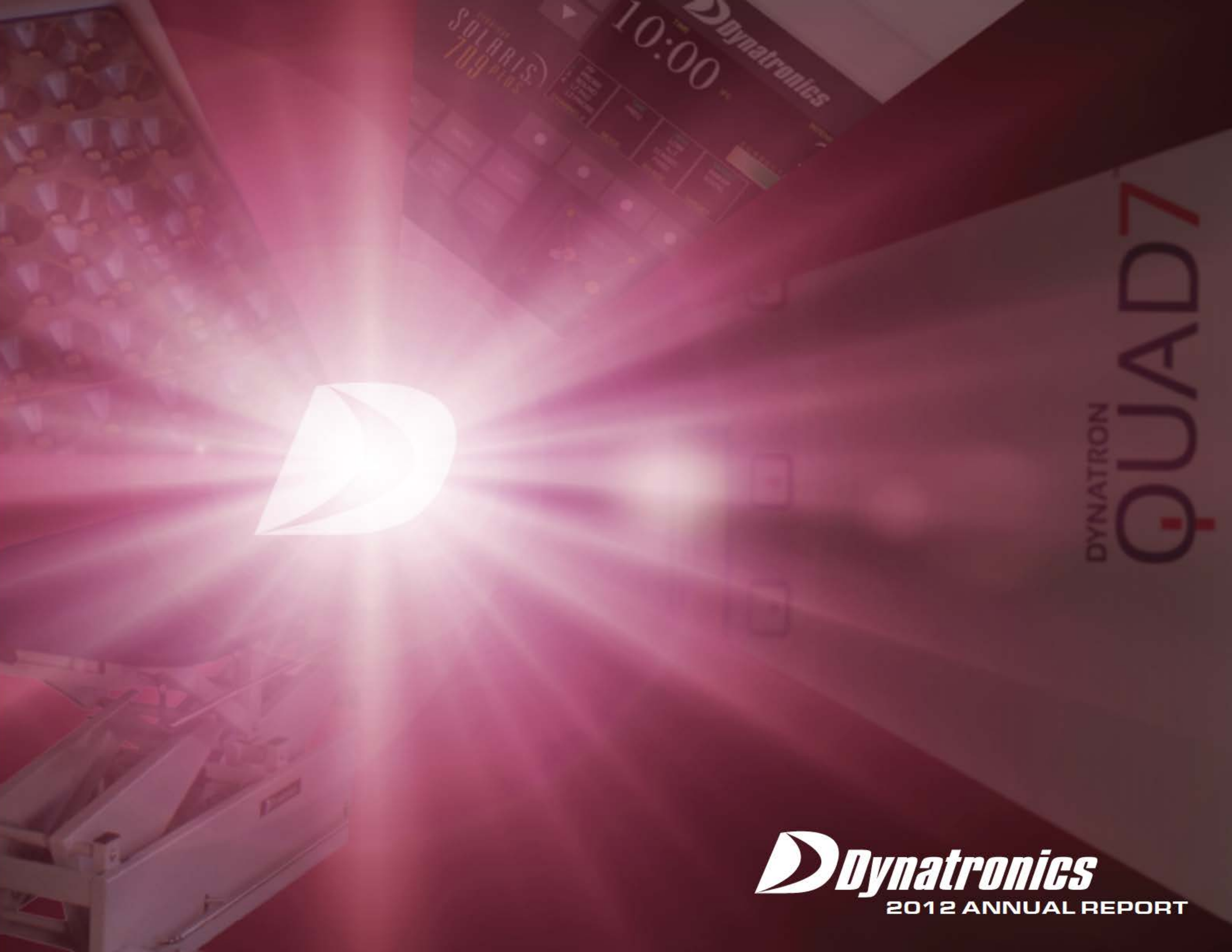

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Dynatronics Corporation 2012 Annual Report

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For the past two years we have been engaged in the most intensive research and development projects in the history of the company. Investing in research and development has been a key to our success over the years. It has earned Dynatronics a reputation for being innovative, creative and progressive in the design and development of new products for the markets we serve. This level of innovation has been critical in maintaining a competitive edge.

However, engaging in intensive research and development comes at a cost. For the last two fiscal years we have averaged approximately $1,400,000 in annual research and development costs. This compares to approximately $1,085,000 average for the three prior fiscal years – an increase of approximately 30 percent. This added investment has diminished profits by over $300,000 for each of fiscal years 2012 and 2011. Although the investment reduced profitability for the last two years, it has placed us in a position to introduce more new products in fiscal year 2013 than in any other year in our history.

In fact, we anticipate introducing a dozen new products during fiscal year 2013. These new products will effectively renovate and update our core product line and introduce new technologies in combinations never before seen in our marketplace. In August 2012, we introduced the new SolarisPlus line of combination devices. This is our proprietary, top-of-the-line family of therapy devices. It includes seven wave forms of electrotherapy, three frequencies of ultrasound therapy, three wavelengths of light therapy in a probe or pad configuration at powers significantly higher than predecessor products, plus the ability to do combination treatments of electrotherapy and ultrasound or electrotherapy and thermal therapy. No devices on the market are as powerful or capable of so many diverse functions. What's more, all modalities can run simultaneously. That level of power and versatility is unequalled in our competitors' units.

In addition to the SolarisPlus, we have introduced the Quad7 thermal therapy device. This exciting new product provides multiple combinations of thermal and compression therapy and introduces hand-held thermal probes capable of coupling with the SolarisPlus devices to deliver thermal therapy and electrotherapy in combination – another groundbreaking product and design only available from Dynatronics.

Other new products are contemplated for introduction in the latter half of fiscal year 2013. We expect that these will further establish Dynatronics as a leader in the design and development of inventive new products. We believe that the addition of these products will drive sales in the coming years and prove the investment in research and development of the last two years to have been very worthwhile, despite the impact on profitability.

Fiscal year 2012 was only the fourth year that we have not shown a profit since we began commercializing products in 1987. Although our net loss was only $23,535, it was nevertheless a loss. The investment in research and development was only part of the reason for the net loss for the fiscal year. Diminished sales also contributed. Through December 2011, sales were running slightly ahead of the prior fiscal year. However, from January through June 2012, the trend reversed and sales were down approximately 10 percent over the prior year.

There are many reasons for the drop in sales. We had one large customer that became insolvent and closed its doors. We also had a product line similar to the Quad7 product we previously distributed that was no longer available to us. In fact, it was the loss of that line that motivated the development and introduction of our Quad7 product. There has also been a perceptible fatigue in our market caused by ongoing economic strain. The impending effects of health care reform have caused many to proceed with caution. Normal cycles for replacing capital equipment have been lengthened as practitioners have made do with existing devices and equipment. The opening of new clinics and expansion of existing clinics has slowed to a proverbial crawl. All of these factors have combined to produce an adverse impact on our sales and profitability.

Our response to these conditions has been two-pronged. The first prong has been to reduce expenses. Following an unexpectedly large loss in the quarter ended March 31, 2012, we took steps to reduce expenses, including staffing and R&D costs. The result is that we have cut expenses by over $750,000 annually. This reduction in expenses offsets the loss of margin associated with lower sales.

The second prong of our response has been to stimulate sales through the introduction of new products. The best way to encourage purchase of new products is to offer innovative and unique products that exceed practitioners' expectations. We believe SolarisPlus, Quad7 and the other new products scheduled for introduction in this next year will do just that. The introduction of these new products is also timely as it places us in an excellent position to take advantage of recovering economic markets and any increased demand that may be associated with healthcare reform.

The continuing impact of the Affordable Care Act looms large for small companies like Dynatronics. While there is a possibility of increased demand resulting from the addition of millions of patients to the rolls of the insured, such potential is blunted by the reality of the medical device tax imposed on manufacturers such as Dynatronics to help pay for adding those insured. We estimate that had the device tax been effective this last year we would have been required to pay approximately $400,000 in excise taxes despite reporting a net loss. An excise tax is based on sales, not profitability. The medical device tax is scheduled to become effective in January 2013. We plan to raise prices to cover this added financial burden, but there is no guarantee we will be able to cover the entire tax, as there is little tolerance for price increases in the market. As a board member of the Medical Device Manufacturers Association, I have been actively lobbying Congress for the repeal of this onerous tax. I am pleased that a bill introduced by our own Senator from Utah, Orrin Hatch, proposes a repeal of this tax. The repeal has already been passed in the House of Representatives. The November elections will have a significant bearing on whether Senator Hatch will be successful in pushing the repeal through the Senate.

