DYNATRONICS CORP
Form 10QSB
May 16, 2005

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

FORM 10-QSB

(Mark One)

[X] QUARTERLY REPORT UNDER SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2005.

[ ] TRANSITION REPORT UNDER SECTION 13 OR 15(D) OF THE EXCHANGE ACT

For the transition period from _________ to _________

Commission File Number: 0-12697

Dynatronics Corporation

(Exact name of small business issuer as specified in its charter)

Utah	87-0398434
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

7030 Park Centre Drive, Salt Lake City, UT 84121

(Address of principal executive offices)

(801) 568-7000

(Issuer's telephone number)

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

The number of shares outstanding of the issuer's common stock, no par value, as of May 13, 2005 is 9,007,568.

Transitional Small Business Disclosure Format (Check one): Yes __ No X

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DYNATRONICS CORPORATION
Balance Sheets

Assets	March 31, 2005 (Unaudited)	June 30, 2004 (Audited)
Current assets:		
Cash	$ 418,837	573,027
Trade accounts receivable, less allowance for doubtful accounts of $245,559 at March 31, 2005 and $182,941 at June 30, 2004	3,597,245	3,737,420
Other receivables	172,587	76,213
Inventories	4,647,200	4,687,797
Prepaid expenses	258,781	452,754
Deferred tax asset-current	335,000	335,000
Total current assets	9,429,650	9,862,211
Property and equipment, net	3,308,474	3,310,083
Goodwill, net of accumulated amortization of $649,792 at March 31, 2005 and at June 30, 2004	789,422	789,422
Other assets	435,891	310,863
	$ 13,963,437	14,272,579

Liabilities and Stockholders' Equity

Current liabilities:		
Current installments of long-term debt	$ 204,474	207,019
Line of credit	591,236	1,604,535
Accounts payable	982,278	681,335
Accrued expenses	465,630	444,474
Accrued payroll and benefit expenses	479,809	423,972
Income tax payable	39,503	200,294
Total current liabilities	2,762,930	3,561,629
Long-term debt, excluding current installments	1,399,250	1,553,832
Deferred compensation	353,144	331,022
Deferred tax liability - noncurrent	150,000	150,000
Total liabilities	4,665,324	5,596,483
Stockholders' equity:		
Common stock, no par value. Authorized 50,000,000 shares; issued 8,992,568 shares at March 31, 2005 and 8,956,688 shares at June 30, 2004	2,733,204	2,670,404
Retained earnings	6,564,909	6,005,692
Total stockholders' equity	9,298,113	8,676,096
	$ 13,963,437	14,272,579

See accompanying notes to financial statements.

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DYNATRONICS CORPORATION
Condensed Statements Of Income
(Unaudited)

	Three Months Ended March 31		Ni
	2005	2004	2005
Net sales	$ 5,048,108	5,246,044	15,289,610
Cost of sales	3,031,174	3,106,290	9,082,178
Gross profit	2,016,934	2,139,754	6,207,432
Selling, general, and admin. expenses	1,372,927	1,446,932	4,328,640
Research and development expenses	356,313	275,910	885,467

Operating income		287,694	416,912	993,325
Other income (expense):				
Interest income		2,753	3,275	4,657
Interest expense		(33,247)	(42,376)	(107,649
Other income, net		10,705	2,811	18,963
Total other income (expense)		(19,789)	(36,290)	(84,029
Income before income taxes		267,905	380,622	909,296
Income tax expense		103,143	70,920	350,079
Net income	$	164,762	309,702	559,217
Basic and diluted net income per common share	$	0.02	0.03	0.06

Weighted average basic and diluted common shares outstanding

Basic	8,974,707	8,868,201	8,963,842
Diluted	9,261,151	9,344,707	9,213,259

See accompanying notes to condensed financial statements.

DYNATRONICS CORPORATION
Statements of Cash Flows
(Unaudited)

		Nine M Ma 2005
Cash flows from operating activities:		
Net income	$	559,217
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of property and equipment		272,315

Other amortization		5,493
Provision for doubtful accounts		72,000
Provision for inventory obsolescence		207,000
Provision for warranty reserve		121,541
Provision for deferred compensation		22,122
Compensation expense on stock options		19,800
Change in operating assets and liabilities:		
Receivables		(28,199)
Inventories		(166,403)
Prepaid expenses and other assets		73,352
Accounts payable and accrued expenses		256,395
Prepaid income taxes		(160,791)
Net cash provided by (used in) operating activities		1,253,842
Cash flows from investing activities:		
Capital expenditures		(270,675)
Proceeds from sale of assets		(31)
Net cash used in investing activities		(270,706)
Cash flows from financing activities:		
Principal payments on long-term debt		(157,127)
Net change in line of credit		(1,013,299)
Proceeds from issuance of common stock		33,100
Redemption of common stock		-
Net cash (used in) provided by financing activities		(1,137,326)
Net change in cash and cash equivalents		(154,190)
Cash at beginning of period		573,027
Cash at end of period	$	418,837
Supplemental disclosures of cash flow information:		
Cash paid for interest	$	109,656
Cash paid for income taxes		510,870
Supplemental disclosure of non-cash investing and financing activities:		
Common stock issued for consulting services		29,700

See accompanying notes to financial statements.

