Dynatronics

2016 Annual Report

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.

2016 LETTER TO SHAREHOLDERS

In last year's letter to our shareholders, I detailed the change in direction we initiated when we partnered with private equity investors affiliated with Prettybrook Partners. These investors injected over $4 million in capital into Dynatronics in June, 2015. We are now a full year into that partnership and our progress has been notable. Change has been the hallmark of the past year – and it has been calculated to build the right platform and infrastructure to facilitate achieving our strategic objectives. Those objectives can be generally summarized in three stated goals.

- Achieve organic growth in our existing business through more aggressive sales management and marketing, expanding geographic coverage domestically and internationally, introducing new products, and pursuing post-acute care markets
- Actively seek acquisitions within the areas of physical therapy and athletic training that will enhance our product offering, leverage our sales force and potentially expand our distribution capabilities
- Improve shareholder value as we achieve the first two objectives by implementing an investor relations plan to keep the market abreast of Dynatronics' progress

While our objectives are simple, laying the foundation to achieve them has required strategic planning and measured change to better position us for success.

One of the most significant changes of this last year has been the turnover on our board of directors. I would take this opportunity to express appreciation to former board members who served the company well for many years: Howard Edwards, the late Joseph Barton, Richard Linder, Val Christensen and Larry Beardall were all instrumental in building the foundation on which our new strategic plans are being constructed.

Our board as currently constituted represents a cross-section of men and women with significant relevant business experience. The new board members appointed this past year include:

- Erin Enright – Managing Partner of Prettybrook Partners LLC; former medical technology executive and Managing Director of Equity Capital Markets with Citigroup
- David Holtz – Principal of Provco Group Ltd.; former CEO of Nucryst Pharmaceuticals Corp. and former SVP of Finance for Integra Lifesciences
- Scott Klosterman – Executive Vice President at HNI Healthcare; former Division President, COO and CFO of Chattanooga Group (a division of DJO, Inc.)
- Brian Larkin – Senior Vice President and General Manager at Acelity LP; former Corporate Vice President of Integra Lifesciences

Add to this Dr. Scott Ward, a legacy board member and director of the physical therapy program at the University of Utah and five-time past president of the American Physical Therapy Association, and we believe we have a board with expertise in the industry, finance, sales and corporate transactions, which will help us in our efforts to increase shareholder value.

We have also experienced significant management changes this past year. Longtime sales and marketing executive, Larry Beardall, whose vision and skill helped build the company over three decades, left the company in June 2016. Mr. Jeff Gephart was hired in March 2016 as the senior vice president of sales and has assumed many of Mr. Beardall's duties. Jeff has extensive experience in the industry, including many years as vice president of sales with Chattanooga Group — one of our primary competitors. Jeff has strengthened our sales management team and instituted a strategy to build Dynatronics' business organically. Recent hires include a new sales manager to manage the eastern region sales territory, and a new director to head up international sales, both of whom had long experience with Chattanooga Group.

In August 2015 we hired Jim Ogilvie as our director of business development. Jim's duties are primarily focused on our second strategic objective of growth through acquisitions. However, his excellent analytical skills and experience have been broadly valuable to the management team. Most recently, Bob Cardon, who served as an officer of Dynatronics for almost three decades, retired in July 2016, and Jim has assumed investor relations duties in his stead.

In September 2016, we announced the appointment of David A. Wirthlin as Chief Financial Officer (CFO), effective October 11, 2016. Mr. Wirthlin will succeed Terry Atkinson who will continue to serve an important role at Dynatronics as Director of Accounting. David's deep expertise and experience as both a private and public company CFO brings significant depth to the Dynatronics' management team.

