

E-Z-EM, Inc.
Form 10-Q
January 10, 2008

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 December 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).

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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

As of January 4, 2008, there were 11,085,080 shares of the issuer's common stock outstanding.

E-Z-EM, Inc. and Subsidiaries

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E-Z-EM, Inc. and Subsidiaries

CONSOLIDATED BALANCE SHEETS
(in thousands)

	December 1, 2007	June 2, 2007
	(unaudited)	(audited)
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 9,887	\$ 8,037
Debt and equity securities, at fair value	34,671	36,163
Accounts receivable, principally trade, net of allowance for doubtful accounts of \$882 and \$928 at December 1, 2007 and June 2, 2007, respectively	26,334	23,460
Inventories, net	34,305	29,799
Refundable income taxes	460	981
Other current assets	4,189	5,788
	<u> </u>	<u> </u>
Total current assets	109,846	104,228
PROPERTY, PLANT AND EQUIPMENT - AT COST, less accumulated depreciation and amortization of \$31,434 and \$28,574 at December 1, 2007 and June 2, 2007, respectively	19,583	16,863
INTANGIBLE ASSETS, less accumulated amortization of \$1,963 and \$1,591 at December 1, 2007 and June 2, 2007, respectively	3,008	3,380
DEBT AND EQUITY SECURITIES, at fair value		1,196
CASH SURRENDER VALUE OF LIFE INSURANCE	6,739	6,471
OTHER ASSETS	4,063	2,804
	<u> </u>	<u> </u>
Total assets	\$ 143,239	\$ 134,942
	<u> </u>	<u> </u>

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)

	December 1, 2007	June 2, 2007
	(unaudited)	(audited)
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES		
Accounts payable	\$ 8,400	\$ 7,574
Accrued liabilities	8,910	8,435
Accrued income taxes	741	1,175
	<u> </u>	<u> </u>
Total current liabilities	18,051	17,184
NONCURRENT LIABILITIES		
	<u>3,693</u>	<u>3,721</u>
Total liabilities	<u>21,744</u>	<u>20,905</u>
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS EQUITY		
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 11,085,080 shares at December 1, 2007 and 10,976,549 shares at June 2, 2007 (excluding 89,205 shares held in treasury at December 1, 2007 and June 2, 2007)	1,109	1,098
Additional paid-in capital	33,714	31,779
Retained earnings	76,211	72,806
Accumulated other comprehensive income	10,461	8,354
	<u> </u>	<u> </u>
Total stockholders equity	<u>121,495</u>	<u>114,037</u>
Total liabilities and stockholders equity	<u>\$ 143,239</u>	<u>\$ 134,942</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)

	Thirteen weeks ended		Twenty-six weeks ended	
	December 1, 2007	December 2, 2006	December 1, 2007	December 2, 2006
Net sales	\$ 43,637	\$ 34,171	\$ 76,604	\$ 67,611
Cost of goods sold	24,814	18,882	43,315	37,731
Gross profit	18,823	15,289	33,289	29,880
Operating expenses				
Selling, general and administrative	12,767	11,437	24,899	22,578
Costs associated with planned merger	1,031		1,067	
Research and development	1,654	1,559	3,589	2,935
Total operating expenses	15,452	12,996	29,555	25,513
Operating profit	3,371	2,293	3,734	4,367
Other income (expense)				
Interest income	383	311	803	667
Interest expense	(74)	(106)	(144)	(176)
Foreign currency exchange gains (losses)	(227)	247	(283)	466
Other, net	600	56	783	111
Earnings from continuing operations before income taxes	4,053	2,801	4,893	5,435
Income tax provision	1,293	983	1,488	1,834
Earnings from continuing operations	2,760	1,818	3,405	3,601
Loss from discontinued operation, net of income tax benefit of \$19 and 139 for the thirteen and twenty-six weeks ended December 2, 2006		(14)		(235)
NET EARNINGS	\$ 2,760	\$ 1,804	\$ 3,405	\$ 3,366
Basic earnings (loss) per common share				
From continuing operations	\$ 0.25	\$ 0.17	\$ 0.31	\$ 0.33
From discontinued operation, net of income tax benefit				(0.02)

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From total operations	\$ 0.25	\$ 0.17	\$ 0.31	\$ 0.31
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Diluted earnings (loss) per common share				
From continuing operations	\$ 0.25	\$ 0.16	\$ 0.30	\$ 0.32
From discontinued operation, net of income tax benefit				(0.02)
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
From total operations	\$ 0.25	\$ 0.16	\$ 0.30	\$ 0.30
	<u> </u>	<u> </u>	<u> </u>	<u> </u>

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

E-Z-EM, Inc. and Subsidiaries

CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY AND COMPREHENSIVE INCOME

Twenty-six weeks ended December 1, 2007

(unaudited)

(in thousands, except share data)

	Common stock		Additional paid-in capital	Retained earnings	Accumulated other comprehensive income	Total	Compre- hensive income
	Shares	Amount					
Balance at June 2, 2007	10,976,549	\$ 1,098	\$ 31,779	\$ 72,806	\$ 8,354	\$ 114,037	
Exercise of stock options	100,781	10	1,434			1,444	
Income tax benefits on stock options exercised			186			186	
Compensation related to stock option plans			156			156	
Issuance of stock	7,750	1	159			160	
Net earnings				3,405		3,405	\$ 3,405
Unrealized holding loss on debt and equity securities							
Arising during the period					(176)	(176)	(176)
Reclassification adjustment for gains included in net earnings					(437)	(437)	(437)
Foreign currency translation adjustments					2,720	2,720	2,720
Comprehensive income							\$ 5,512
Balance at December 1, 2007	11,085,080	\$ 1,109	\$ 33,714	\$ 76,211	\$ 10,461	\$ 121,495	