DYNATRONICS CORPORATION
NOTES TO CONDENSED FINANCIAL STATEMENTS

March 31, 2005
(Unaudited)

NOTE 1. PRESENTATION

The financial statements as of March 31, 2005 (unaudited) were prepared by the Company without audit pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). 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 pursuant to such rules and regulations. In the opinion of management, all necessary adjustments, which consist only of normal recurring adjustments, to the financial statements have been made to present fairly the financial position and results of operations and cash flows. The results of operations for the respective periods presented are not necessarily indicative of the results for the respective complete years. The Company has previously filed with the SEC an annual report on Form 10-KSB which included audited financial statements for the two years ended June 30, 2004 and 2003. It is suggested that the financial statements contained in this filing be read in conjunction with the statements and notes thereto contained in the Company's 10-KSB filing.

NOTE 2. NET INCOME PER COMMON SHARE

Net income per common share is computed based on the weighted-average number of common shares and, as appropriate, dilutive common stock equivalents outstanding during the period. Stock options are considered to be common stock equivalents.

Basic net income per common share is the amount of net income for the period available to each share of common stock outstanding during the reporting period. Diluted net income per common share is the amount of net income for the period available to each share of common stock outstanding during the reporting period and to each share that would have been outstanding assuming the issuance of common shares for all dilutive potential common shares outstanding during the period.

In calculating net income per common share, the net income was the same for both the basic and diluted calculation. A reconciliation between the basic and diluted weighted-average number of common shares for the three and nine months ended March 31, 2005 and 2004 is summarized as follows:

	(Unaudited) Three Months Ended March 31,		(U Nine M Ma
	2005	2004	2005
Basic weighted average number of common shares outstanding during the period	8,974,707	8,868,201	8,963,842
Weighted average number of dilutive common stock options outstanding during the period	286,444	476,506	249,417
Diluted weighted average number of common and common equivalent shares outstanding during the period	9,261,151	9,344,707	9,213,259

NOTE 3. EMPLOYEE STOCK COMPENSATION

The Company employs the footnote disclosure provisions of Statement of Financial Accounting Standard (" SFAS") No. 123, Accounting for Stock-Based Compensation, as amended by SFAS No. 148, Accounting for Stock-Based Compensation - Transition and Disclosure, an amendment of SFAS Statement No. 123. SFAS No. 123 encourages entities to adopt a fair-value-based method of accounting for stock options or similar equity instruments. However, it also allows an entity to continue measuring compensation cost for stock-based compensation using the intrinsic-value method of accounting prescribed by Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees (APB 25). The Company has elected to apply the provisions of APB 25; accordingly, no compensation expense has been recognized for the stock option plan. Had compensation expense for the Company's stock option plan been determined based on the fair value at the grant date for awards consistent with the provisions of SFAS No. 123, the Company's results of operations would have been reduced to the pro forma amounts indicated below:

		Three months ended March 31, 2005	Three months ended March 31, 2004
Net income as reported	$	164,762	309,702
Less: pro forma adjustment for stock based compensation, net of income tax		(11,095)	(28,203)
Pro forma net income	$	153,667	281,499
Basic net income per share:			
As reported	$	0.02	0.03
Effect of pro forma adjustment		-	-
Pro forma		0.02	0.03
Diluted net income per share:			
As reported		0.02	0.03
Effect of pro forma adjustment		-	-
Pro forma	$	0.02	0.03

		Nine months ended March 31, 2005	Nine months ended March 31, 2004
Net income as reported	$	559,217	725,059
Less: pro forma adjustment for stock based compensation, net of income tax		(32,595)	(86,820)
Pro forma net income	$	526,622	638,239
Basic net income per share:			
As reported	$	0.06	0.08

Effect of pro forma adjustment		-	(0.01)
Pro forma		0.06	0.07
Diluted net income per share:			
As reported		0.06	0.08
Effect of pro forma adjustment		-	(0.01)
Pro forma	$	0.06	0.07

The per share weighted-average fair value of stock options granted for the three months ended March 31, 2005 and 2004 was $1.29 and $2.07 per share, and for the nine months ended March 31, 2005 and 2004 was $1.27 and $1.42 per share, respectively, on the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions:

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	Three months ended March 31, 2005	Three months ended March 31, 2004
Expected dividend yield	0%	0%
Risk-free interest rate	3.72 - 4.45%	3.31 - 3.65%
Expected volatility	86 - 89%	86 - 88%
Expected life	5 & 7 years	5 & 7 years
	Nine months ended March 31, 2005	**Nine months ended March 31, 2004**
Expected dividend yield	0%	0%
Risk-free interest rate	3.66 - 4.45%	3.31 - 3.72%
Expected volatility	86 - 89%	82 - 88%
Expected life	5 & 7 years	5 & 7 years

NOTE 4. COMPREHENSIVE INCOME

For the periods ended March 31, 2005 and 2004, comprehensive income was equal to the net income as presented in the accompanying condensed statements of income.