With the challenges to profitability of the past year, we have been notified by NASDAQ that our failure to maintain the $1 minimum bid price on our stock must be cured by November 5, 2012 or our stock will be de-listed. It is the stated intent of the board of directors that appropriate steps be taken to maintain the visibility of our common stock on NASDAQ with the goal of preserving shareholder liquidity and confidence. The specifics of that plan will be disclosed in our proxy statement filed in connection with our upcoming annual meeting of shareholders.

These are challenging economic times. It has required constant restructuring and re-evaluation of strategies to be responsive to the challenges. Our efforts to grow through securing contracts with group purchasing organizations have not been effective. Despite offering proposals confirmed by the GPOs as being competitive, most have chosen to award sole source contracts to a competitor. There seems to be little motivation to engage a new supplier. While these results are discouraging, we are not prepared to surrender the effort. We will continue to vie for portions of that business we believe are accessible.

In the meantime we are positioning ourselves as the vendor of choice for the private practice segment of the market. We continue to recruit new sales persons and dealers to broaden our reach. We will introduce a new, comprehensive 2013-14 catalog that will offer products from other manufacturers not offered in the past. As one of only two companies in our market with a direct sales force coast to coast, we fill an important niche that is enhanced by the fact we are a manufacturer of many of the products we sell. Being a manufacturer not only allows us to be more price competitive than those that are just distributors, but also permits us to control the innovative nature and quality of the products. No other company in our industry has the breadth of manufacturing that we offer, married with a significant national sales force. These are the elements that should help keep us competitive in the face of economic challenge and government regulation.

The significant investment in research and development during the past two years may have diminished profits, but it also positioned us to experience new growth through the introduction of a dozen new products in fiscal 2013 – more new products than have been rolled out in any other year of our history. And these are not minor products. They reinvent the core product lines of our company. Add to this the fact we have taken steps to reduce our expenses by over $750,000 annually and are poised to not only offset lost sales from the past year, but to return to much more significant levels of profitability.

We appreciate the patience of our shareholders and the faith and trust you place in us. We are committed to making fiscal year 2013 a breakout year with the new products we will introduce.

Sincerely,

Kelvyn H. Cullimore Jr.
Chairman, President and CEO

Marketing

Dynatron Solaris®Plus

The introduction of our new Dynatron Solaris®Plus product line represents the most comprehensive redesign project in our history and the culmination of a three-year research and development initiative. This initiative will spawn many new products including the new SolarisPlus 709, 708, 706, 705 and 702 – the most advanced technology devices of their kind on the market. The 709 is capable of providing seven waveforms of electrotherapy, together with the company's patented three-frequency ultrasound therapy, and light therapy, through a newly designed, Tri-wave light probe and dual light pads. The other devices in the family provide varying combinations of these features.

Introducing Tri-Wave Light

The revolutionary, new Tri-wave light technology consists of red, infrared and blue-wavelength light delivered using two proprietary light pads for treating larger areas of the body or a light probe for treating smaller areas. The new Tri-wave light probes and pads are significantly more powerful than predecessor devices and provide a greater degree of flexibility in patient treatments. In fact, they are capable of delivering seven different combinations of light therapy wavelengths, allowing practitioners to select the optimal treatment for their patients.

The SolarisPlus units are our flagship products and represent the most powerful and versatile units available today for our practitioners and their patients. These units can be mounted on a new customized cart for transporting the units easily between treatment stations at the clinic.

DYNATRON SOLARIS® PLUS

"The combination of features on our new SolarisPlus unit is very advantageous for our clinic. I have never seen another product like this one. The SolarisPlus treatment outcomes have been excellent and we are getting great results for our patients."

Valerie Elie DPT
Stern Rehabilitation
Monsey, NY

Tri-Wave Light
Light Pad & Probe

Solaris 709Plus on cart
5 Channel Combo Unit

FOUR
MODALITIES
COLD HEAT STIM COMPRESSION

SEVEN
TREATMENT OPTIONS

DYNATRON
QUAD7™

Unlike other compression and cold devices, the Quad7 has the power to deliver four modalities: compression, cold, heat, and stim (electrotherapy), as well as a combination of cold/stim or heat/stim therapy using the patent pending Thermo-Stim™ probe, creating seven different treatment options.

The ability to offer such a variety of treatments is unique to the Quad7 and dramatically expands both the variety and location of conditions that can be treated. The Dynatron Quad7 employs state-of-the-art technology providing precise temperature control while moving beyond the current standard by eliminating the need for ice when providing cold therapy.

QUAD7
Cold, Compression, & More

Management Team

Kelvyn H. Cullimore, Jr.
Chairman, President and CEO

Larry K. Beardall
Executive Vice President of Sales and Marketing

Terry M. Atkinson, CPA
Chief Financial Officer

Robert J. (Bob) Cardon
Vice President of Administration Secretary/Treasurer

Douglas G. Sampson
Vice President of Production and R&D

Bryan D. Alsop
Vice President of Information Technology

Board Of Directors

Kelvyn H. Cullimore Jr.
Chairman, President and CEO

Larry K. Beardall
Executive Vice President of Sales and Marketing

Joseph H. Barton
Director

Howard L. Edwards
Director

Val J. Christensen
Director

Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion should be read in conjunction with our consolidated financial statements and notes to those consolidated financial statements, included elsewhere in this Annual Report on Form 10-K. In addition to historical information, this discussion contains forward-looking statements that involve risks, uncertainties and assumptions that could cause actual results to differ materially from our expectations.

Overview

Our principal business is the manufacture, distribution and marketing of physical medicine products and aesthetic products, many of which we design and manufacture. We offer a broad line of medical equipment including therapy devices, medical supplies and soft goods, treatment tables and rehabilitation equipment. Our line of aesthetic equipment includes aesthetic massage and microdermabrasion devices, as well as skin care products. Our products are sold to and used primarily by physical therapists, chiropractors, sports medicine practitioners, podiatrists, plastic surgeons, dermatologists, aestheticians and other aesthetic services providers. Our fiscal year ends on June 30. Reference to fiscal year 2012 refers to the year ended June 30, 2012.

Results of Operations

Fiscal Year 2012 Compared to Fiscal Year 2011

Net Sales

Net sales in fiscal year 2012 were $31,664,181 compared to $32,692,859 in fiscal year 2011. The $1,028,678 decrease in sales is primarily attributable to the following factors: 1) the apparent insolvency of and interruption of purchases by a large, independent distributor that historically purchased between $150,000 to $250,000 per quarter from the Company; and 2) lower sales of capital equipment likely due to continuing weakness of the U.S. economy leading to a postponement of purchases of durable medical equipment. We also believe the uncertainty surrounding healthcare reform in the United States has had the effect of limiting expansion and improvements in our market sector. We expect the introduction of our new SolarisPlus products and Quad 7 devices to stimulate sales in fiscal year 2013.

Sales of manufactured physical medicine products represented approximately 42% and 43% of total physical medicine product sales in fiscal years 2012 and 2011, respectively. Distribution of products manufactured by other suppliers accounted for the balance of our physical medicine product sales in those years. Sales of manufactured aesthetic products in fiscal years 2012 and 2011, represented approximately 73% and 77% of total aesthetic product sales, respectively, with distributed products making up the balance.

The majority of our sales revenues come from the sale of physical medicine products, both manufactured and distributed. In fiscal years 2012 and 2011, sales of physical medicine products accounted for 91% and 92% of total sales, respectively. Chargeable repairs, billable freight revenue, aesthetic product sales and other miscellaneous revenue accounted for approximately 9% and 8% of total revenues in 2012 and 2011.

Gross Profit

Gross profit totaled $11,943,233, or 37.7% of net sales, in fiscal year 2012, compared to $12,484,824, or 38.2% of net sales, in fiscal year 2011. The decrease in gross profit in absolute dollars and as a percentage of net sales during the year mostly reflects the decrease in total sales attributed to the factors discussed above. The most significant reduction in sales was our higher margin capital equipment which had the effect of lowering the gross margin percentage as lower margin supplies and distributed items became a larger percentage of overall sales in fiscal year 2012. Looking ahead, we expect to generate improved sales of higher margin capital equipment with the introduction of our new SolarisPlus products (released in August 2012) and the Quad 7. In addition, as the effects of healthcare reform become clearer following the presidential and general elections in the United States in November 2012, we expect confidence to increase and demand for our products to begin to strengthen.