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)

	Twenty-six weeks ended	
	December 1, 2007	December 2, 2006
Cash flows from operating activities:		
Net earnings	\$ 3,405	\$ 3,366
Loss from discontinued operation, net of tax		235
Adjustments to reconcile net earnings to net cash provided by operating activities		
Depreciation and amortization	1,977	1,755
Gain on sale of investments	(669)	
Provision for (reduction in) doubtful accounts	(18)	46
Deferred income tax provision	165	648
Stock option compensation cost	156	42
Stock compensation cost	160	134
Changes in operating assets and liabilities, net of business divested		
Accounts receivable	(2,487)	(2,392)
Inventories	(3,171)	(892)
Other current assets	2,298	1,470
Other assets	(1,385)	(23)
Accounts payable	688	253
Accrued liabilities	289	(2,385)
Accrued income taxes	(457)	309
Other noncurrent liabilities	(73)	38
Net cash used in operating activities of discontinued operation		(123)
Net cash provided by operating activities	878	2,481
Cash flows from investing activities:		
Additions to property, plant and equipment, net	(3,642)	(3,502)
Available-for-sale securities		
Purchases	(79,675)	(226,025)
Proceeds from sale	82,093	230,376
Net cash provided by investing activities of discontinued operation		2
Net cash provided by (used in) investing activities	(1,224)	851

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)

	Twenty-six weeks ended	
	December 1, 2007	December 2, 2006
Cash flows from financing activities:		
Repayments of debt		\$ (26)
Proceeds from exercise of stock options	\$ 1,444	760
Tax benefit on exercise of stock options	186	339
Net cash used in financing activities of discontinued operation		(148)
	1,630	925
Effect of exchange rate changes on cash and cash equivalents	566	(948)
	1,850	3,309
INCREASE IN CASH AND CASH EQUIVALENTS		
Cash and cash equivalents		
Beginning of period	8,037	6,749
	\$ 9,887	\$ 10,058
Supplemental disclosures of cash flow information:		
Cash paid (refunded) during the period for:		
Interest	\$ 105	\$ 103
	\$ 1,060	\$ (398)

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

E-Z-EM, Inc. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 1, 2007 and December 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 December 1, 2007, the consolidated statement of stockholders' equity and comprehensive income for the twenty-six weeks ended December 1, 2007, the consolidated statements of earnings for the thirteen and twenty-six weeks ended December 1, 2007 and December 2, 2006, and the consolidated statements of cash flows for the twenty-six weeks ended December 1, 2007 and December 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 December 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 December 1, 2007, and December 2, 2006, are not necessarily indicative of the operating results for the respective full years.

E-Z-EM, Inc. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE A NATURE OF BUSINESS AND BASIS OF PRESENTATION (continued)

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 periods ended December 2, 2006 within the consolidated financial statements (see Note C). All significant intercompany balances and transactions have been eliminated.

NOTE B - MERGER AGREEMENT

On October 30, 2007, the Company, Bracco Diagnostics, Inc., a Delaware corporation (Bracco), Eagle Acquisition Sub, Inc., a wholly owned subsidiary of Bracco (Merger Sub), and, for limited purposes, Bracco Imaging S.p.A., an Italian corporation (Bracco Imaging) entered into a definitive Agreement and Plan of Merger (the Merger Agreement). Under the terms of the Merger Agreement, Merger Sub will merge with and into the Company (the Merger), with the Company continuing after the Merger as the surviving entity and a wholly owned subsidiary of Bracco. Bracco is the U.S.-based subsidiary of the Bracco Group, which is headquartered in Milan, Italy.

Under the terms of the Merger Agreement, at the effective time of the Merger, each of the issued and outstanding shares of common stock of the Company (other than shares held by Bracco, Merger Sub, the Company or any of their respective wholly owned subsidiaries, or shares held by any stockholders exercising appraisal rights) will be converted into the right to receive \$21.00 in cash per share (without interest and subject to any required tax withholding).

The Merger Agreement has been approved unanimously by the Board of Directors of the Company, with the two non-independent directors abstaining.

The Merger Agreement contains customary representations and warranties by the Company, Bracco and Merger Sub. The Merger Agreement also contains customary covenants and agreements, including with respect to the operation of the business of the Company and its subsidiaries between signing and closing, governmental filings and approvals, public disclosures and similar matters. Additionally, the Company has agreed not to solicit alternative transactions or, subject to certain exceptions relating to unsolicited proposals, participate in discussions relating to an alternative transaction or furnish non-public information relating to an alternative transaction. The Company has also agreed that during the pendency of the Merger it will operate its business in the ordinary course of business consistent with past practice and not to take certain actions specified in the Merger Agreement.