NOTE 5. INVENTORIES

Inventories consisted of the following:

		March 31, 2005	June 30, 2004
Raw Material	$	2,869,826	2,906,721
Finished Goods		2,310,490	2,115,469
Inventory Reserve		(533,116)	(334,393)
	$	4,647,200	4,687,797

NOTE 6. PROPERTY AND EQUIPMENT

Property and equipment were as follows:

	March 31, 2005	June 30, 2004
Land	$ 354,744	354,743
Buildings	2,921,127	2,899,729
Machinery and equipment	1,558,429	1,753,220
Office equipment	999,616	801,297
Vehicles	101,837	80,680
	5,935,753	5,889,669
Less accumulated depreciation and amortization	2,627,279	2,579,586
	$ 3,308,474	3,310,083

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NOTE 7. GOODWILL AND INTANGIBLE ASSETS

Goodwill represents the excess of costs over fair value of assets of businesses acquired. The Company adopted the provisions of Statement of Financial Accounting Standards (SFAS) No. 142, Goodwill and Other Intangible Assets, as of July 1, 2002. Goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but instead tested for impairment at least annually in accordance with the provisions of SFAS No. 142. Management is primarily responsible for the SFAS No. 142 valuation determination. In compliance with SFAS No. 142, management utilizes standard principles of financial analysis and valuation including: transaction value, market value, and income value methods to arrive at a reasonable estimate of the fair value of the Company in comparison to its book value. The Company has determined it has one reporting unit. As of July 1, 2002, the fair value of the Company exceeded the book value of the Company. Therefore, there was not an indication of impairment upon adoption of SFAS No. 142. Management performed its annual impairment assessment during the Company's fourth quarter ending June 30, 2004 and determined there was not an indication of impairment. SFAS No. 142 also requires that intangible assets with estimable useful lives be amortized over their respective estimated useful lives to their estimated residual values, and reviewed for impairment in accordance with SFAS No. 144, Accounting for Impairment or Disposal of Long-Lived Assets.

Goodwill. As of March 31, 2005, the Company had goodwill, net, of $789,422 from the acquisition of Superior Orthopaedic Supplies, Inc on May 1, 1996 and the exchange of Dynatronics Laser Corporation common stock for a minority interest in Dynatronics Marketing Corporation on June 30, 1983. Through June 30, 2002, goodwill from these transactions was amortized over a period of 15 and 30 years, respectively, on a straight-line basis.

License Agreement. Identifiable intangible assets consist of a license agreement entered into on August 16, 2000 for a certain concept and process relating to a patent. The license agreement is being amortized over ten years on a straight-line basis. The following table sets forth the gross carrying amount, accumulated amortization and net carrying amount of the license agreement:

	As of March 31, 2005	As of June 30, 2004
Gross carrying amount	$ 73,240	$ 73,240
Accumulated amortization	33,569	28,076
Net carrying amount	$ 39,671	$ 45,164

Amortization expense associated with the license agreement was $1,831 and $5,493, respectively, for the three and nine months ended March 31, 2005 and 2004. Estimated amortization expense for the existing license agreement is expected to be $7,324 for each of the fiscal years ending June 30, 2005 through June 30, 2010. The license agreement is included in other assets.

NOTE 8. PRODUCT WARRANTY RESERVE

The Company adopted the provisions of FASB Interpretation No. 45, Guarantors' Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, as of December 31, 2002. The Company accrues the estimated costs to be incurred in connection with its product warranty programs as products are sold based on historical warranty rates. The product warranty reserve is included in accrued expenses at December 31, 2004 and June 30, 2004. A reconciliation of the changes in the warranty liability is as follows:

	Three months ended March 31, 2005	Three months end March 31, 2004
Beginning product warranty reserve balance	$ 196,000	$ 172,000
Warranty repairs	(40,334)	(38,830
Warranties issued	52,497	54,556
Changes in estimated warranty costs	(6,163)	(9,726
Ending product warranty liability balance	$ 202,000	$ 178,000

	Nine months ended March 31, 2005	Nine months ende March 31, 2004
Beginning product warranty reserve balance	$ 184,000	$ 160,000

Warranty repairs	(109,540)	(102,249
Warranties issued	159,002	161,844
Changes in estimated warranty costs	(31,462)	(41,595
Ending product warranty liability balance	$ 202,000	$ 178,000

NOTE 9. COMMON STOCK.

The Company received proceeds of $33,100 during the nine months ended March 31, 2005 for 35,880 shares of common stock that were issued upon the exercise of options by employees. During the nine months ended March 31, 2004 the Company received proceeds of $184,205 for 157,317 shares of common stock that were issued upon the exercise of options by employees. During the period ended March 31, 2004, the Company also acquired and retired 77,400 shares of common at a cost of $89,000 under the Company's open-market share repurchase program that was approved July 15, 2003.