Selling, General and Administrative Expenses

SG&A expenses were $10,506,460, or 33.2% of net sales, in fiscal year 2012, compared to $10,431,463, or 31.9% of net sales, in fiscal year 2011. The $74,997 increase in SG&A expenses in fiscal year 2012 as compared to 2011 is a result of the following:

- $24,231 of higher selling expenses;
- $31,735 of higher production labor and depreciation expenses;
- $19,031 of higher general expenses including higher regulatory compliance costs and legal fees

During the fourth quarter of fiscal year 2012 and the first quarter of fiscal year 2013, the Company identified over $750,000 of annual cost reductions which are being implemented to 1) reduce labor costs through a reduction in force; 2) reduce overhead costs; and 3) improve operating efficiencies.

Research and Development

Over the last two years, we have undertaken the most extensive research and development efforts in our history. More new products will be introduced in fiscal 2013 than any year since the Company began. As a result, research and development ("R&D") expense increased 2%, or $26,694, to $1,410,406 in fiscal year 2012, from $1,383,712 in 2011. R&D expense increased as a percentage of net sales in fiscal year 2012 to 4.5% from 4.2% of net sales in fiscal year 2011. In March 2012, we introduced the Dynatron Quad7, the first of several new planned product introductions. The Company has been heavily involved with developing five new SolarisPlus units, four of which were introduced to the market in August 2012. These development efforts are directly responsible for the significant R&D expenses for the past two years. By contrast, the average annual R&D expenditures in the three years ended June 30, 2010 were $1,087,671. R&D expenses are expected to normalize closer to historic levels in fiscal year 2013, as a result of the completion of development of the new SolarisPlus products. R&D costs are expensed as incurred.

Interest Expense

Interest expense decreased by $32,411, to $261,993 in fiscal year 2012 compared to $294,404 in fiscal year 2011 due to lower negotiated borrowing rates on our bank line of credit compared to fiscal year 2011, and the first mortgage on our Salt Lake City facility entering the final two years of its term.

Income/Loss Before Income Tax Provision

Pre-tax loss in fiscal year 2012 was $190,241, compared to pre-tax income of $418,864 in fiscal year 2011. The reduction in income before income tax provision for 2012 resulted from lower sales and gross profits generated during the year as explained above, along with higher selling, labor, depreciation and R&D expenses. The reduction of gross margin accounted for $542,000 of the $609,000 difference in pre-tax results, or about 90%. The balance of the difference is accounted for by higher SG&A expenses as well as higher R&D expenses. The increase in selling expense was associated with our pursuit of GPO and national account business, while increased depreciation expense was related to increased investments in information systems. We offset some of these higher expenses with lower interest expense for the year ended June 30, 2012. As noted above, steps have been taken to reduce expenses at an annualized amount of approximately $750,000, the effect of which only began to be realized in the last two months of the fiscal year.

Income Tax Provision/Benefit

Income tax benefit was $166,706 in fiscal year 2012, compared to income tax provision of $147,976 in fiscal year 2011. Due to tax benefits associated with R&D tax credits and other credits, the income tax benefit reduced the pre-tax loss in fiscal year 2012 by 87.6% compared to an effective tax rate of 35.3% in 2011. The difference in the effective tax rates is attributable to higher R&D tax credits in fiscal year 2012, as well as certain permanent book to tax differences.

Net Income/Loss

Net loss was $23,535 ($.00 per share) in fiscal year 2012, compared to net income of $270,888 ($.02 per share) in fiscal year 2011. The reduction in net income in 2012 was caused primarily by decreased sales and margins generated during the year compared to fiscal year 2011. However, the net loss was mitigated by the recognition of significant tax benefits associated with R&D tax credit as explained above. We expect that R&D expense will decrease in fiscal year 2013 as a result of the completion of development of the new SolarisPlus products in August 2012. We expect improved profitability in fiscal year 2013, due to a reduction in R&D expense and with other reductions implemented or anticipated to be made as well as sales of new products that we recently introduced.

Liquidity and Capital Resources

We have financed operations through available cash reserves and borrowings under a line of credit with a bank. Working capital was $3,565,858 as of June 30, 2012, inclusive of the current portion of long-term obligations and credit facilities, compared to working capital of $4,552,731 as of June 30, 2011. During fiscal year 2012, we generated $35,812 in cash from operating activities, used $401,408 to repurchase and retire common stock, paid $328,707 for capital expenditures primarily related to improving our e-commerce and IT infrastructure, and paid $371,339 in principal on long-term debt. In addition, we purchased $450,782 of inventory primarily for the introduction of the new Dynatron Quad7 product. During fiscal year 2012, the outstanding balance on our line of credit increased by $913,660.

Accounts Receivable

Trade accounts receivable, net of allowance for doubtful accounts, decreased $5,042, or 0.1%, to $3,667,086 as of June 30, 2012, compared to $3,672,128 as of June 30, 2011. Trade accounts receivable represent amounts due from our dealer network as well as from medical practitioners and clinics. We believe that our estimate of 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 agreed terms.

Inventories

Inventories, net of reserves, increased $450,782, or 8.0%, to $6,098,597 as of June 30, 2012, compared to $5,647,815 as of June 30, 2011. The amount of inventory we carry fluctuates each period based on the timing of large inventory purchases from overseas suppliers. Inventory levels increased in fiscal year 2012 in conjunction with the introduction of the Dynatron Quad7 unit.

Accounts Payable

Accounts payable increased $286,038, to $2,413,201 as of June 30, 2012, from $2,127,163 as of June 30, 2011. The increase in accounts payable is a result of the timing of our weekly payments to suppliers and the timing of purchases of product components. Accounts payable are generally not aged beyond the terms of our suppliers. We take advantage of available early payment discounts when offered by our vendors.

Cash and Cash Equivalents

Our cash position as of June 30, 2012 was $278,263, compared to cash of $384,904 as of June 30, 2011. We expect that cash flows from operating activities, together with amounts available through an existing line-of-credit facility, will be sufficient to cover operating needs in the ordinary course of business for the next twelve months. If we experience an adverse operating environment, including a further worsening of the general economy in the United States, 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 terms favorable to us, or at all.

Line of Credit

During fiscal year 2012, the outstanding balance on our line of credit increased by $913,660, leaving a balance outstanding of $3,497,597 as of June 30, 2012, compared to $2,583,937 as of June 30, 2011. The increase in the line of credit was primarily the result of $401,408 used to repurchase and retire common stock, $328,707 for capital expenditures primarily related to improving our e-commerce and IT infrastructure and $371,339 in principal payments on long-term debt. We also purchased an additional $450,782 of inventory primarily related to the introduction of the new Dynatron Quad7 product.

Interest on the line of credit is based on the 90-day LIBOR rate (0.46% as of June 30, 2012) plus 3%. The line of credit is collateralized by accounts receivable and inventories. Borrowing limitations are based on approximately 45% of eligible inventory and up to 80% of eligible accounts receivable, up to a maximum credit facility of $7,000,000. Interest payments on the line are due monthly. As of June 30, 2012, the borrowing base was approximately $5,115,000, resulting in approximately $1,617,000 available on the line. The line of credit is renewable on December 15, 2012 and includes covenants requiring us to maintain certain financial ratios. As of June 30, 2012, we were in compliance with the loan covenants.

The current ratio was 1.5 to 1 as of June 30, 2012 compared to 1.8 to 1 as of June 30, 2011. Current assets represented 70% of total assets as of June 30, 2012 and June 30, 2011. The lower current ratio reflects the use of short term borrowings to finance stock repurchases, capital equipment investments and repayment of long-term debt.

Debt

Long-term debt (excluding current installments) totaled $1,916,315 as of June 30, 2012, compared to $2,238,417 as of June 30, 2011. 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 $2,118,000 with monthly principal and interest payments of $37,503. For a more complete explanation of the long-term debt, see Note 7 to the financial statements.

Critical Accounting Policies

Management's discussion and analysis of financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with U.S. generally accepted accounting principles. The preparation of these financial statements requires estimates and judgments that affect the reported amounts of our assets, liabilities, net sales and expenses. Management bases estimates on historical experience and other assumptions it believes to be reasonable given the circumstances and evaluates these estimates on an ongoing basis. Actual results may differ from these estimates under different assumptions or conditions.

We believe that the following critical accounting policies involve a high degree of judgment and complexity. See Note 1 to our consolidated financial statements for fiscal year 2012, for a complete discussion of our significant accounting policies. The following summary sets forth information regarding significant estimates and judgments used in the preparation of our consolidated financial statements.

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; and
- Character of the inventory as a distributed item, finished manufactured item or raw material.

Any modifications to estimates of inventory valuation reserves are reflected in cost of goods sold within the statements of operations during the period in which such modifications are determined necessary by management. As of June 30, 2012 and 2011, our inventory valuation reserve balance, which established a new cost basis, was $292,999 and $337,748, respectively, and our inventory balance was $6,098,597 and $5,647,815, net of reserves, respectively.