E-Z-EM, Inc. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE B - MERGER AGREEMENT (continued)

Consummation of the Merger is subject to the satisfaction of customary closing conditions, including (i) the approval of the Merger by the Company's stockholders, (ii) the absence of any order, injunction or legal restraint or prohibition preventing the consummation of the Merger, (iii) the accuracy of the representations and warranties of the other party (subject to the materiality standards and, with respect to the Company's representations, an overall material adverse effect standard contained in the Merger Agreement), and (iv) compliance in all material respects of the other party with its covenants. In addition, the Merger is subject to clearance under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 and the Exon-Florio provision of the Defense Protection Act of 1950, and the receipt of regulatory approvals under German competition regulations. All of the initial filings and notifications required to obtain such antitrust and other regulatory approvals have been made, although neither the Company nor Bracco has yet obtained any of such antitrust or other regulatory approvals required to complete the merger. Stockholders will be asked to vote on the proposed transaction at a special meeting on a date to be announced. The Company currently anticipates that it will file its preliminary proxy statement regarding the merger in January 2008 and that, if all of the conditions to consummating the merger are satisfied, the merger will close in the first or second calendar quarter of 2008. Availability of financing for the Merger is not a condition to Bracco's obligation to complete the Merger, and Bracco Imaging has agreed to cause Bracco to have sufficient funds to pay the merger consideration and otherwise satisfy its obligations under the Merger Agreement.

The Merger Agreement contains certain termination rights for both the Company and Bracco and provides that, upon termination of the Merger Agreement under specified circumstances described in the Merger Agreement, the Company will be required to pay Bracco a termination fee of \$9.0 million.

The Merger Agreement contains representations and warranties that the parties have made to each other as of specific dates. The assertions embodied in those representations and warranties were made solely for purposes of the contract between the parties, and may be subject to important qualifications and limitations agreed to by the parties in connection with negotiating its terms. Moreover, the representations and warranties are subject to a contractual standard of materiality that may be different from what may be viewed as material to stockholders, and the representations and warranties may have been intended not as statements of fact, but rather as a way of allocating risk among the parties. Accordingly, they should not be relied on as statements of factual information. Stockholders are not third-party beneficiaries under the Merger Agreement and should not rely on the representations, warranties and covenants or any descriptions thereof as characterizations of the actual state of facts or condition of the Company or its subsidiaries.

E-Z-EM, Inc. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE B - MERGER AGREEMENT (continued)

Concurrently with the entry into the Merger Agreement, certain stockholders of the Company owning an aggregate of approximately 34% of the Company's outstanding shares as of October 30, 2007, entered into a voting agreement with Bracco and the Company pursuant to which they have agreed, subject to certain exceptions, to vote in favor of adopting the Merger Agreement and approving the Merger and the transactions contemplated thereby and against any transaction or other action that is or would reasonably be expected to prevent or materially delay the merger and the other transactions contemplated by the Merger Agreement.

For the thirteen and twenty-six weeks ended December 1, 2007, merger costs, primarily legal, accounting and investment banking fees, aggregated \$1,031,000 and \$1,067,000, respectively.

NOTE C DISCONTINUED OPERATION

In fiscal 2007, the Company completed the wind-down of Toho. The Company decided to close Toho and exit the Japanese 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 gains (losses) of \$10,000 and (\$23,000), respectively, included in accumulated other comprehensive income have been charged to results of operations for the thirteen and twenty-six weeks ended December 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 periods ended December 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.

E-Z-EM, Inc. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTSDecember 1, 2007 and December 2, 2006
(unaudited)**NOTE C DISCONTINUED OPERATION (continued)**

For the thirteen and twenty-six weeks ended December 2, 2006, project costs (credits), primarily severance and the above-mentioned impairment, aggregated (\$12,000) and \$218,000, respectively. Changes in project costs are as follows:

	Thirteen weeks ended December 2, 2006	Twenty-six weeks ended December 2, 2006
	<u> </u>	<u> </u>
	(in thousands)	
Beginning balance	\$ 263	\$ 333
Recorded	(12)	218
Paid	(17)	(317)
	<u> </u>	<u> </u>
Ending balance	<u>\$ 234</u>	<u>\$ 234</u>

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

	Thirteen weeks ended December 2, 2006	Twenty-six weeks ended December 2, 2006
	<u> </u>	<u> </u>
	(in thousands)	
Net sales (credits) from unaffiliated customers	\$ (11)	\$ 183
	<u> </u>	<u> </u>
Total net sales (credits)	<u>\$ (11)</u>	<u>\$ 183</u>
	<u> </u>	<u> </u>
Loss before income taxes	\$ (33)	\$ (374)
Income tax benefit	(19)	(139)
	<u> </u>	<u> </u>
Loss from discontinued operation	<u>\$ (14)</u>	<u>\$ (235)</u>

NOTE D - 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.

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E-Z-EM, Inc. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE D - STOCK-BASED COMPENSATION (continued)

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.

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 and twenty-six weeks ended December 1, 2007, the Company recognized pre-tax share-based compensation expense of \$78,000 (\$51,000 after tax effects) and \$156,000 (\$102,000 after tax effects), respectively, for awards to members of the Board of Directors granted during the fourth quarter of fiscal 2007. For the thirteen and twenty-six weeks ended December 2, 2006, the Company recognized pre-tax share-based compensation expense of \$21,000 (\$14,000 after tax effects) and \$42,000 (\$27,000 after tax effects), respectively, 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 December 1, 2007, there was \$156,000 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 one-half year.

E-Z-EM, Inc. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE D - STOCK-BASED COMPENSATION (continued)

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.

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 December 1, 2007, there were 696,175 shares available for grants of options and other awards under the 2004 Plan.

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E-Z-EM, Inc. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE D - 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 and twenty-six weeks ended December 1, 2007 and December 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.