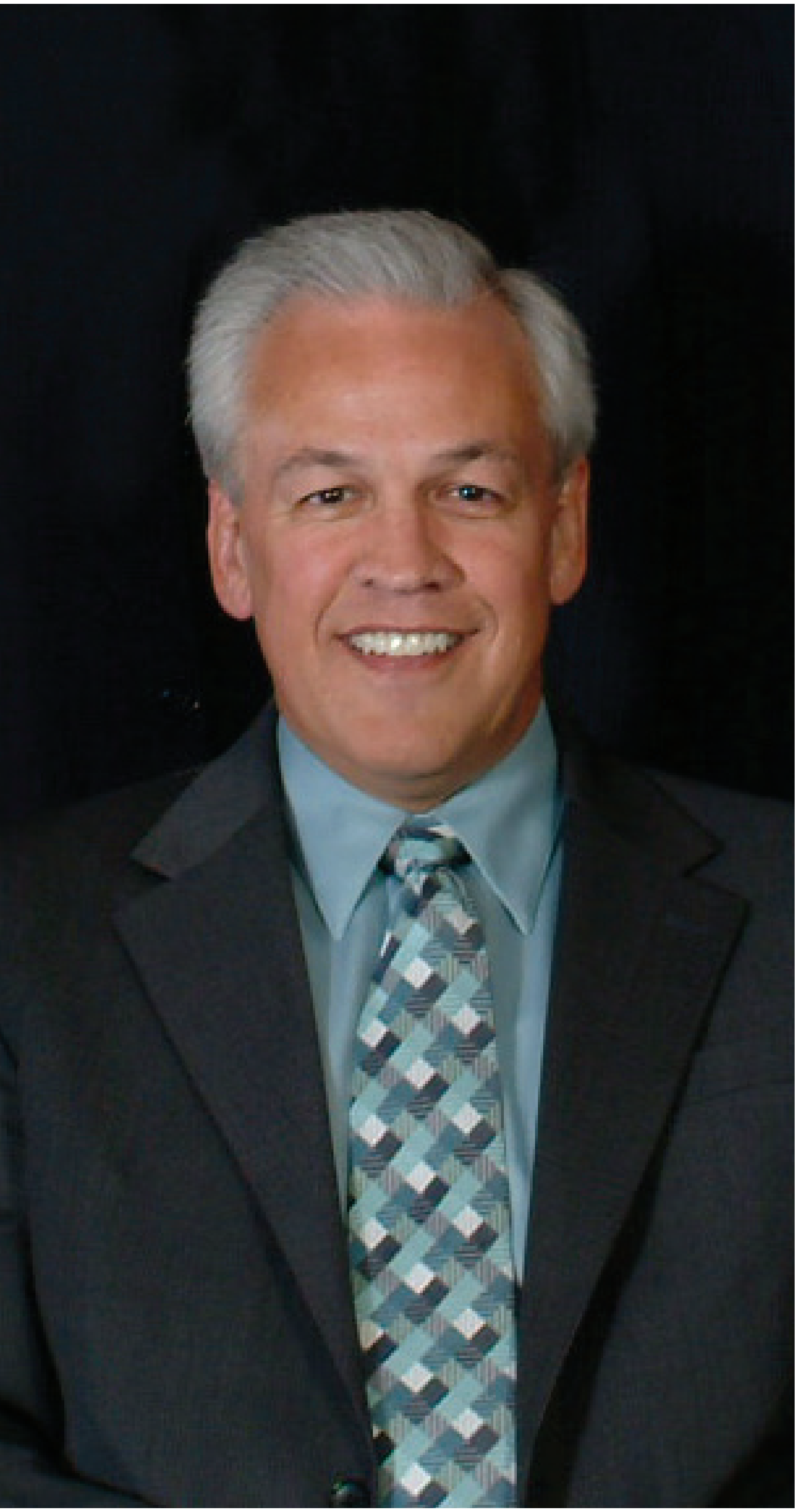
We believe these changes have positioned us to achieve our stated objectives. They have entailed significant investment in the core business, which we expect will positively impact our financial performance in fiscal 2017 and thereafter.

Of course, none of this change would be possible without the support and vision of our partners at Prettybrook Partners. We could not ask for a better partnership than what we have developed with Prettybrook.

For the second consecutive fiscal year, we realized revenue increases. Growth in fiscal year 2016 was over 4 percent, compared to approximately 6 percent for fiscal year 2015 and in contrast to the approximately 7 percent sales declines we experienced during the two previous fiscal years. We believe we can achieve continued revenue growth in fiscal year 2017.