Revenue Recognition

Our sales force and distributors sell our 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 collectability 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 $3,667,086 and $3,672,128, net of allowance for doubtful accounts of $201,349 and $293,436, as of June 30, 2012 and 2011, respectively.

Deferred Income Tax Assets

In August 2012 and August 2011, our management performed an analysis of the deferred income tax assets and their recoverability. Based on several factors, including our strong earnings history of pre-tax profit averaging over $500,000 per year in 18 of the last 22 fiscal years and the fact that the principal causes of the loss in fiscal 2008 (goodwill impairment and expenses resulting from six acquisitions) are considered to be unusual and are not expected to recur in the near future, we believe that it is more likely than not that all of the net deferred income tax assets will be realized.

Business Plan and Outlook

During the past two years, we have focused much of our resources and energy on developing new and innovative products. The scope of that R&D effort has been more significant than at any time in our history. As a result, more new products will be introduced during fiscal year 2013 than we have introduced in any other year.

In March 2012, we introduced the new Dynatron Quad7 therapy device to the market. The innovative Quad7 utilizes thermoelectric technology to deliver thermal therapy (either cold or hot therapy) combined with compression treatments through a variety of wraps and innovative ThermoStim Probes. The ThermoStim Probes are unique in their design as they allow for delivery of electrotherapy treatments concurrent with thermal therapy. The Quad7 has the flexibility to offer seven different treatments including intermittent compression, cold with compression, heat with compression, cold with stim, heat with stim, cold therapy alone, and heat therapy alone. This capability dramatically expands both the variety and location of conditions that can be treated. The Quad7 employs state-of-the-art technology providing precise temperature control moving beyond the current technology by eliminating the need for ice. Thermal therapy in our Quad7 is achieved by using a thermoelectric computer chip technology.

In August 2012, we introduced to the market our new Dynatron SolarisPlus line of electrotherapy/ultrasound/ light therapy units. This new product line consists of four new units: the Dynatron SolarisPlus 709, 708, 706, and 705. These attractive new units provide our most advanced technology in combination therapy devices by adding tri-wave light therapy capabilities to enhanced electrotherapy and ultrasound combination devices. Tri-wave light therapy features infrared, red and blue wavelength light. The new Dynatron Solaris light pad is capable of treating large areas of the body via unattended infrared, red and blue wavelength light therapy. As part of the SolarisPlus product line introduction, we also introduced a new display cart specifically designed for these units. This new cart is expected to begin shipping in October 2012. The SolarisPlus line is expected to quickly become popular for its power and versatility. The new units are capable of simultaneously powering five electrotherapy channels, ultrasound therapy, a light probe and light pad.

The commitment to innovation of high-quality products has been a hallmark of Dynatronics and will continue to be part of our future strategic objectives. This emphasis on R&D contributed in large part to the lower profitability we experienced over the past two years. R&D costs for us have been cyclical in nature. The higher costs in fiscal year 2012 reflect the fact that we have been in a more intense part of the development cycle. With the new products introduced to the market in August 2012, we expect that R&D costs will cycle back to a lower level more in line with historical amounts. However, we have several additional products that are targeted for introduction in the coming fiscal year that will build on the technology developed over the past two years. Management is confident the higher costs associated with the more intense part of the development cycle in the short term will yield long-term benefits and are important to assuring that we maintain our reputation in the industry for being an innovator and leader in product development.

In calendar 2011, we announced the signing of contracts with four Group Purchasing Organizations (GPOs): Premier, Inc., Amerinet, Inc., FirstChoice Cooperative and Champs Group Purchasing. These GPOs represent tens of thousands of clinics and hospitals around the nation. With the broader offering of products now available through our catalog and e-commerce website, we are better able to compete for this high volume business. Over the past two years, we have also been successful in becoming a preferred vendor to many national and regional accounts.

The contracts with the GPOs represent a license to solicit business directly from the members of the respective GPOs. The GPOs do not order any product directly. They serve the function of negotiating favorable pricing terms on behalf of their members. We believe it will require years of effort to develop relationships with the individual GPO and national account clinics and hospitals and convert this business to our brand. This has been manifest by the lack of significant progress under the limited contracts with Premier and Amerinet and the decision by other GPO's like MedAssets and Novation to not put Dynatronics on contract. While we will continue to seek effective ways of accessing business with GPO members outside of a GPO contract, the pattern of the GPO's has not been conducive to putting new vendors, like Dynatronics, on contract. Therefore, while we will continue to petition for fairer treatment by the GPO's we also realize that the resources that may be required to secure contracts with the GPO's could be more productively deployed in other ways to improve sales of our products. While we are not abandoning the GPO effort, we recognize that the GPO bar is set very high and we would be better served initiating other strategies to increase sales.

In late 2012 or early 2013 we plan to introduce a new, updated version of our product catalog. This new catalog will expand our product offering in order to better service the broader needs of our customers. It will also provide an excellent new sales tool for all of our sales representatives in the field as well as provide a foundation for expanding our e-commerce platform.

Over the past few years, consolidations in our market have changed the landscape of our industry's distribution channels. At the present time, we believe that there remain only two companies with a national direct sales force selling proprietary and distributed products: Dynatronics and Patterson Medical. All other distribution in our market is directed through catalog companies with no direct sales force, or through independent local dealers that have limited geographical reach. In the past year, we have reinforced our direct sales team to include 53 direct sales employees and independent sales representatives. In addition to these direct sales representatives, we continue to enjoy a strong relationship with scores of independent dealers. We believe we have the best trained and most knowledgeable sales force in the industry. The changes taking place within our market provide a unique opportunity for us to grow market share in the coming years through recruitment of high-quality sales representatives and dealers.

To further our efforts to recruit high-quality direct sales representatives and dealers, we intend to continue to improve efficiencies of our operations and the sales support for the industry. Chief among the steps we are taking to make these improvements was the introduction of our first true e-commerce solution on July 6, 2010 and the enhancements to that portal in the two years since its introduction. With the availability of this e-commerce solution, customers are able to more easily place orders and obtain information about their accounts. Sales representatives are increasing their effectiveness with the abundance of information available to them electronically through our e-quote system, which is a companion to the e-commerce solution introduced. Not only is our e-commerce solution easy and efficient to use, it should also facilitate reducing transactional costs thus enabling us to accommodate higher sales without significantly increasing overhead.

The passage in 2010 of the Patient Protection and Affordable Care Act and with the Health Care and Educational Reconciliation Act will affect our future operations. The addition of millions to the rolls of the insured is expected to increase demand for services. That increased demand could lead to increased sales of our products. The magnitude of those increases is difficult to assess at this time. A negative impact of this legislation as enacted is its imposition of an excise tax on all manufacturers and importers of medical devices. An excise tax is assessed against sales, not profits. Therefore, even in a year when we may have no profits, we will still owe the excise tax to the federal government. Barring a change in the statute, we estimate that this tax would be approximately $300,000 to $400,000 annually based on current sales levels. Because of the phase-in of various provisions in the legislation, the impact of the 2012 elections, and possible legislative actions, we cannot predict what the full effects of this legislation on our business and industry will be. The first impact is expected in the early part of calendar year 2013. In addition, rule-making under the law is not yet complete which could mean a temporary postponement in implementing the tax. In the meantime, we are taking full advantage of every opportunity presented by this legislation to increase sales and to offset any negative effects that may accompany those opportunities. Should the tax become effective January 1, 2013 as anticipated, we will likely be compelled to raise prices as a reflection of that new tax.

Economic pressures from the recent recession in the United States have affected available credit that would facilitate large capital purchases, and have also reduced demand for discretionary services such as those provided by the purchasers of our aesthetic products. As a result, we reduced our expenses in the Synergie department. We believe that our aesthetic devices remain the best value on the market and we are seeking innovative ways to market these products, including strategic partnerships, both domestic and international, to help enhance sales momentum.

We have long believed that international markets present an untapped potential for growth and expansion. Adding new distributors in several countries will be the key to this expansion effort. We remain committed to finding the most effective ways to expand our markets internationally. Over the coming year, our efforts will be focused on partnering with key manufacturers and distributors interested in our product line or technology. Our Utah facility, where all electrotherapy, ultrasound, traction, light therapy and Synergie products are manufactured, is certified to ISO 13485:2003, an internationally recognized standard of excellence in medical device manufacturing. This designation is an important requirement in obtaining the CE Mark certification, which allows us to market our products in the European Union and in other international locations.

Refining our business model for supporting sales representatives and distributors also will be a focal point of operations. We will continue to evaluate the most efficient ways to maintain our satellite sales offices and warehouses. The ongoing refinement of this model is expected to yield further efficiencies that will better achieve sales goals while, at the same time, reduce expenses.