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

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E-Z-EM, Inc. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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NOTE D - STOCK-BASED COMPENSATION (continued)

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.

The following is a summary of the stock option activity during the twenty-six weeks ended December 1, 2007:

	Number of Shares (000)	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life in Years	Aggregate Intrinsic Value (000)
Outstanding at beginning of period	1,279	\$ 12.45	6.80	
Exercised	(101)	14.33	7.29	
Outstanding at end of period	1,178	\$ 12.29	6.23	\$ 9,907
Vested or expected to vest at end of period	1,143	\$ 12.16	6.13	\$ 9,767
Exercisable at end of period	1,143	\$ 12.16	6.13	\$ 9,767

The following is a summary of the stock option activity during the twenty-six weeks ended December 2, 2006:

	Number of Shares (000)	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life in Years	Aggregate Intrinsic Value (000)
Outstanding at beginning of period	1,358	\$ 12.23	7.65	
Exercised	(67)	\$ 11.37	6.46	
Forfeited	(7)	\$ 12.97	7.75	
Outstanding at end of period	1,284	\$ 12.27	7.19	\$ 5,179

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	_____			_____
Vested or expected to vest at end of period	1,284	\$ 12.27	7.19	\$ 5,179
	_____			_____
Exercisable at end of period	1,284	\$ 12.27	7.19	\$ 5,179
	_____			_____

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 and twenty-six weeks ended December 1, 2007 was \$621,000. The total intrinsic value of stock options exercised during the thirteen and twenty-six weeks ended December 2, 2006 was \$272,000 and \$323,000, respectively.

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E-Z-EM, Inc. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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NOTE D - STOCK-BASED COMPENSATION (continued)

The Company received cash of \$1,444,000 from stock options exercised during the thirteen and twenty-six weeks ended December 1, 2007, and \$710,000 and \$760,000 from stock options exercised during the thirteen and twenty-six weeks ended December 2, 2006, respectively. These cash receipts are included in financing activities in the accompanying consolidated statements of cash flows. The Company realized tax benefits of \$186,000 from the exercise of stock options during the thirteen and twenty-six weeks ended December 1, 2007 and \$224,000 and \$339,000 from the exercise of stock options during the thirteen and twenty-six weeks ended December 2, 2006, respectively.

On November 1, 2007 and November 1, 2006, the Company issued 7,750 shares of common stock to members of its Board of Directors and, as a result, recognized share-based compensation expense of \$160,000 and \$133,000 for the thirteen and twenty-six weeks ended December 1, 2007 and December 2, 2006, respectively. These expenses are included in selling, general and administrative expense in the accompanying consolidated statements of earnings.

NOTE E - EARNINGS PER COMMON SHARE

Basic earnings per share are based on the weighted average number of common shares outstanding without consideration of potential common shares. Diluted earnings per share are based on the weighted average number of common shares 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 of the common shares during the period.

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

	Thirteen weeks ended		Twenty-six weeks ended	
	December 1, 2007	December 2, 2006	December 1, 2007	December 2, 2006
	(in thousands)			
Basic	11,014	10,892	10,995	10,880
Effect of dilutive securities (stock options)	244	195	218	193
Diluted	11,258	11,087	11,213	11,073

Excluded from the calculation of earnings per common share, are options to purchase 224,750 shares of common stock for the thirteen and twenty-six weeks ended December 2, 2006 as their inclusion would be anti-dilutive. The range of exercise prices of the excluded options was \$15.64 to \$17.49 per share for the thirteen and twenty-six weeks ended December 2, 2006.

E-Z-EM, Inc. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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NOTE F - EFFECTS OF RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In June 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48), an interpretation of FASB Statement No. 109. 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 criterion, 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.

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

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NOTE G - COMPREHENSIVE INCOME

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

	Thirteen weeks ended		Twenty-six weeks ended	
	December 1, 2007	December 2, 2006	December 1, 2007	December 2, 2006
	(in thousands)			
Net earnings	\$ 2,760	\$ 1,804	\$ 3,405	\$ 3,366
Unrealized holding gain (loss) on debt and equity securities:				
Arising during the period	92	77	(176)	177
Reclassification adjustment for gains included in net earnings	(355)		(437)	
Foreign currency translation adjustments arising during the period	2,469	(1,213)	2,720	(1,253)
Comprehensive income	\$ 4,966	\$ 668	\$ 5,512	\$ 2,290

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

	December 1, 2007	June 2, 2007
	(in thousands)	
Unrealized holding gain on debt and equity securities		\$ 613
Cumulative translation adjustments	\$ 10,461	7,741
Accumulated other comprehensive income	\$ 10,461	\$ 8,354

E-Z-EM, Inc. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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NOTE H - DEBT AND EQUITY SECURITIES

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

	Amortized cost	Fair value
	(in thousands)	
<u>Current</u>		
Available-for-sale securities (carried on the balance sheet at fair value)		
Municipal bonds with maturities		
Due in one through 10 years	\$ 9,300	\$ 9,300
Due after 10 years and through 20 years	200	200
Due after 20 years	25,155	25,155
Other	16	16
	<u>\$ 34,671</u>	<u>\$ 34,671</u>

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

	Amortized cost	Fair value	Unrealized holding gain
	(in thousands)		
<u>Current</u>			
Available-for-sale securities (carried on the balance sheet at fair value)			
Municipal bonds with maturities			
Due after 10 years and through 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>	
<u>Noncurrent</u>			
Available-for-sale securities (carried on the balance sheet at fair value)			
Equity securities	\$ 257	\$ 1,196	\$ 939
	<u>\$ 257</u>	<u>\$ 1,196</u>	<u>\$ 939</u>

E-Z-EM, Inc. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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NOTE H - DEBT AND EQUITY SECURITIES (continued)

During the thirteen and twenty-six weeks ended December 1, 2007, the Company sold 32,332 shares and 42,332 shares, respectively, of its investment in Vital Images Inc. The Company recognized gains on these sales totaling \$543,000 and \$669,000, respectively, during the thirteen and twenty-six weeks ended December 1, 2007, which are included in the consolidated statements of earnings under the caption Other, net .