The financial results for fiscal year 2016 reflect the strategic investments I have outlined. The company reported a net loss applicable to shareholders of $2,275,000. Of that amount, we recorded one time severance expenses of $768,000, and we booked an inventory write-down of approximately $270,000 due primarily to non-performing inventory purchased for a GPO contract two years ago. An additional $372,000 in expense was associated with non-cash dividends to preferred shareholders, which were paid in common stock. These three factors account for $1,410,000 of the $2,275,000 reported loss applicable to stockholders. The remaining approximately $900,000 in losses were in large part attributable to expenses related to new employees and other strategic decisions designed to build a solid platform for achieving our objectives in fiscal year 2017.

Our cash position decreased during the year from almost $4 million to approximately $1 million. Of this $3 million decline, $2.2 million was the repayment of debt, including retiring our working capital line of credit. The balance of the cash use was related to capital expenditures as well as financing operating losses during the year.



Despite the decrease in cash during the year, we believe that our cash position is adequate to fund operations for the coming year. In addition to the cash on the balance sheet, we put a $1.0 million working capital line of credit in place in September of 2016. We believe that our existing revenue stream, current capital resources, together with the working capital line of credit will be more than sufficient to fund operations.

Dynatronics today looks very different than the company of the past. Fiscal year 2016 was a year of change, restructuring and repositioning to better execute on our strategic plans. The changes have been significant and somewhat costly as we reorganized and augmented the company's management and supporting personnel. We enter fiscal 2017 confident that Dynatronics is well on its way to achieving our strategic objectives.

KELVYN H. CULLIMORE, JR.
Chairman, President and CEO

Sales & Marketing

Outside the Box

SALES AND MARKETING: OUTSIDE THE BOX

We are implementing an inbound marketing strategy to deliver qualified leads to our sales force beginning in November and December of 2016. This new strategy is focused on a redesign of our website, strategic trade shows and targeted marketing campaigns within our core markets. These programs are being implemented according to the market research we have just completed. Moving forward, all marketing programs will be designed around a clearly defined strategy and measured to achieve the greatest ROI. In addition to generating leads for our sales force, this inbound marketing strategy will increase our brand awareness in core markets.

Our inbound marketing plan is built around these strategies:

- Creating new customer acquisitions by increasing traffic to our website, utilizing search engine optimization (SEO) tools, social media monitoring and blogging platforms
- Converting the traffic on our website and at tradeshows to sales by offering problem-solving solutions
- Personalizing the remarketing process by using website behavior and individual user data to personalize email campaigns
- Implementing a new customer tracking system to more accurately capture customer data, providing an increased level of customer service

SALES

The reorganization of our sales force has been designed to create a scalable platform for future growth. We have implemented a sales management system to provide not only the area sales representatives but also the management team with better insight into short- and long-term sales forecasting. The objective is to increase sales force efficiency by focusing efforts on revenue drivers.

In fiscal year 2017 we are launching several new products, which will help drive new growth domestically and internationally. The September 2016 launch of our new Dynatron® 125B Stand-Alone Ultrasound and the July launches of the redesigned iBox™ Iontophoresis unit and the Dynatron Solaris® Plus line nicely complement our modality portfolio. Additionally, products in the R&D pipeline are scheduled for release in the last half of fiscal year 2017.

We continue to enhance distribution in all U.S. and international markets. Domestically, we will add sales representatives to increase penetration into key markets. Also, we are increasing efforts to partner with key distributors for our core manufactured products such as tables, hot/cold products and the 25 Series™ of therapeutic modalities. Internationally, we are assessing key markets where we can add distributors most efficiently, based on market opportunities.

Our sales force is refocusing on our core markets of physical therapy, chiropractic and athletic training. Within the physical therapy space we are developing a strategy that targets the post-acute care market. The post-acute care market (more commonly known as long-term care) continues to expand, and the demand for rehabilitation services within these facilities is also growing. Dynatronics' extensive portfolio of products gives us a unique opportunity to compete for contracts large and small.