NOTE 10. RECENT ACCOUNTING PRONOUNCEMENTS

On December 16, 2004, the Financial Accounting Standards Board ("FASB") published Statement of Financial Accounting Standards No. 123 (Revised 2004), Share Based Payment ("SFAS 123R"). SFAS 123R requires that compensation cost related to share-based payment transactions be recognized in the financial statements. Share-based payment transactions within the scope of SFAS 123R include stock options, restricted stock plans, performance-based awards, stock appreciation rights, and employee share purchase plans. The provisions of SFAS 123R are effective as of the first interim period that begins after December 15, 2005. Accordingly, the Company will implement the revised standard in the third quarter of fiscal year 2006. Currently, the Company accounts for its share-based payment transactions under the provisions of APB 25, which does not necessarily require the recognition of compensation cost in the financial statements. Management is assessing the implications of this revised standard and the effect the adoption of SFAS 123R will have on our financial position, results of operations, or cash flow. See Stock-Based Compensation in Note 3 of our Notes to Consolidated Financial Statements for more information related to the proforma effects on our reported net income and net income per share of applying the fair value recognition provisions of the previous SFAS 123, Accounting for Stock-Based Compensation, to stock-based employee compensation.

In November of 2004, the FASB issued SFAS No. 151, Inventory Costs - An Amendment of ARB No. 43, Chapter 4 (SFAS 151). SFAS 151 clarifies treatment of abnormal amounts of idle facility expense, freight, handling costs and spoilage, specifying that such costs should be expensed as incurred and not included in overhead. The new statement also requires that allocation of fixed production overheads to conversion costs should be based on normal capacity of the production facilities. The provisions in SFAS 151 are effective for inventory costs incurred during fiscal years beginning after June 15, 2005. Companies must apply the standard prospectively. The Company does not believe that the impact of this new standard will have a material effect on our financial statements or results of operations.

Item 2. Management's Discussion and Analysis or Plan of Operation

The following discussion and analysis of our financial condition and results of

operations should be read in conjunction with the Financial Statements (unaudited) and Notes thereto appearing elsewhere in this report on Form 10-QSB.

Results of Operations

The Company's fiscal year ends on June 30th. This report covers the third quarter ended March 31, 2005, for the Company's fiscal year ending June 30, 2005.

Net Sales

During the quarter ended March 31, 2005, the Company generated sales of $5,048,108, compared to $5,246,044 in the quarter ended March 31, 2004. Sales for the nine-month period ended March 31, 2005, were $15,289,610, compared to $15,562,919 for the same period in 2004. The decrease in revenue for the quarter and nine months ended March 31, 2005 compared to the prior year periods is due entirely to lower sales of the Company's predecessor `50 Series' devices and other older product lines. The decrease was partially offset by sales of the Company's newer Solaris light therapy products which were higher than last year's levels.

The Solaris family of advanced technology combination therapy devices introduced in the first quarter of fiscal year 2004 incorporates seven electrotherapy waveforms and/or ultrasound therapy in combination with an optional infrared light therapy or laser therapy probe. Infrared light or laser therapy is commonly used for treating muscle and joint pain as well as arthritis pain and stiffness.

Consistent with its reputation as a leading innovator in the field of physical medicine products, the Company has significantly expanded its R&D efforts and has several new light therapy and other products under development which are expected to increase Company sales beginning in July 2005.

Gross Profit

During the quarter ended March 31, 2005, total gross profit was $2,016,934 or 40.0% of net sales compared to $2,139,754 or 40.8% of net sales in the quarter ended March 31, 2004. For the nine months ended March 31, 2005, total gross profit was $6,207,432 or 40.6% of net sales compared to $6,151,889 or 39.5% of net sales in the similar period ended March 31, 2004. The 0.8 percentage point reduction in gross profit in the current reporting quarter reflects lower sales of `50 Series' devices which carry above average margins. The 1.1 percentage point increase in gross margins for the nine months ended March 31, 2005 reflects increased sales of higher-margin Solaris and Synergie devices compared to the prior year period.

Selling, General and Administrative Expense

Selling, general and administrative (SG&A) expenses for the quarter ended March 31, 2005, were $1,372,927 or 27.2% of net sales compared to $1,446,932 or 27.6% of net sales in the quarter ended March 31, 2004. SG&A expenses for the nine months ended March 31, 2005, were $4,328,640 or 28.3% of net sales compared to $4,147,250 or 26.6% of net sales in the period ended March 31, 2004. SG&A expenses for the quarter ended March 31, 2005 decreased by $74,005 or 5% compared to the prior year period due primarily to approximately $44,000 in lower selling expenses related to reduced sales commissions and tradeshow activity for the Company's Synergie products as well as lower cost of sales incentive programs for rehabilitation products. In addition, the variable compensation amount paid to employees was approximately $43,000 lower in the quarter ended March 31, 2005 compared to the similar period in 2004. These amounts were partly offset by higher healthcare insurance premiums in 2005 compared to 2004.

SG&A expenses for the nine months ended March 31, 2005 increased by $181,390 or 4% over the prior year period due primarily to approximately $73,000 in increased labor costs, approximately $64,000 in higher healthcare insurance premiums, and approximately $103,000 in costs primarily associated with the Company's new enterprise-wide software system including increased support personnel and related depreciation expense. This new system is designed to increase operating efficiencies through the integration of the functionality of three previous software systems into one system. These amounts were partially offset by reduced expenses for rehabilitation sales incentive programs during the nine months ended March 31, 2005 compared to 2004.