NOTE I - INVENTORIES

Inventories consist of the following:

	December 1, 2007	June 2, 2007
	<u> </u>	<u> </u>
	(in thousands)	
Finished goods	\$ 16,648	\$ 15,016
Work in process	500	247
Raw materials	17,157	14,536
	<u> </u>	<u> </u>
	\$ 34,305	\$ 29,799
	<u> </u>	<u> </u>

NOTE J - INCOME TAXES

For the thirteen weeks ended December 1, 2007, 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. For the twenty-six weeks ended December 1, 2007, the Company's effective tax rate of 30% 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 December 2, 2006, the Company's effective tax rate of 35% differed from the Federal statutory tax rate of 34% due primarily to non-deductible expenses and state income taxes, partially offset by tax-exempt income. For the twenty-six weeks ended December 2, 2006, the Company's effective tax rate of 34% equaled the Federal statutory tax rate as the effects of non-deductible expenses offset tax-exempt income.

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.

E-Z-EM, Inc. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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NOTE J - INCOME TAXES (continued)

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.

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 with prejudice of Tyco from the action.

E-Z-EM, Inc. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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NOTE K CONTINGENCIES (continued)

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 an 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 December 1, 2007 and December 2, 2006, sales of products to Merry X-Ray Corporation (Merry X-Ray) represented 25% and 34% of total sales, respectively. For the twenty-six weeks ended December 1, 2007 and December 2, 2006, sales of products to Merry X-Ray represented 28% and 34% of total sales, respectively. Approximately 28% and 35% of accounts receivable pertained to Merry X-Ray at December 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.

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 and twenty-six weeks ended December 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.

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, 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.

Proposed Merger with Bracco Diagnostics, Inc.

On October 30, 2007, we, Bracco Diagnostics, Inc., a Delaware corporation (Bracco), Eagle Acquisition Sub, Inc., a wholly owned subsidiary of Bracco (Merger Sub), and, for limited purposes, Bracco Imaging S.p.A., an Italian corporation (Bracco Imaging) entered into a definitive Agreement and Plan of Merger (the merger agreement). Under the terms of the merger agreement,

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Merger Sub will merge with and into E-Z-EM (the merger), with E-Z-EM continuing after the merger as the surviving entity and a wholly owned subsidiary of Bracco. Bracco is the U.S.-based subsidiary of the Bracco Group, which is headquartered in Milan, Italy.

Under the terms of the merger agreement, at the effective time of the merger, each of our issued and outstanding shares of common stock (other than shares held by Bracco, Merger Sub, E-Z-EM or any of their respective wholly owned subsidiaries, or shares held by any stockholders exercising appraisal rights) will be converted into the right to receive \$21.00 in cash per share (without interest and subject to any required tax withholding).

The merger agreement has been approved unanimously by our board of directors, with the two non-independent directors abstaining.

The merger agreement contains customary representations and warranties by us, Bracco and Merger Sub. The merger agreement also contains customary covenants and agreements, including with respect to the operation of our business and that of our subsidiaries between signing and closing, governmental filings and approvals, public disclosures and similar matters. Additionally, we have agreed not to solicit alternative transactions or, subject to certain exceptions relating to unsolicited proposals, participate in discussions relating to an alternative transaction or furnish non-public information relating to an alternative transaction. We have also agreed that during the pendency of the merger we will operate our business in the ordinary course of business consistent with past practice and not take certain actions specified in the merger agreement.

Consummation of the merger is subject to the satisfaction of customary closing conditions, including (i) the approval of the merger by our stockholders, (ii) the absence of any order, injunction or legal restraint or prohibition preventing the consummation of the merger, (iii) the accuracy of the representations and warranties of the other party (subject to the materiality standards and, with respect to our representations, an overall material adverse effect standard contained in the merger agreement), and (iv) compliance in all material respects of the other party with its covenants. In addition, the merger is subject to clearance under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 and the Exon-Florio provision of the Defense Protection Act of 1950, and the receipt of regulatory approvals under German competition regulations. All of the initial filings and notifications required to obtain such antitrust and other regulatory approvals have been made, although neither we nor Bracco have yet obtained any of such antitrust or other regulatory approvals required to complete the merger. Stockholders will be asked to vote on the proposed transaction at a special meeting on a date to be announced. We currently anticipate that we will file our preliminary proxy statement regarding the merger in January 2008 and that, if all of the conditions to consummating the merger are satisfied, the merger will close in the first or second calendar quarter of 2008. Availability of financing for the merger is not a condition to Bracco's obligation to complete the merger, and Bracco Imaging has agreed to cause Bracco to have sufficient funds to pay the merger consideration and otherwise satisfy its obligations under the merger agreement.

The merger agreement contains certain termination rights for both us and Bracco and provides that, upon termination of the merger agreement under specified circumstances described in the merger agreement, we will be required to pay Bracco a termination fee of \$9.0 million.