Our efforts to prudently reduce costs in the face of some economic uncertainty have made us a leaner operation. During calendar 2012, we identified a number of cost saving measures totaling more than $750,000 annually that have been or will be implemented to reduce expenses. We will continue to be vigilant in maintaining appropriate overhead costs and operating costs while still providing support for anticipated increases in sales from our new products.

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

- Increasing market share of manufactured capital products by promoting sales of our new state-of-the-art Dynatron Quad7 and Dynatron SolarisPlus products introduced in calendar 2012.
- Introducing additional new products to better capitalize on opportunities in our core market including the market for the Quad 7 technology. The introduction of additional new products in the coming year is made possible by the technology platform built over the past two years of intense R&D effort. Therefore, the new products can be introduced with minimal additional R&D expenditures.
- Continue to seek ways of petitioning for more business with GPO's, but redirect focus to more viable and immediate opportunities in the private practice market including customers that may be members of GPO's, but not required to purchase under a GPO contract. Increased focus will be given to developing business with large chains of clinics, including national and regional accounts.
- Introducing a new 2013-14 product catalog featuring a broader product offering.
- Using our e-commerce solution in order to facilitate business opportunities and reduce transactional costs.
- Reinforcing distribution through a strategy of recruiting direct sales representatives and working closely with the most successful distributors of capital equipment.
- Improving operational efficiencies by reducing costs to be more reflective of current levels of sales. Strengthening pricing management and procurement methodologies.
- Minimizing expense associated in the Synergie department until demand for capital equipment re-emerges, and, in the meantime, seeking additional independent distributors and strategic partnerships.
- Focusing international sales efforts on identifying key distributors and strategic partners who could represent the Company's product line, particularly in Europe.
- Improving efficiencies as a distributor of other manufacturers' products and considering ways to enhance our role as a distributor and not just a manufacturer.
- Exploring strategic business alliances that will leverage and complement our competitive strengths, increase market reach and supplement capital resources.

NASDAQ Minimum Bid Requirement

On May 9, 2012, we received a deficiency letter from the NASDAQ Stock Market, indicating that we had failed to comply with the minimum bid requirement for continued inclusion under Marketplace Rule 4310(c)(4). Under the deficiency notice, our common stock is subject to potential delisting because, for a period of 180 consecutive days, the bid price of the common stock closed below the minimum $1.00 per share requirement for continued inclusion. NASDAQ allows six months to comply with the rule and an additional six months if certain criteria are met. The deadline for our compliance with the rule is November 5, 2012. If prior to that date the bid price of our common stock closes at $1.00 per share or more for a minimum of 10 consecutive business days, NASDAQ staff may provide written notification that we have achieved compliance with the rule.

If compliance is not achieved, we may seek shareholder approval for a reverse stock split in order to cure the NASDAQ listing deficiency. Alternatively, the Company's stock may be delisted and begin trading on the OTC bulletin board or OTC Markets where there is no minimum bid requirement. There can be no assurance that a market will develop for the Company's stock under any of these alternatives.

Market Information

As of September 22, 2012, we had approximately 12,688,650 shares of common stock issued and outstanding. Our common stock is included on the NASDAQ Capital Market (symbol: DYNT). The following table shows the range of high and low sale prices for our common stock as quoted on the NASDAQ system for the quarterly periods indicated:

	Fiscal Year Ended June 30,			
	2012		2011	
	High	Low	High	Low
1st Quarter (July-September)	$1.77	$.80	$.75	$0.62
2nd Quarter (October-December)	$.83	$.62	$.72	$0.60
3rd Quarter (January-March)	$.93	$.67	$1.18	$0.62
4th Quarter (April-June)	$.80	$.47	$2.14	$1.12

Shareholders

As of September 22, 2012, the approximate number of stockholders of record was 430. This number does not include beneficial owners of shares held in "nominee" or "street" name. Including such beneficial owners, we estimate that the total number of beneficial owners of our common stock is approximately 2,600.

Dividends

We have never paid cash dividends on our common stock. Our anticipated capital requirements are such that we intend to follow a policy of retaining earnings in order to finance the development of the business.

TANNER

To the Board of Directors and Stockholders of
Dynatronics Corporation

We have audited the consolidated balance sheets of Dynatronics Corporation and subsidiary (collectively, the Company) as of June 30, 2012 and 2011, and the related consolidated statements of operations, stockholders' equity, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Dynatronics Corporation and subsidiary as of June 30, 2012 and 2011, and the results of their operations and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Tanner LLC

Salt Lake City, Utah
September 28, 2012

Assets	**2012**	**2011**
Current assets:		
Cash and cash equivalents	$ 278,263	384,904
Trade accounts receivable, less allowance for doubtful accounts of $201,349 as of June 30, 2012 and $293,436 as of June 30, 2011	3,667,086	3,672,128
Other receivables	11,718	14,164
Inventories, net	6,098,597	5,647,815
Prepaid expenses and other	226,596	266,439
Prepaid income taxes	3,550	28,754
Current portion of deferred income tax assets	368,348	418,607
Total current assets	10,654,158	10,432,811
Property and equipment, net	3,677,898	3,722,749
Intangible assets, net	324,715	369,352
Other assets	482,719	294,269
Deferred income tax assets, net of current portion	131,440	-
Total assets	$ 15,270,930	14,819,181
Liabilities and Stockholders' Equity		
Current liabilities:		
Current portion of long-term debt	$ 395,055	368,135
Line of credit	3,497,597	2,583,937
Warranty reserve	181,000	185,245
Accounts payable	2,413,201	2,127,163
Accrued expenses	386,229	379,336
Accrued payroll and benefits expense	215,218	236,264
Total current liabilities	7,088,300	5,880,080
Long-term debt, net of current portion	1,916,315	2,238,417
Deferred income tax liabilities, net of current portion	-	85,525
Total liabilities	9,004,615	8,204,022
Commitments and contingencies		
Stockholders' equity:		
Common stock, no par value: Authorized 50,000,000 shares; issued 12,688,650 shares as of June 30, 2012 and 13,060,392 shares as of June 30, 2011	7,091,935	7,417,244
Accumulated deficit	(825,620)	(802,085)
Total stockholders' equity	6,266,315	6,615,159
Total liabilities and stockholders' equity	$ 15,270,930	14,819,181

See accompanying notes to consolidated financial statements.

Consolidated Statements of Operations - Years Ended June 30, 2012 and 2011

	2012	2011
Net sales	$ 31,664,181	32,692,859
Cost of sales	19,720,948	20,208,035
Gross profit	11,943,233	12,484,824
Selling, general, and administrative expenses	10,506,460	10,431,463
Research and development expenses	1,410,406	1,383,712
Operating income	26,367	669,649
Other income (expense):		
Interest income	16,183	16,395
Interest expense	(261,993)	(294,404)
Other income, net	29,202	27,224
Total other income (expense)	(216,608)	(250,785)
Income (loss) before income tax benefit (provision)	(190,241)	418,864
Income tax benefit (provision)	166,706	(147,976)
Net income (loss)	$ (23,535)	270,888
Basic and diluted net income (loss) per common share	$ (0.00)	0.02
Weighted-average basic and diluted common shares outstanding:		
Basic	12,811,017	13,332,583
Diluted	12,811,017	13,367,049

See accompanying notes to consolidated financial statements.

Consolidated Statements of Stockholders' Equity - Years Ended June 30, 2012 and 2011

	Number of shares		Common stock	Accumulated deficit	Total stockholders' equity
Balances as of July 1, 2010	13,591,152	$	7,872,250	(1,072,973)	6,799,277
Issuance of common stock upon exercise of employee stock options	4,884		7,949	-	7,949
Repurchase of common stock	(543,240)		(519,053)	-	(519,053)
Stock-based compensation	7,596		56,098	-	56,098
Net income	-		-	270,888	270,888
Balances as of June 30, 2011	13,060,392	$	7,417,244	(802,085)	6,615,159
Repurchase of common stock	(399,287)		(401,408)	-	(401,408)
Stock-based compensation	27,545		76,099	-	76,099
Net loss	-		-	(23,535)	(23,535)
Balances as of June 30, 2012	12,688,650	$	7,091,935	(825,620)	6,266,315

See accompanying notes to consolidated financial statements.