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Research and Development

The Company is currently developing a number of innovative products using its light therapy technology. In addition to light therapy products, the Company is developing new motorized treatment tables, a state-of-the-art traction device and an iontophoresis device for non-invasive drug delivery. To accelerate the development process, we have increased our engineering staff and budgeted a company record amount for research and development in fiscal 2005. The new products currently under development are scheduled for introduction beginning in the summer of 2005. Designing innovative new products is a strategic philosophy that we believe allows the Company to maintain a leadership position in the physical medicine market.

Research and development expenses were $80,403 higher at $356,313 during the quarter ended March 31, 2005 compared to $275,910 for the similar period in 2004. R&D expenses represented approximately 7.1% and 5.3% of the net sales of the Company in the 2005 and 2004 quarterly periods, respectively. Research and development expenses were $885,467 during the nine months ended March 31, 2005 compared to $837,028 for the similar period in 2004. These R&D expenses represented approximately 5.8% and 5.4% of the net sales of the Company in the 2005 and 2004 periods, respectively. R&D costs are expensed as incurred.

Pre-tax Profit

Pre-tax profit for the quarter ended March 31, 2005 was $267,905 compared to $380,622 during the same period of the prior year. Pre-tax profit for the nine months ended March 31, 2005 was $909,296 compared to $1,054,433 during the same period of the prior year. Lower sales of the Company's older product lines, together with higher R&D expenses, resulted in a reduction in pre-tax profits for the quarter and nine months ended March 31, 2005 compared to the prior year periods. In addition, higher SG&A expenses related to increased labor expense and the installation of a new enterprise-wide software system contributed to the decrease in pre-tax profit for the nine months ended March 31, 2005 compared to the prior year period.

Income Tax

Income tax expense for the three months ended March 31, 2005 was $103,143 compared to $70,920 in the three months ended March 31, 2004. The effective tax rates were 38.5% and 18.6% for the quarters ended March 31, 2005 and 2004, respectively. Income tax expense for the nine months ended March 31, 2005 was $350,079 compared to $329,374 in the nine months ended March 31, 2004. The effective tax rates were 38.5% and 31.2% for the nine month periods ended March 31, 2005 and 2004, respectively. The estimated tax rate was higher in the quarter and nine months ended March 31, 2005 than in the comparable periods in 2004 due to a change in the Company's tax estimates.

Net Income

Net income for the quarter ended March 31, 2005 was $164,762 (approximately $.02 per share) compared to $309,702 (approximately $.03 per share) for the quarter ended March 31, 2004. Net income for the nine months ended March 31, 2005 was $559,217 (approximately $.06 per share) compared to $725,059 (approximately $.08 per share) for the similar period ended March 31, 2004. The decrease in sales related to older product lines together with higher R&D expenses and higher estimated tax rates in the current reporting periods lead to a decrease in net income for the quarter and nine months ended March 31, 2005 when compared to the similar periods one year ago. In addition, higher SG&A expenses in the nine months ended March 31, 2005 contributed to the decrease in net income compared to the similar period in 2004.

Liquidity and Capital Resources

The Company has financed its operations through cash reserves, available borrowings under its line of credit, and from cash provided by operations. The Company had working capital of $6,666,720 at March 31, 2005, inclusive of the current portion of long-term obligations and credit facilities, as compared to working capital of $6,300,582 at June 30, 2004.

Accounts Receivable

Trade accounts receivable, net of allowance for doubtful accounts, decreased $140,175 to $3,597,245 at March 31, 2005 compared to $3,737,420 at June 30, 2004. Management anticipates accounts receivable will likely remain at current levels or increase modestly in future periods due to continuing demand for the Company's Solaris Series products and the several new products anticipated for release in the summer of 2005 which are expected to increase sales.

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Trade accounts receivable represent amounts due from the Company's dealer network and from medical practitioners and clinics. We estimate that the allowance for doubtful accounts is adequate based on our historical knowledge and relationship with these customers. Accounts receivable are generally collected within 30 days of the terms extended.

Inventories

Inventories, net of reserves, at March 31, 2005 decreased $40,597 to $4,647,200 compared to $4,687,797 at June 30, 2004. Management expects that inventories will increase modestly in coming months as a result of several planned new product introductions.

Prepaid Expenses

Prepaid expenses decreased $193,973 to $258,781 at March 31, 2005 compared to $452,754 at June 30, 2004 due to a reduction in prepayments to suppliers as well as a reclassification of approximately $100,000 of prepaid expenses to Other Assets.