With our reorganized sales force, expanding domestic and international coverage, the introduction of new products and the refocus on our core competencies in physical therapy, Dynatronics is poised for meaningful growth.

BOARD OF DIRECTORS

Pictured below, in order from left to right

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

Erin S. Enright
Managing Partner of Prettybrook Partners, LLC

David B. Holtz
Principal of Provco Group Ltd.

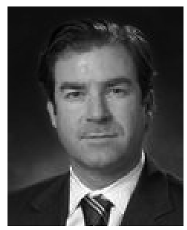
Scott A. Klosterman
Executive Vice President at HNI Healthcare

Brian M. Larkin
Senior Vice President of Acelity LP

R. Scott Ward, Ph.D.
Chairman of the Department of Physical Therapy at the University of Utah








MANAGEMENT TEAM

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

David A. Wirthlin
Chief Financial Officer

T. Jeff Gephart
Senior Vice President of Sales

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

Bryan D. Alsop
Vice President of Information Technology

MANAGEMENT DISCUSSION AND ANALYSIS

The following discussion should be read in conjunction with our consolidated financial statements and notes to those consolidated financial statements, included elsewhere in our Annual Report on Form 10-K filed with the Securities and Exchange Commision on Sept. 28, 2016. 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. Factors that could cause or contribute to those differences include, but are not limited to, those identified below and those discussed in the section of the Annual Report entitled "Item 1A. Risk Factors."

OVERVIEW

Our principal business is the manufacturing, distribution and marketing of physical medicine products. We offer a broad line of medical equipment including therapy devices, medical supplies and soft goods, treatment tables and rehabilitation equipment. Our products are sold to and used primarily by physical therapists, chiropractors, sports medicine practitioners, and podiatrists. Our fiscal year ends on June 30. Reference to fiscal year 2016 refers to the year ended June 30, 2016.

RESULTS OF OPERATIONS

Fiscal Year 2016 Compared to Fiscal Year 2015

Net Sales

Net sales in fiscal year 2016, increased $1.3 million or 4.4% to $30.4 million, compared to $29.1 million in fiscal year 2015. Net sales in the fourth quarter of fiscal year 2016 increased approximately $260,000 or 2.8% to $8.1 million, compared to $7.9 million in the fourth quarter of 2015. The rate of sales growth throughout fiscal 2016 was driven by new clinic openings, clinic expansions, and addition of new sales management and personnel, as well as strengthening demand in our core domestic market. Sales of capital equipment (both proprietary and distributed), especially the Dynatron Solaris® line of products, were the leading growth categories in 2016. We believe that the upward trend in sales indicates increased customer confidence in our markets.

Sales of proprietary manufactured physical medicine products represented approximately 44% of total physical medicine product sales in fiscal years 2016 and 2015. Distribution of products manufactured by other suppliers accounted for the balance of our physical medicine product sales in those years.

In fiscal years 2016 and 2015, sales of physical medicine products accounted for 91.7% and 91.4%, respectively. Chargeable repairs, billable freight and a small amount of revenue from products outside of physical medicine accounted for the balance of revenues in both years.

During the fiscal year ended June 30, 2016, we phased out the sales of our aesthetic product line known as Synergie®. In fiscal years 2016 and 2015, sales of Synergie® were approximately $110,000 and $160,000, respectively. These sales were included in the non-physical medicine product revenue.

Gross Profit

Gross profit totaled $10.4 million, or 34.0% of net sales, in fiscal year 2016, compared to $9.1 million, or 31.1% of net sales, in fiscal year 2015. In fiscal year 2016, we recorded a $270,000 non-cash charge to write off obsolete inventory primarily related to non-performing products purchased in 2014 for the Amerinet GPO contract, defective products rejected for quality purposes, and our standard inventory allowance of $120,000 annually. We do not anticipate significant inventory adjustment charges in the future beyond our standard allowance.