The merger agreement contains representations and warranties that the parties have made to each other as of specific dates. The assertions embodied in those representations and warranties were made solely for purposes of the contract between the parties, and may be subject to important qualifications and limitations agreed to by the parties in connection with negotiating its terms. Moreover, the representations and warranties are subject to a contractual standard of materiality that may be different from what may be viewed as material to stockholders, and the representations and warranties may have been intended not as statements of fact, but rather as a way of allocating risk among the parties. Accordingly, they should not be relied on as statements of factual information. Stockholders are not third-party beneficiaries under the merger agreement and should not rely on the representations, warranties and covenants or any descriptions thereof as characterizations of the actual state of facts or our condition or that of our subsidiaries.

Concurrently with the entry into the merger agreement, certain stockholders of E-Z-EM owning an aggregate of approximately 34% of our outstanding shares as of October 30, 2007, entered into a voting agreement with Bracco and us pursuant to which they have agreed, subject to certain exceptions, to vote in favor of adopting the merger agreement and approving the merger and the transactions contemplated thereby and against any transaction or other action that is or would reasonably be expected to prevent or materially delay the merger and the other transactions contemplated by the merger agreement.

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. Our focus has been 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 and MR power injectors that deliver injectable 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 March 2007, the U.S. Department of Defense (DoD) determined that RSDL had satisfied all final configuration testing criteria, and approved it for initial procurements by the individual service branches. The decision, known as Milestone C, cleared the way for deployment of RSDL 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. Since then, we have received additional orders for RSDL and its training variant totaling approximately \$12.5 million from the U.S. Army Space and Missile Command. At the DoD s request, we stored approximately \$3.5 million of RSDL product relating to the initial order at our facility pending the DoD s order to ship. The DoD inspected and formally accepted this product in May 2007 and paid for this product in July 2007. In November

2007, we shipped this product as well as the balance of the initial \$5.07 million order and recognized the revenue from this transaction. We expect to ship the balance of these orders by the end of our current fiscal year. Revenues will be recognized when the product is shipped.

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. 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 adversely affected by the Deficit Reduction Act of 2005 (DRA), which took effect on January 1, 2007. The DRA effectively reduced Medicare and Medicaid reimbursement rates for MR, CT and PET/CT procedures performed at outpatient imaging centers. Although the effect of DRA 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.

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 and six months ended December 2, 2006, Toho is accounted for as a discontinued operation in our financial statements in accordance with SFAS No. 144, Accounting for Impairment and Disposal of Long-Lived Assets.

Results of Operations

Quarters ended December 1, 2007 and December 2, 2006

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

Consolidated Results of Operations

For the quarter ended December 1, 2007, we reported net earnings of \$2,760,000, or \$0.25 per common share on both a basic and diluted basis, as compared to net earnings of \$1,804,000, or \$0.17 and \$0.16 per common share

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on a basic and diluted basis, respectively, 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 December 1, 2007 and December 2, 2006:

	<u>2007</u>	<u>2006</u>
	(in thousands)	
Earnings from continuing operations	\$ 2,760	\$ 1,818
Loss from discontinued operation		(14)
	<u> </u>	<u> </u>
Net earnings	<u>\$ 2,760</u>	<u>\$ 1,804</u>

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

	<u>2007</u>	<u>2006</u>
Net sales	100.0%	100.0%
Cost of goods sold	<u>56.9</u>	<u>55.3</u>
Gross profit	<u>43.1</u>	<u>44.7</u>
Operating expenses		
Selling, general and administrative	29.2	33.5
Costs associated with planned merger	2.4	
Research and development	<u>3.8</u>	<u>4.5</u>
Total operating expenses	<u>35.4</u>	<u>38.0</u>
Operating profit	7.7	6.7
Other income (expense)		
Interest income	0.9	0.9
Interest expense	(0.2)	(0.3)
Foreign currency exchange gains (losses)	(0.5)	0.7
Other, net	<u>1.4</u>	<u>0.2</u>
Earnings from continuing operations before income taxes	9.3	8.2
Income tax provision	<u>3.0</u>	<u>2.9</u>
Earnings from continuing operations	6.3	5.3
Loss from discontinued operation, net of income tax benefit		<u>(0.0)</u>

NET EARNINGS	6.3%	5.3%
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Continuing Operations

Operating profit for the current quarter increased by \$1,078,000 due to increased sales, partially offset by increased operating expenses of \$2,456,000, including \$1,031,000 in costs incurred in connection with the planned merger with Bracco.

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Net sales for the quarter ended December 1, 2007 increased 28%, or \$9,466,000, as compared to the quarter ended December 2, 2006, due to higher sales volumes, foreign currency exchange fluctuations, which increased the translated amounts of foreign subsidiaries' sales to U.S. dollars for financial reporting purposes by \$1,505,000, and price increases. Price increases accounted for approximately 2.4% 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 increase resulted primarily from increased sales of healthcare decontaminants of \$5,847,000, CT injector systems of \$1,696,000, contact manufacturing products of \$1,391,000 and virtual colonoscopy products of \$396,000.

