Eastern District of Texas, Marshall Division. The complaint alleged that we willfully, deliberately and intentionally infringed and are continuing to infringe on U.S. patent no. 5,868,710 (the "710 patent") by making, using, offering to sell, selling and/or importing certain injector systems, including but not limited to our Empower CT® and Empower CTA® injectors. The complaint alleged that our actions have caused, and will continue to cause, the plaintiffs to suffer substantial damage and irreparable injury. The complaint sought to prohibit us from continuing to market and sell these products and asked for compensatory and treble money damages, reasonable attorneys' fees, costs and pre-judgment interest.

On August 30, 2007, we filed an answer denying the allegations in the complaint, pleading several affirmative defenses and bringing a counterclaim seeking a declaration that the claims of the 710 patent are invalid. We also moved to dismiss Tyco and Mallinckrodt as plaintiffs for lack of standing. The parties entered into a stipulation to remove Tyco as a plaintiff in the action and, on September 19, 2007, the court ordered the dismissal of Tyco with prejudice.

On September 18, 2007, Mallinckrodt and Liebel-Flarsheim filed a first amended complaint that substantially restated the claims alleged in the initial complaint. On October 1, 2007, we filed our answer denying the allegations in the first amended complaint, pleading several affirmative defenses and bringing a counterclaim seeking a declaration that the claims of the 710 patent are invalid. We believe that we have valid defenses to the infringement claims, including invalidity of certain claims of the 710 patent, and intend to defend the matter vigorously.

**Item 1A. Risk Factors**

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the fiscal year ended June 2, 2007, which could materially affect our business, financial condition and/or future results. The risks described in our Form 10-K are not the only risks facing our company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or future results. There have been no material changes from the risk factors previously disclosed in Part I, "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the fiscal year ended June 2, 2007.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

None.

Item 3. **Defaults Upon Senior Securities**

None.

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

None.

Item 5. **Other Information**

None.

Item 6. **Exhibits**

| <u>No.</u> | <u>Description</u>   | <u>Page</u> |
|------------|--|-------------|
| 3.1        | Restated Certificate of Incorporation of the Registrant, as amended  | (a)         |
| 3.2        | Amended and Restated By-laws of the Registrant   | (b)         |
| 10.1       | Employment agreement dated as of June 27, 2007, between E-Z-EM, Inc. and Anthony A. Lombardo   | (c)         |
| 31.1       | <u>Certification pursuant to Rule 13a-14(a)/15d-14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (Anthony A. Lombardo)</u>                   | 39          |
| 31.2       | <u>Certification pursuant to Rule 13a-14(a)/15d-14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (Joseph A. Cacchioli)</u>                   | 41          |
| 32.1       | <u>Certification pursuant to Title 18, United States Code, Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Anthony A. Lombardo)</u> | 43          |
| 32.2       | <u>Certification pursuant to Title 18, United States Code, Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Joseph A. Cacchioli)</u> | 44          |
| (a)        | Incorporated by reference to Exhibit 3.1 to the Registrant's Registration Statement on Form 8-A filed with the Commission on April 8, 2005.                            |             |
| (b)        | Incorporated by reference to Exhibit 3.2 to the Registrant's Current Report on Form 8-K filed with the Commission on January 21, 2005.                                 |             |
| (c)        | Incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed with the Commission on July 3, 2007.                                    |             |

**SIGNATURES**

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

E-Z-EM, Inc.

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(Registrant)

Date October 11, 2007

/s/ Anthony A. Lombardo

Anthony A. Lombardo, President,  
Chief Executive Officer, Director  
(Principal Executive Officer)

Date October 11, 2007

/s/ Joseph A. Cacchioli

Joseph A. Cacchioli, Vice President -  
Controller and Acting Chief Financial  
Officer (Principal Financial Officer  
and Principal Accounting Officer)