Goodwill

Goodwill at March 31, 2005 and June 30, 2004 totaled $789,422. Beginning July 1, 2002, the Company adopted the provisions of SFAS No. 142 Goodwill and other Intangible Assets. In compliance with SFAS 142, management utilized standard principles of financial analysis and valuation including: transaction value, market value and income value methods to arrive at a reasonable estimate of the

fair value of the Company in comparison to its book value. The Company has determined it has one reporting unit. As of July 1, 2002 and June 30, 2004, the fair value of the Company exceeded the book value of the Company. Therefore, there was no indication of impairment upon adoption of SFAS No. 142 or at June 30, 2004. Management is primarily responsible for the FAS 142 valuation determination and performs the annual impairment assessment each year during the Company's fourth quarter.

Accounts Payable

Accounts payable increased by $300,943 to $982,278 at March 31, 2005 compared to $681,335 at June 30, 2004. The increase in accounts payable is a result of the timing of our weekly invoice payments to suppliers and the timing of purchases of product components. The Company continues to take advantage of available early payment discounts when offered.

Cash

The Company's cash position at March 31, 2005 was $418,837 compared to $573,027 at June 30, 2004. The Company believes that its current cash balances, amounts available under its line of credit and cash provided by operations will be sufficient to cover its operating needs in the ordinary course of business for the next twelve months. If we experience an adverse operating environment or unusual capital expenditure requirements, additional financing may be required. However, no assurance can be given that additional financing, if required, would be available on favorable terms.

Line of Credit

The Company maintains a revolving line of credit with a commercial bank in the amount of $4,500,000. The outstanding balance on our line of credit decreased by $1,013,299 to $591,236 at March 31, 2005 compared to $1,604,535 at June 30, 2004. Interest on the line of credit is based on the bank's prime rate, which at March 31, 2005, was 5.75%. The line of credit is collateralized by accounts receivable and inventories. Borrowing limitations are based on 30% of eligible inventory and up to 80% of eligible accounts receivable. At March 31, 2005, the maximum borrowing base was calculated to be approximately $3.9 million. The line of credit is renewable annually on December 1st and includes covenants requiring the Company to maintain certain financial ratios. As of March 31, 2005, the Company was in compliance with all loan covenants.

The current ratio at March 31, 2005 increased to 3.4 to 1 compared to 2.8 to 1 at June 30, 2004. Current assets represent 68% of total assets at March 31, 2005.

Debt

Long-term debt excluding current installments totaled $1,399,250 at March 31, 2005 compared to $1,553,832 at June 30, 2004. Long-term debt is comprised primarily of the mortgage loans on our office and manufacturing facilities in Utah and Tennessee. The principal balance on the mortgage loans is approximately $1.5 million with monthly principal and interest payments of $21,345.

Stock Repurchase Program

On September 3, 2003, the Company announced a stock repurchase program. The Board of Directors authorized the expenditure of up to $500,000 to purchase the Company's common stock on the open market pursuant to regulatory restrictions governing such repurchases. During fiscal year 2004, the Company purchased

$89,000 of stock, leaving over $400,000 of authorized funds for future stock repurchases. The stock repurchase program is conducted pursuant to safe harbor regulations under Rule 10b-18 of the Exchange Act for the repurchase by an issuer of its own shares.

Critical Accounting Policies

We have identified the policies below as critical to our business operations and the understanding of our results of operations. The impact and risks related to these policies on our business operations are discussed in this Management's Discussion and Analysis of Financial Condition and Results of Operations where such policies affect our reported and expected financial results. For a detailed discussion of the application of these and other accounting policies, see Notes to the Audited Financial Statements contained in the Company's 10-KSB report for the year ended June 30, 2004. In all material respects, management believes that the accounting principles that are utilized conform to accounting principles generally accepted in the United States of America.

The preparation of this quarterly report requires us to make significant estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. By their nature, these judgments are subject to an inherent degree of uncertainty. On an on-going basis, we evaluate these estimates, including those related to bad debts, inventories, intangible assets, warranty obligations, product liability, revenue, and income taxes. We base our estimates on historical experience and other facts and circumstances that are believed to be reasonable, and the results form the basis for making judgments about the carrying value of assets and liabilities. The actual results may differ from these estimates under different assumptions or conditions.

Inventory Reserves

The nature of our business requires that we maintain sufficient inventory on hand at all times to meet the requirements of our customers. We record finished goods inventory at the lower of standard cost, which approximates actual costs (first-in, first-out) or market. Raw materials are recorded at the lower of cost (first-in, first-out) or market. Inventory valuation reserves are maintained for the estimated impairment of the inventory. Impairment may be a result of slow moving or excess inventory, product obsolescence or changes in the valuation of the inventory. In determining the adequacy of reserves, we analyze the following, among other things:

- Current inventory quantities on hand.
- Product acceptance in the marketplace.
- Customer demand.
- Historical sales.
- Forecast sales.
- Product obsolescence.
- Technological innovations.

Any modifications to estimates of inventory valuation reserves are reflected in the cost of goods sold within the statements of income during the period in which such modifications are determined necessary by management. At March 31, 2005 and June 30, 2004, our inventory valuation reserve balance, which established a new cost basis, was $533,116 and $334,393, respectively, and our inventory balance was $4,647,200 and $4,687,797 net of reserves, respectively.