The CT imaging market in calendar 2007 has been adversely affected by the Deficit Reduction Act of 2005 (DRA), which took effect on January 1, 2007. The DRA effectively reduced Medicare and Medicaid reimbursement rates for MR, CT and PET/CT procedures performed at outpatient imaging centers. Although the effect of DRA 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 27%, or \$2,869,000, for the current quarter from the prior year's quarter due to higher sales volumes, foreign currency exchange fluctuations, which increased the translated amounts of foreign subsidiaries' sales to U.S. dollars for financial reporting purposes by \$865,000, and price increases, which accounted for approximately 1½% of net sales in international markets for the current quarter. On a product line basis, the net sales increase resulted primarily from increased sales of contact manufacturing products of \$800,000, CT injector systems of \$691,000, X-ray fluoroscopy products of \$654,000 and virtual colonoscopy products of \$473,000.

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

	2007		2006	
	\$	%	\$	%
	(dollars in thousands)			
CT Imaging Contrast	\$ 9,083	20.8	\$ 9,170	26.8
CT Injector Systems	8,652	19.8	6,956	20.4
Total CT Imaging	17,735	40.6	16,126	47.2
X-Ray Fluoroscopy	11,294	25.9	11,179	32.7
Healthcare Decontaminants	6,196	14.2	349	1.0
Contract Manufacturing	3,113	7.1	1,722	5.0
Virtual Colonoscopy	1,796	4.1	1,400	4.1
Accessory Medical Devices	1,316	3.0	1,226	3.6
Gastroenterology	1,203	2.8	1,062	3.1
Other	984	2.3	1,107	3.3
	\$ 43,637	100.0	\$ 34,171	100.0

Gross profit, expressed as a percentage of net sales, was 43% for the current quarter compared to 45% for the comparable quarter of the prior year due to increased costs for finished products purchased from our Canadian subsidiary,

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which resulted from the continued weakening of the U.S. dollar against the Canadian dollar, partially offset by sales price increases.

Selling, general and administrative (SG&A) expenses were \$12,767,000 for the quarter ended December 1, 2007 compared to \$11,437,000 for the quarter ended December 2, 2006. This increase of \$1,330,000, or 12%, was due primarily to 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 \$400,000, costs of \$340,000 associated with an increase in the size of our North American sales force, and legal fees of \$261,000 incurred in the defense of the Tyco lawsuit, which is continuing.

Research and development (R&D) expenditures for the current quarter increased 6% to \$1,654,000, or 4% of net sales, from \$1,559,000, or 5% of net sales, for the comparable quarter of the prior year due to increased general regulatory costs resulting from our adding personnel to support planned increases in international product registrations. Of the R&D expenditures for the current quarter, approximately 61% related to CT imaging and X-ray fluoroscopy projects, 31% to general regulatory costs, 4% to gastroenterology projects and 4% 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 \$682,000 of income for the current quarter compared to income of \$508,000 for the comparable period of last year. This improvement is due primarily to gains of \$543,000 from sales of non-core equity securities and increased interest income of \$72,000, partially offset by unfavorable changes in foreign currency exchange gains and losses of \$474,000, resulting from the weakening of the U.S. dollar.

For the quarter ended December 1, 2007, 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. For the quarter ended December 2, 2006, our effective tax rate of 35% differed from the Federal statutory tax rate of 34% due primarily to non-deductible expenses and state income taxes, partially offset by tax-exempt income.

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 December 2, 2006 are as follows:

	(in thousands)
Net sales (credits) from unaffiliated customers	\$ (11)
Total net sales (credits)	\$ (11)
Loss before income taxes	\$ (33)
Income tax benefit	(19)
Loss from discontinued operation	\$ (14)

Six months ended December 1, 2007 and December 2, 2006

Our six months ended December 1, 2007 and December 2, 2006 both represent twenty-six weeks.

Consolidated Results of Operations

For the six months ended December 1, 2007, we reported net earnings of \$3,405,000, or \$0.31 and \$0.30 per common share on a basic and diluted basis, respectively, as compared to net earnings of \$3,366,000, or \$0.31 and \$0.30 per common share on a basic and diluted basis, respectively, for the comparable period of last year.

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

	2007	2006
	_____	_____
	(in thousands)	
Earnings from continuing operations	\$ 3,405	\$ 3,601
Loss from discontinued operation		(235)
	_____	_____
Net earnings	\$ 3,405	\$ 3,366
	_____	_____

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

	2007	2006
	_____	_____
Net sales	100.0%	100.0%
Cost of goods sold	56.5	55.8
	_____	_____
Gross profit	43.5	44.2
	_____	_____
Operating expenses		
Selling, general and administrative	32.5	33.4
Costs associated with planned merger	1.4	
Research and development	4.7	4.3
	_____	_____
Total operating expenses	38.6	37.7
	_____	_____
Operating profit	4.9	6.5
Other income (expense)		
Interest income	1.0	1.0
Interest expense	(0.2)	(0.3)
Foreign currency exchange gains (losses)	(0.4)	0.7
Other, net	1.0	0.1
	_____	_____
Earnings from continuing operations before income taxes	6.3	8.0
Income tax provision	1.9	2.7

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	<u> </u>	<u> </u>
Earnings from continuing operations	4.4	5.3
Loss from discontinued operation, net of income tax benefit		(0.3)
	<u> </u>	<u> </u>
NET EARNINGS	4.4%	5.0%
	<u> </u>	<u> </u>

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Continuing Operations

Operating profit for the current period declined by \$633,000 due to increased operating expenses of \$4,042,000, including \$1,067,000 in costs incurred in connection with the planned merger with Bracco, partially offset by increased sales.