Dynatronics Corporation

Consolidated Statements of Cash Flows - Years Ended June 30, 2012 and 2011

	2012	2011
Cash flows from operating activities:		
Net income (loss)	$ (23,535)	270,888
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization of property and equipment	404,374	370,726
Amortization of intangible assets	44,637	83,206
Gain on disposal of assets	-	(703)
Stock-based compensation expense	76,099	56,098
Change in deferred income tax assets	(166,706)	209,325
Provision for doubtful accounts receivable	108,000	108,000
Provision for inventory obsolescence	120,000	90,000
Change in operating assets and liabilities:		
Receivables	(100,512)	11,878
Inventories	(570,782)	28,985
Prepaid expenses and other assets	(148,607)	16,659
Prepaid income taxes	27,771	(84,690)
Accounts payable and accrued expenses	265,073	447,997
Net cash provided by operating activities	35,812	1,608,369
Cash flows from investing activities:		
Purchase of property and equipment	(328,707)	(534,001)
Proceeds from sale of property and equipment	-	2,500
Net cash used in investing activities	(328,707)	(531,501)
Cash flows from financing activities:		
Proceeds from issuance of long-term debt	45,341	-
Principal payments on long-term debt	(371,339)	(380,061)
Net change in line of credit	913,660	(184,555)
Proceeds from issuance of common stock	-	7,949
Purchase and retirement of common stock	(401,408)	(519,053)
Net cash provided by (used in) financing activities	186,254	(1,075,720)
Net change in cash and cash equivalents	(106,641)	1,148
Cash and cash equivalents at beginning of the year	384,904	383,756
Cash and cash equivalents at end of the year	$ 278,263	384,904
Supplemental disclosure of cash flow information:		
Cash paid for interest	$ 263,491	298,941
Cash paid for income taxes	2,100	12,100
Supplemental disclosure of non-cash investing and financing activities:		
Long-term debt incurred for purchase of property and equipment	44,334	-

See accompanying notes to consolidated financial statements.

(1) Basis of Presentation and Summary of Significant Accounting Policies

(a) Description of Business

Dynatronics Corporation (the Company), a Utah corporation, distributes and markets a broad line of medical and aesthetic products, many of which are designed and manufactured by the Company. Among the products offered by the Company are therapeutic, diagnostic, and rehabilitation equipment, medical supplies and soft goods, treatment tables and aesthetic medical devices to an expanding market of physical therapists, podiatrists, orthopedists, chiropractors, plastic surgeons, dermatologists, and other medical professionals.

(b) Principles of Consolidation

The consolidated financial statements include the accounts and operations of Dynatronics Corporation and its wholly owned subsidiary, Dynatronics Distribution Company, LLC. All significant intercompany account balances and transactions have been eliminated in consolidation.

(c) Cash Equivalents

Cash equivalents include all highly liquid investments with maturities of three months or less at the date of purchase. Also included within cash equivalents are deposits in-transit from banks for payments related to third-party credit card and debit card transactions.

(d) Inventories

Finished goods inventories are stated at the lower of standard cost (first-in, first-out method), which approximates actual cost, or market. Raw materials are stated at the lower of cost (first in, first out method) or market.

(e) Trade Accounts Receivable

Trade accounts receivable are recorded at the invoiced amount and do not bear interest, although a finance charge may be applied to such receivables that are past the due date. The allowance for doubtful accounts is the Company's best estimate of the amount of probable credit losses in the Company's existing accounts receivable. The Company determines the allowance based on a combination of statistical analysis, historical collections, customers' current credit worthiness, the age of the receivable balance both individually and in the aggregate and general economic conditions that may affect the customer's ability to pay. All account balances are reviewed on an individual basis. Account balances are charged off against the allowance when the potential for recovery is considered remote. Recoveries of receivables previously charged off are recognized when payment is received.

(f) Property and Equipment

Property and equipment are stated at cost and are depreciated using the straight line method over the estimated useful lives of the assets. The building and its component parts are being depreciated over their estimated useful lives that range from 5 to 31.5 years. Estimated lives for all other depreciable assets range from 3 to 7 years.

(g) Long-Lived Assets

Long–lived assets, such as property and equipment, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized for the difference between the carrying amount of the asset and the fair value of the asset. Assets to be disposed of are separately presented in the balance sheet and reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated.

(h) Intangible Assets

Costs associated with the acquisition of trademarks, trade names, license rights and non-compete agreements are capitalized and amortized using the straight-line method over periods ranging from 3 months to 15 years.

(i) Revenue Recognition

The Company recognizes revenue 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.

(j) Research and Development Costs

Direct research and development costs are expensed as incurred.

(k) Product Warranty Costs

Costs estimated to be incurred in connection with the Company's product warranty programs are charged to expense as products are sold based on historical warranty rates.

(l) Net Income (Loss) per Common Share

Net income (loss) per common share is computed based on the weighted-average number of common shares outstanding and, when appropriate, dilutive common stock equivalents outstanding during the year. Stock options are considered to be common stock equivalents. The computation of diluted net income (loss) per common share does not assume exercise or conversion of securities that would have an anti-dilutive effect.

Basic net income (loss) per common share is the amount of net income (loss) for the year available to each weighted-average share of common stock outstanding during the year. Diluted net income (loss) per common share is the amount of net income (loss) for the year available to each weighted-average share of common stock outstanding during the year and to each common stock equivalent outstanding during the year, unless inclusion of common stock equivalents would have an anti-dilutive effect.

The reconciliation between the basic and diluted weighted-average number of common shares for the years ended June 30, 2012 and 2011 is summarized as follows:

	2012	2011
Basic weighted-average number of common shares outstanding during the year	12,811,017	13,332,583
Weighted-average number of dilutive common stock options outstanding during the year	-	34,466
Diluted weighted-average number of common and common equivalent shares outstanding during the year	12,811,017	13,367,049

Outstanding options not included in the computation of diluted net loss per common share totaled 865,463 as of June 30, 2012. These common stock equivalents were not included in the computation because to do so would have been antidilutive.

(m) Income Taxes

The Company recognizes an asset or liability for the deferred income tax consequences of all temporary differences between the tax bases of assets and liabilities and their reported amounts in the consolidated financial statements that will result in taxable or deductible amounts in future years when the reported amounts of the assets and liabilities are recovered or settled. Accruals for uncertain tax positions are provided for in accordance with the requirements of Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 740-10, Income Taxes. Under ASC 740-10, the Company may recognize the tax benefits from an uncertain tax position only if it is more-likely-than-not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position are measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. ASC 740-10 also provides guidance on derecognition of income tax assets and liabilities, classification of current and deferred income tax assets and liabilities, accounting for interest and penalties associated with tax positions, and income tax disclosures. Judgment is required in assessing the future tax consequences of events that have been recognized in the financial statements or tax returns. Variations in the actual outcome of these future tax consequences could materially impact the Company's financial position, results of operations and cash flows.

(n) Stock-Based Compensation

The Company accounts for stock-based compensation in accordance with FASB ASC 718, Stock Compensation. Stock-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense over the applicable vesting period of the stock award (generally five years) using the straight-line method.

(o) Concentration of Risk

In the normal course of business, the Company provides unsecured credit to its customers. Most of the Company's customers are involved in the medical industry. The Company performs ongoing credit evaluations of its customers and maintains allowances for probable losses which, when realized, have been within the range of management's expectations. The Company maintains its cash in bank deposit accounts which at times may exceed federally insured limits. The Company has not experienced any losses in such accounts. The Company believes it is not exposed to any significant credit risks with respect to cash or cash equivalents.

(p) Operating Segments

The Company operates in one line of business: the development, marketing, and distribution of a broad line of medical products for the physical therapy and aesthetics markets. As such, the Company has only one reportable operating segment.

The Company groups its sales into physical medicine products and aesthetic products. Physical medicine products made up 91% and 92% of net sales for the years ended June 30, 2012 and 2011, respectively. Aesthetics products made up 1% of net sales for both the years ended June 30, 2012 and 2011. Chargeable repairs, billable freight and other miscellaneous revenues account for the remaining 8% and 7% of net sales for the years ended June 30, 2012 and 2011, respectively.

(q) Use of Estimates

Management of the Company has made a number of estimates and assumptions relating to the reporting of assets, liabilities, revenues and expenses, and the disclosure of contingent assets and liabilities in accordance with US Generally Accepted Accounting Principles (US GAAP). Significant items subject to such estimates and assumptions include the carrying amount of property and equipment; valuation allowances for receivables, income taxes, and inventories; accrued product warranty costs; and estimated recoverability of intangible assets. Actual results could differ from those estimates.

(r) Advertising Costs

Advertising costs are expensed as incurred. Advertising expense for the years ended June 30, 2012 and 2011 was approximately $87,400 and $115,300, respectively.