Revenue Recognition

Our products are sold primarily to customers who are independent distributors and equipment dealers. These distributors resell the products to end users including physical therapists, professional trainers, athletic trainers, chiropractors, medical doctors and aestheticians. Sales revenues are recorded when products are shipped FOB shipping point under an agreement with a customer, risk of loss and title have passed to the customer, and collection of any resulting receivable is reasonably assured. Amounts billed for shipping and handling of products are recorded as sales revenue. Costs for shipping and handling of products to customers are recorded as cost of sales.

Allowance for Doubtful Accounts

We must make estimates of the collectibility of accounts receivable. In doing so, we analyze historical bad debt trends, customer credit-worthiness, current economic trends and changes in customer payment patterns when evaluating the adequacy of the allowance for doubtful accounts. Our accounts receivable balance was $3,597,245 and $3,737,420, net of allowance for doubtful accounts of $245,559 and $182,941, at March 31, 2005 and June 30, 2004, respectively.

Business Plan and Outlook

Over the past six years, annual net sales have grown from $12.6 million in fiscal year 1998 to $20.6 million in fiscal year 2004. During fiscal year 2005, we continue to focus our efforts on fueling and sustaining growth through the development of new products for the rehabilitation and aesthetics markets while, at the same time, strengthening our channels of distribution and improving operating efficiencies.

In September 2003, we introduced the Solaris product line of advanced technology electrotherapy/ultrasound products featuring an infrared light therapy probe. This new family of products has quickly become our top selling line, due largely to the popularity of light therapy. Light therapy is becoming widely recognized for its successful treatment of various types of pain. The Solaris product line is designed to accommodate additional light therapy probes as they are developed. This design insures that practitioners can, over time, economically accumulate multiple light therapy probes for various therapeutic purposes - all powered by the same Solaris device.

Consistent with that design, in June 2004 the Company received FDA marketing clearance for the Dynatron 890, a low-power laser accessory probe for the Solaris Series products. Laser technology takes the Company back to its origin 25 years ago when the Company first attempted to gain FDA approval for a laser therapy device. However, the Dynatron 890 is 500 times more powerful than the original devices 25 years ago, which enhances efficacy and significantly reduces treatment times for patients. Shipment of the new Dynatron 890 probe began in August, 2004.

In fiscal 2005, the Company expanded its R&D program by hiring additional engineers to accelerate the development of new products and increase the breadth of products being developed. As a result, the Company plans to introduce a record number of new products during fiscal year 2006 beginning in July 2005. Of the new products scheduled for introduction, several are based on Dynatronics' light therapy technology. Other new products include newly designed treatment tables, an innovative traction device and an iontophoresis device for non-invasive drug delivery.

Going forward, we intend to continue to strengthen our manufacturing capabilities with the goal of improving margins and gaining greater pricing advantages over competitors. To that end, some products previously purchased from other manufacturers are being converted to in-house manufacturing. Other

products are being sourced from overseas manufacturers or moved to more competitive domestic manufacturers.

Another important part of our strategic plan is the expansion of worldwide marketing efforts. The Company's Salt Lake City operation, where all electrotherapy, ultrasound, STS devices, light therapy and Synergie products are manufactured, is certified to ISO 13485, an internationally recognized standard of excellence in medical device manufacturing. This designation is an essential requirement to obtain CE Mark certification, an approval which allows us to market our products in the European Union. In January 2005, the Company obtained the CE Mark certification for the Solaris product line making them eligible for marketing in Europe. The attractive features of the Solaris Series products are expected to make foreign distribution channels more accessible. Interest in our aesthetic products under the Synergie brand is presently leading the way for international expansion with the establishment of new distributors in Japan, South Africa, Europe and Southeast Asia.

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In January 2004, we introduced the Synergie LT device, an infrared light therapy unit designed specifically for aesthetic applications. Interest in light therapy applications among aestheticians has been an important factor in increasing sales of our Synergie products over the past year. The introduction of the Synergie LT device is positioning Dynatronics to compete more fully in the spa and beauty market, both domestically and internationally. We plan to develop and introduce additional light therapy probes for the aesthetic market using different wavelengths of light. For instance, in September 2004, we introduced the Synergie 470 probe, a therapy probe compatible with the Synergie LT base unit that emits light in the blue spectrum.

Based on our defined strategic initiatives, we are focusing our resources in the following areas:

o Reinforcing our position in the physical medicine market through an aggressive research and development campaign that will result in the introduction of more new products, both high tech and commodity, over the coming year.

- Increasing sales of Solaris Series devices through the introduction of new light therapy accessories and by developing new markets for light therapy applications.

- Improving sales and distribution of rehabilitation products domestically through strengthened relationships with dealers, particularly the high-volume specialty dealers.

- Improving distribution of aesthetic products domestically and exploring the opportunities to introduce more light therapy devices into the aesthetics market.

- Expanding distribution of both rehabilitation and aesthetic products internationally.

- Seeking strategic partnerships to further expand our presence in and market share of the physical rehabilitation and the aesthetics markets.