Net sales for the six months ended December 1, 2007 increased 13%, or \$8,993,000, as compared to the six months ended December 2, 2006, due to higher sales volumes, 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 \$1,953,000. Price increases accounted for approximately 2.7% of net sales for the current period, 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 increase resulted primarily from increased sales of healthcare decontaminants of \$5,594,000, CT injector systems of \$3,392,000, contract manufacturing products of \$1,392,000, partially offset by decreased sales of CT imaging contrast products of \$1,147,000 and X-ray fluoroscopy products of \$427,000.

Net sales in international markets, including direct exports from the U.S., increased 14%, or \$3,031,000, for the current period from the comparable prior year period due to higher sales volumes, foreign currency exchange fluctuations, which increased the translated amounts of foreign subsidiaries' sales to U.S. dollars for financial reporting purposes by \$1,268,000, and price increases, which accounted for approximately 1.7% of net sales in international markets for the current period. On a product line basis, the net sales increase resulted from increased sales of CT injector systems of \$1,251,000, contract manufacturing products of \$964,000, virtual colonoscopy products of \$533,000 and X-ray fluoroscopy products of \$435,000.

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

	2007		2006	
	\$	%	\$	%
	(dollars in thousands)			
CT Imaging Contrast	\$ 17,271	22.5	\$ 18,418	27.2
CT Injector Systems	16,893	22.1	13,501	20.0
Total CT Imaging	34,164	44.6	31,919	47.2
X-Ray Fluoroscopy	21,610	28.2	22,037	32.6
Healthcare Decontaminants	6,440	8.4	846	1.3
Contract Manufacturing	4,798	6.3	3,406	5.0
Virtual Colonoscopy	2,869	3.7	2,588	3.8
Accessory Medical Devices	2,574	3.4	2,679	4.0
Gastroenterology	2,301	3.0	2,197	3.2
Other	1,848	2.4	1,939	2.9
	\$ 76,604	100.0	\$ 67,611	100.0

Gross profit, expressed as a percentage of net sales, decreased to 43% for the current period from 44% for the comparable period of the prior year due to increased costs for finished products purchased from our Canadian subsidiary, which resulted from the continued weakening of the U.S. dollar against the Canadian dollar, partially offset by sales price increases.

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SG&A expenses were \$24,899,000 for the six months ended December 1, 2007 compared to \$22,578,000 for the six months ended December 2, 2006. This increase of \$2,321,000, or 10%, was due to costs of \$724,000 associated with an increase in the size of our North American sales force, 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 \$586,000, legal fees of \$523,000 incurred in the defense of the Tyco lawsuit, which is continuing, and severance costs of \$216,000.

R&D expenditures for the current period increased 22% to \$3,589,000, or 5% of net sales, from \$2,935,000, or 4% of net sales, for the comparable period of the prior year due to increased general regulatory costs of \$429,000, resulting from our adding personnel to support planned increases in international product registrations, and increased costs of \$308,000 for CT imaging and X-ray fluoroscopy projects. Of the R&D expenditures for the current period, approximately 57% related to CT imaging and X-ray fluoroscopy projects, 32% to general regulatory costs, 5% to gastroenterology projects, 1% to virtual colonoscopy projects, 1% to healthcare decontaminant projects and 4% to other projects.

Other income (expense) totaled \$1,159,000 of income for the current period compared to income of \$1,068,000 for the comparable period of last year. This improvement is due primarily to gains of \$669,000 from sales of non-core equity securities and increased interest income of \$136,000, partially offset by unfavorable changes in foreign currency exchange gains and losses of \$749,000, resulting from the weakening of the U.S. dollar.

For the six months ended December 1, 2007, our effective tax rate of 30% differed from the Federal statutory tax rate of 34% due primarily to tax-exempt income, partially offset by non-deductible expenses. For the six months ended December 2, 2006, our effective tax rate of 34% equaled the Federal statutory tax rate as the effects of non-deductible expenses offset tax-exempt income.

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 six months ended December 2, 2006 are as follows:

	(in thousands)
Net sales from unaffiliated customers	\$ 183
Total net sales	\$ 183
Loss before income taxes	\$ (374)
Income tax benefit	(139)
Loss from discontinued operation	\$ (235)

Liquidity and Capital Resources

For the quarter ended December 1, 2007, operations and capital expenditures were funded by working capital and proceeds from the exercise of stock options. Our policy has generally been to fund operations and capital requirements without incurring significant debt. At December 1, 2007 and

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June 2, 2007, we had no outstanding indebtedness for borrowed money. We have available \$2,000,000 under a bank line of credit, of which no amounts were outstanding at December 1, 2007.

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

Payments Due By Period as of December 1, 2007

	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
(in thousands)					
Contractual Obligations:					
Operating leases ⁽¹⁾	\$ 6,255	\$ 2,075	\$ 3,231	\$ 341	\$ 608
Purchase obligations ⁽¹⁾	5,090	5,066	24		
Employment contract ⁽¹⁾	720	720			
Other liabilities reflected on the consolidated balance sheet					
Deferred compensation ⁽²⁾	2,759	107	238	264	2,150
License arrangements	36	36			
Accrued severance benefits	116	116			
	\$ 14,976	\$ 8,120	\$ 3,493	\$ 605	\$ 2,758

⁽¹⁾ 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.

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

At December 1, 2007, approximately \$44,558,000, or 31%, of our assets consisted of cash and cash equivalents and short-term debt and equity securities. The current ratio was 6.09 to 1, with net working capital of \$91,795,000, at December 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 and six months ended December 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