(2) Inventories

Inventories consist of the following as of June 30:

	2012	2011
Raw materials	$ 2,401,676	2,329,536
Finished goods	3,989,920	3,656,027
Inventory reserve	(292,999)	(337,748)
	$ 6,098,597	5,647,815

(3) Property and Equipment

Property and equipment consist of the following as of June 30:

	2012	2011
Land	$ 354,743	354,743
Buildings	3,745,404	3,726,224
Machinery and equipment	1,521,896	1,530,389
Office equipment	263,861	260,626
Office equipment	1,905,332	1,732,700
Vehicles	289,678	247,369
	8,080,914	7,852,051
Less accumulated depreciation and amortization	(4,403,016)	(4,129,302)
	$ 3,677,898	3,722,749

(4) Intangible Assets

Identifiable intangible assets and their useful lives consist of the following as of June 30:

	2012	2011
Trade name – 15 years	$ 339,400	339,400
Domain name – 15 years	5,400	5,400
Non-compete covenant – 4 years	149,400	149,400
Customer relationships – 7 years	120,000	120,000
Trademark licensing agreement – 20 years	45,000	45,000
Backlog of orders – 3 months	2,700	2,700
Customer database – 7 years	38,100	38,100
License agreement – 10 years	73,240	73,240
Total identifiable intangibles	773,240	773,240
Less accumulated amortization	(448,525)	(403,888)
Net carrying amount	$ 324,715	369,352

Amortization expense associated with the intangible assets was $44,637 and $83,206 for fiscal years 2012 and 2011, respectively. Estimated amortization expense for the identifiable intangibles is expected to be as follows: 2013, $44,637; 2014, $44,637; 2015, $30,680; 2016, $30,680; 2017, $30,680 and thereafter $143,400.

(5) Warranty Reserve

A reconciliation of the change in the warranty reserve consists of the following for the fiscal years ended June 30:

	2012	2011
Beginning warranty reserve balance	$ 185,245	186,022
Warranty repairs	(124,844)	(135,542)
Warranties issued	127,059	149,362
Changes in estimated warranty costs	(6,460)	(14,597)
Ending product warranty reserve	$ 181,000	185,245

(6) Line of Credit

The Company has a revolving line-of-credit facility with a commercial bank in the amount of $7,000,000. Borrowing limitations are based on 45% of eligible inventory and up to 80% of eligible accounts receivable resulting in a borrowing limit of $5,115,000 as of June 30, 2012. As of June 30, 2012 and 2011, the outstanding balance was approximately $3,498,000 and $2,584,000, respectively. Available borrowings as of June 30, 2012 were $1,617,000. The line of credit is collateralized by inventory and accounts receivable and bears interest at a rate based on the lender's 90-day LIBOR rate plus 3%. The interest rate was 3.5% and 3.2% as of June 30, 2012 and 2011, respectively. This line is subject to biennial renewal and matures on December 15, 2012. Accrued interest is payable monthly.

The Company's revolving line of credit agreement includes covenants requiring the Company to maintain certain financial ratios. As of June 30, 2012, management believes the Company was in compliance with its loan covenants.

(7) Long Term Debt

Long term debt consists of the following as of June 30:

	2012	2011
6.44% promissory note secured by trust deed on real property, maturing January 2021, payable in monthly installments of $13,278	$ 1,048,496	1,137,179
5.649% promissory note secured by building, maturing December 2017, payable in monthly installments of $16,985	961,196	1,105,292
6.21% promissory note secured by a trust deed on real property, maturing November 2013, payable in monthly installments of $7,240	108,243	183,687
8.49% promissory note secured by equipment, payable in monthly installments of $2,097 through December 2014	56,515	75,980
14.305% promissory note secured by equipment, payable in monthly installments of $2,338 through May 2014	46,781	66,572
4.75% promissory note secured by a vehicle, payable in monthly installments of $721 through May 2017	37,859	-
5.531% promissory note secured by a vehicle, payable in monthly installments of $482 through August 2016	21,460	-
5.887% promissory note secured by a vehicle, payable in monthly installments of $390 through March 2017	19,284	-
5.75% promissory note secured by a vehicle, payable in monthly installments of $435 through October 2013	6,661	11,351
10.15% promissory note secured by a vehicle, payable in monthly installments of $448 through December 2012	2,612	7,456
13.001% promissory note secured by equipment, payable in monthly installments of $70 through October 2015	2,263	-
7.95% promissory note secured by a vehicle, payable in monthly installments of $724 through July 2013	-	16,627
16.35% promissory note secured by equipment, payable in monthly installments of $409 through October 2011	-	1,580
9.69% promissory note secured by equipment, payable in monthly installments of $318 through October 2011	-	828
Total long-term debt	2,311,370	2,606,552
Less current portion	(395,055)	(368,135)
Long-term debt, net of current portion	$ 1,916,315	2,238,417

The aggregate maturities of long term debt for each of the years subsequent to 2012 are as follows: 2013, $395,055; 2014, $355,217; 2015, $308,500; 2016, $314,467; 2017, $327,162 and thereafter $610,969.

(8) Leases

The Company leases vehicles under noncancelable operating lease agreements. Lease expense for the years ended June 30, 2012 and 2011, was $7,812 and $15,898, respectively. Future minimum lease payments required under noncancelable operating leases that have initial or remaining lease terms in excess of one year as of 2012 are as follows: 2013, $6,507.

The Company rents office, warehouse and storage space and office equipment under agreements which run one year or more in duration. The rent expense for the years ended June 30, 2012 and 2011 was $231,142 and $285,347, respectively. Future minimum rental payments required under operating leases that have a duration of one year or more as of June 30, 2012 are as follows: 2013, $109,775; 2014, $56,400; 2015, $39,775 and 2016, $29,925.

During fiscal year 2011, the office and warehouse spaces in Girard, Ohio; Detroit, Michigan; Pleasanton, California; and Hopkins, Minnesota were leased on an annual/monthly basis from employees/stockholders; or entities controlled by stockholders, who were previously principals of the dealers acquired in June and July, 2007. The leases are related-party transactions with four employee/stockholders, however, management believes the lease agreements have been conducted on an arms-length basis and the terms are similar to those that would be available to other third parties. Effective July 1, 2011, the office in Girard, Ohio was moved to Boardman, Ohio and is leased through from a third party.

(9) Income Taxes

Income tax benefit (provision) for the years ended June 30 consists of:

	Current	Deferred	Total
2012:			
U.S. federal	$ -	159,921	159,921
State and local	-	6,785	6,785
	$ -	166,706	166,706
2011:			
U.S. federal	$ 61,449	(209,689)	(148,240)
State and local	(100)	364	264
	$ 61,349	(209,325)	(147,976)

The actual income tax benefit (provision) differs from the "expected" tax benefit (provision) computed by applying the U.S. federal corporate income tax rate of 34% to income (loss) before income taxes for the years ended June 30, are as follows:

	2012	2011
Expected tax benefit (provision)	$ 64,682	(142,414)
State taxes, net of federal tax benefit	4,478	(12,650)
R&D tax credit	75,000	-
Other, net	22,546	7,088
	$ 166,706	(147,976)

Deferred income tax assets and liabilities related to the tax effects of temporary differences are as follow as of June 30:

	2012	2011
Net deferred income tax assets – current:		
Inventory capitalization for income tax purposes	$ 75,127	73,812
Inventory reserve	114,270	131,721
Warranty reserve	70,590	72,245
Accrued product liability	29,835	26,389
Allowance for doubtful accounts	78,526	114,440
Total deferred income tax asset - current	368,348	418,607
Net deferred income tax assets (liabilities) – non-current:		
Property and equipment, principally due to differences in depreciation	(268,839)	(266,858)
Research and development credit carryover	328,927	212,161
Other intangibles	(126,640)	(144,047)
Operating loss carry forwards	197,992	113,219
Total deferred income tax assets (liabilities) – non-current	$ 131,440	(85,525)

In assessing the realizability of deferred income tax assets, management considers whether it is more likely than not that some portion or all of the deferred income tax assets will not be realized. The ultimate realization of deferred income tax assets is dependent upon the generation of future taxable income during the years in which those temporary differences become deductible. Management considers the scheduled reversal of deferred income tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. Based upon the level of historical taxable income and projections for future taxable income over the periods which the deferred income tax assets are deductible, management believes it is more likely than not that the Company will realize the benefits of these deductible differences.

(10) Major Customers and Sales by Geographic Location

During the fiscal years ended June 30, 2012 and 2011, sales to any single customer did not exceed 10% of total net sales.

The Company exports products to approximately 30 countries. Sales outside North America totaled $896,887, or 2.8% of net sales, for the fiscal year ended June 30, 2012 compared to $678,576, or 2.1% of net sales, for the fiscal year ended June 30, 2011.