Cautionary Statement Concerning Forward-Looking Statements

The statements contained in this report on Form 10-QSB, particularly the foregoing discussion in Item 2. Management's Discussion and Analysis or Plan of

Operation, that are not purely historical are "forward-looking statements" within the meaning of Section 21E of the Securities Exchange Act. These statements refer to our expectations, hopes, beliefs, anticipations, commitments, intentions and strategies regarding the future. They may be identified by the use of the words or phrases "believes," "expects," "anticipates," "should," "plans," "estimates," "intends," and "potential," among others. Forward-looking statements include, but are not limited to, statements contained in Management's Discussion and Analysis or Plan of Operation regarding product development, clinical results, market acceptance, financial performance, revenue and expense levels in the future and the sufficiency of its existing assets to fund future operations and capital spending needs. Actual results could differ materially from the anticipated results or other expectations expressed in such forward-looking statements for the reasons detailed in our Annual Report on Form 10-KSB under the headings "Description of Business" and "Risk Factors." The fact that some of the risk factors may be the same or similar to past reports filed with the Securities and Exchange Commission means only that the risks are present in multiple periods. We believe that many of the risks detailed here and in our other SEC filings are part of doing business in the industry in which we operate and compete and will likely be present in all periods reported. The fact that certain risks are endemic to the industry does not lessen their significance.

The forward-looking statements contained in this report are made as of the date of this report and we assume no obligation to update them or to update the reasons why actual results could differ from those projected in such forward-looking statements. Among others, risks and uncertainties that may affect the business, financial condition, performance, development, and results of operations include:

- Market acceptance of our technologies, particularly our core therapy devices, Synergie AMS/MDA product line, and the Solaris infrared light therapy products;
- The ability to hire and retain the services of trained personnel at cost-effective rates;
- Rigorous government scrutiny or the possibility of additional government regulation of the industry in which we market our products;

- Reliance on key management personnel;
- Foreign government regulation of our products and manufacturing practices that may bar or significantly increase the expense of expanding to foreign markets;
- Economic and political risks related to expansion into international markets;
- Failure to sustain or manage growth including the failure to continue to develop new products or to meet demand for existing products;
- Reliance on information technology;
- The timing and extent of research and development expenses;
- The ability to keep pace with technological advances, which can occur rapidly;

- The loss of product market share to competitors;
- Potential adverse effect of taxation;
- Additional terrorist attacks on U.S. interests and businesses;
- The ability to obtain required financing to meet changes or other risks; and
- Escalating costs of raw materials, particularly steel and petroleum based materials.
- As a public company, we are subject to the reporting requirements of the Securities Exchange Act of 1934 and the Sarbanes-Oxley Act of 2002. These requirements may place a strain on our systems and resources. The Securities Exchange Act requires, among other things, that we file annual, quarterly and current reports with respect to our business and financial condition. The Sarbanes-Oxley Act requires, among other things, that we maintain effective disclosure controls and procedures and internal controls over financial reporting. We are currently reviewing and further documenting our internal control procedures. However, the guidelines for the evaluation and attestation of internal control systems have only recently been finalized, and the evaluation and attestation processes are new and untested. Therefore, we can give no assurances that our systems will satisfy the new regulatory requirements. In addition, in order to maintain and improve the effectiveness of our disclosure controls and procedures and internal controls over financial reporting, significant resources and management oversight will be required.

Item 3. Controls and Procedures

Based on evaluation of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act), as of the end of the period covered by this Report, our principal executive and principal financial officers have concluded that our disclosure controls and procedures are effective at the reasonable assurance level. There have been no significant changes in internal controls over financial reporting or in other factors that could significantly affect these controls subsequent to the date of their evaluation, including any corrective actions with regard to significant deficiencies or material weaknesses.

PART II. OTHER INFORMATION

Item 6. Exhibits

(a) Exhibits

3.1 Articles of Incorporation and Bylaws of Dynatronics Laser

Corporation. Incorporated by reference to a Registration Statement on Form S-1 (No. 2-85045) filed with the Securities and Exchange Commission and effective November 2, 1984, as amended by Articles of Amendment dated November 18, 1993.

3.2 Articles of Amendment dated November 21, 1988 (previously filed).

10.1 Employment contract with Kelvyn H. Cullimore, Jr. (previously filed)

10.2 Employment contract with Larry K. Beardall (previously filed)

10.3 Loan Agreement with Zion Bank (previously filed)

10.4 Settlement Agreement dated March 29, 2000 with Kelvyn Cullimore, Sr. (previously filed)

10.5 Amended Loan Agreement with Zions Bank (December 2003)

31.1 Certification under Rule 13a-14(a)/15d-14(a) of principal executive officer

31.2 Certification under Rule 13a-14(a)/15d-14(a) of principal financial officer

32 Certification under Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. SECTION 1350)

SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

DYNATRONICS CORPORATION
Registrant

Date 5/13/05

/s/ Kelvyn H. Cullimore, Jr.

Kelvyn H. Cullimore, Jr.
Chairman, President and Chief Executive Officer
(Duly Authorized Officer and
Principal Executive Officer)

Date 5/13/05

/s/ Terry M. Atkinson, CPA

Terry M. Atkinson, CPA
Chief Financial Officer
(Principal Financial Officer)