(11) Common Stock and Common Stock Equivalents

On July 15, 2003, the board of directors (board) approved an open-market share repurchase program for up to $500,000 of the Company's common stock. On November 27, 2007, the board approved an additional $250,000 for the open-market share repurchase program after the original $500,000 was used. In February 2011, the board approved an additional $1,000,000 for repurchases under the program. During fiscal year 2010, the board authorized the repurchase of up to $100,000 of stock annually for three years from each of two former distributors that were acquired by the Company in 2007. During the year ended June 30, 2012, the Company acquired and retired 399,287 shares of common stock for $401,408. During the year ended June 30, 2011, the Company acquired and retired 543,240 shares of common stock for $519,053.

During the years ended June 30, 2012 and 2011, the Company granted 27,545 and 7,596 shares, respectively, of restricted common stock to directors and officers in connection with compensation arrangements.

The Company maintains a 2005 equity incentive plan for the benefit of employees. Incentive and nonqualified stock options, restricted common stock, stock appreciation rights, and other share-based awards may be granted under the plan. Awards granted under the plan may be performance-based. Effective November 27, 2007, the plan was amended, as approved by the stockholders, to increase the number of shares available by 1,000,000 shares. As of June 30, 2012, 500,869 shares of common stock were authorized and reserved for issuance, but were not granted under the terms of the 2005 equity incentive plan as amended.

The Company granted options to acquire common stock under its 2005 equity incentive plan during fiscal years 2012 and 2011. The options are granted at not less than 100% of the market price of the stock at the date of grant. Option terms are determined by the board, and exercise dates may range from 6 months to 10 years from the date of grant.

The fair value of each option grant was estimated on the date of grant using the Black Scholes option pricing model with the following assumptions:

	2012	2011
Expected dividend yield	0%	0%
Expected stock price volatility	69%	60-64%
Risk-free interest rate	2.09%	2.5 - 3.43%
Expected life of options	10 years	10 years

The weighted average fair value of options granted during fiscal years 2012 and 2011 was $.62 and $.53, respectively.

The following table summarizes the Company's stock option activity during the fiscal years 2012 and 2011:

	2012			2011	
	Number of shares	Weighted average exercise price	Weighted average remaining contractual term	Number of shares	Weighted average exercise price
Options outstanding at beginning of the year	933,462	$ 1.33	4.84 years	932,805	$ 1.35
Options granted	52,277	.82		66,248	.74
Options exercised	-	-		(4,884)	1.63
Options canceled or expired	(120,276)	1.31		(60,707)	1.10
Options outstanding at end of the year	865,463	1.30	4.12 years	933,462	1.33
Options exercisable at end of the year	561,664	1.55		534,412	1.64
Range of exercise prices at end of the year		$ 0.35 - 1.89			$ 0.35 - 1.99

The Company recognized $76,099 and $56,098 in stock-based compensation for the years ended June 30, 2012 and 2011, respectively, which is included in selling, general, and administrative expenses in the consolidated statements of operations. The stock-based compensation includes amounts for both restricted stock and stock options under ASC 718.

As of June 30, 2012 there was $503,528 of unrecognized stock-based compensation cost that is expected to be expensed over periods of four to 10 years.

No options were exercised during the fiscal year 2012, and the aggregate intrinsic value on the date of exercise of options exercised during fiscal year 2011 was $1,552. The aggregate intrinsic value of the outstanding options as of June 30, 2012 and 2011 was $1,281 and $206,721, respectively.

(12) Employee Benefit Plan

The Company has a deferred savings plan which qualifies under Internal Revenue Code Section 401(k). The plan covers all employees of the Company who have at least six months of service and who are age 20 or older. For fiscal years 2012 and 2011, the Company made matching contributions of 25% of the first $2,000 of each employee's contribution. The Company's contributions to the plan for 2012 and 2011 were $37,745 and $38,728, respectively. Company matching contributions for future years are at the discretion of the board of directors.

(13) Subsequent Events

In accordance with ASC 855-10, management determined that through the date of this report, there are no material subsequent events to report.

(14) Recent Accounting Pronouncements

In September 2011, the Financial Accounting Standards Board ("FASB") issued authoritative guidance related to testing goodwill for impairment. This guidance provides that entities may first assess qualitative factors to determine whether it is necessary to perform the two-step goodwill impairment test. If the qualitative assessment results in a more than 50% likely result that the fair value of a reporting unit is less than the carrying amount, then the entity must continue to apply the two-step impairment test. If the entity concludes the fair value exceeds the carrying amount, then neither of the two steps in the goodwill impairment test is required. This guidance is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011 with early adoption permitted. The adoption of this pronouncement had no significant effect on the Company's financial statements.

In June 2011, the FASB issued authoritative guidance on the presentation of comprehensive income. This guidance specifies that an entity has the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In both choices, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. This guidance does not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. It also does not change the presentation of related tax effects, before related tax effects, or the portrayal or calculation of earnings per share. This guidance is to be applied retrospectively and is effective for fiscal years, and interim periods within those years, effective for Dynatronics July 1, 2012. The adoption of this guidance will not have a material effect on our consolidated financial statements as it amended only the presentation of comprehensive income. Comprehensive income (loss) was equal to the net income (loss) as presented in the consolidated financial statements for the fiscal years ended June 30, 2012 and 2011.

Availability of Form 10-K

Dynatronics Corporation files an annual report on Form 10-K each year with the Securities and Exchange Commission. A copy of the Form 10-K for the fiscal year ended June 30, 2012, may be obtained at no charge by sending a written request to: Mr. Bob Cardon, Vice President of Administration, Dynatronics Corporation, 7030 Park Centre Drive, Cottonwood Heights, Utah 84121.

Annual Meeting

The company's annual shareholders meeting will be Monday, December 17, 2012 at 3:00 p.m. MST (or at such other time as is properly noticed) at Dynatronics' corporate headquarters, 7030 Park Centre Drive, Cottonwood Heights, Utah 84121.

General Information

Dynatronics Corporation, a Utah corporation organized on April 29, 1983, manufactures, markets and distributes a broad line of therapeutic, diagnostic and rehabilitation equipment, medical supplies and soft goods, treatment tables, and aesthetic massage and microdermabrasion devices to an expanding market of physical therapists, sports medicine practitioners and athletic trainers, chiropractors, podiatrists, orthopedists, plastic surgeons, dermatologists, aestheticians and other medical professionals.

Officers and Directors

Kelvyn H. Cullimore Jr.
Chairman of the Board, President, and CEO

Larry K. Beardall
Executive Vice President of Sales and Marketing and Director

Terry M. Atkinson, CPA
Chief Financial Officer

Robert J. (Bob) Cardon
Vice President of Administration, Secretary and Treasurer

Douglas G. Sampson
Vice President of Production and R&D

Bryan D. Alsop
Vice President of Information Technology

Howard L. Edwards
Director
Retired Corporate Secretary, ARCO Company

Val J. Christensen
Director
Former President, Energy Solutions Inc.

Joseph H. Barton
Director
Retired Sr. Vice President, GranCare Inc.

Accountants, Legal Counsel and Transfer Agent

Independent Registered Public Accounting Firm
Tanner LLC
Salt Lake City, Utah

Corporate Legal Counsel
Durham Jones & Pinegar
Salt Lake City, Utah

Intellectual Property Legal Counsel
Kirton & McConkie
Salt Lake City, Utah

Transfer Agent
Interwest Transfer Company
P.O. Box 17136
Salt Lake City, Utah 84117

Dynatronics Corporation Headquarters

7030 Park Centre Drive
Cottonwood Heights, Utah 84121

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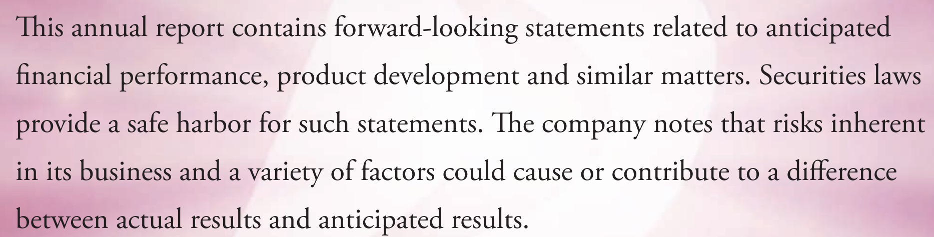

This annual report contains forward-looking statements related to anticipated financial performance, product development and similar matters. Securities laws provide a safe harbor for such statements. The company notes that risks inherent in its business and a variety of factors could cause or contribute to a difference between actual results and anticipated results.

Dynatronics Corporation Headquarters
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