During fiscal year 2015, we also recorded approximately $840,000 in inventory obsolescence charges above the standard annual inventory allowance of $120,000. This additional charge was due primarily to strategic decisions made during the fourth quarter of 2015 to discontinue, re-evaluate or de-emphasize some product lines.

Exclusive of the reduction in obsolete inventory write offs, increased sales of manufactured capital and the Dynatron Solaris® line of products, which carry higher-than-average margins, were the primary contributors to increased gross profit as a percentage of net sales in 2016, compared to 2015.

Management has developed plans for increasing gross profits by focusing sales on the Company's proprietary therapeutic devices. Increasing sales of capital equipment products will be one of the keys to improving gross profit margins going forward.

Selling, General and Administrative Expenses

Selling, general and administrative, or SG&A expenses, were about $11.0 million or 36.1% of net sales in fiscal year 2016, compared to $9.2 million or 31.7% of net sales in fiscal year 2015. During the fourth quarter of fiscal year 2016, we recorded approximately $770,000 in expense related to the severance of two executives. These payments will be made through a combination of cash and common stock over a two year period. We do not anticipate severance charges at these levels to continue in the future.

The increase in SG&A expenses exclusive of severance costs include: (1) approximately $400,000 in increased selling expense related primarily to several new hires in sales management and higher commission expense; (2) approximately $300,000 of increased administrative expense related primarily to higher insurance costs, new hires, and increased regulatory costs; and (3) approximately $300,000 of expense resulting from new initiatives related to our corporate strategy, including Board of Directors fees, director and officer liability insurance, investor relations services, and business development activities. We anticipate the costs associated with the new initiatives under (3) to continue at about the same levels into fiscal 2017.

Research and Development

Research and development (R&D) expenses for 2016, were $1.1 million compared to $925,000 in 2015. As a percentage of net sales, R&D expense increased to 3.5% of net sales in 2016, compared to 3.2% of net sales in fiscal year 2015. We continue to emphasize the importance of being a technological leader in our field. The increased R&D expenses related primarily to the introduction of new products in fiscal year 2016. In the first quarter of fiscal year 2017, we introduced an upgraded version of the Dynatron Solaris® Plus and 25 SeriesTM of combination therapy devices. In addition, we introduced the new Dynatron® 125B stand-alone ultrasound device. In the latter part of fiscal year 2016, we released an updated version of our iontophoresis device. We also have other new products in process for introduction during fiscal year 2017. All these factors combined to increase the cost of R&D for fiscal year 2016. We believe that developing new products is a key element in our strategy and critical to moving purchasing momentum in a positive direction. R&D costs are expensed as incurred and are expected to remain at current levels in the coming year.

Interest Expense

Interest expense decreased by approximately $40,000 in fiscal year 2016, to approximately $290,000, compared to approximately $330,000 in fiscal year 2015. The reduction in interest expense is directly related to the payoff and termination of our line of credit in the third quarter of fiscal year 2016. Exclusive of interest on the line of credit, components of our interest expense include imputed interest from the sale/leaseback of our corporate headquarters facility, mortgage interest on our Tennessee property and a small amount of interest for equipment loans for office furnishings and vehicles. Most of the $290,000 interest expense in fiscal year 2016 ($220,000) was imputed interest related to the lease.

Loss Before Income Tax Benefit

Pre-tax loss in fiscal year 2016 was $2.0 million, compared to $1.4 million in fiscal year 2015. The increase in pre-tax loss is due primarily to (1) $770,000 in severance expense payable to two former executives; (2) $1.0 million increase in expenses associated with increased SG&A; and (3) $145,000 increase in R&D, all of which was partially offset by increased gross profit associated with increased sales as discussed above.

Pre-tax losses in fiscal year 2015 also included incremental inventory write offs of approximately $840,000 in excess of our $120,000 allowance, and approximately $255,000 in aborted acquisition expense.

Income Taxes

Income tax benefit was approximately $65,000 in fiscal year 2016, compared to income tax provision of $850,000 in fiscal year 2015. In fiscal year 2015, the Company determined the valuation allowance was required and as a result implemented a valuation allowance of $1.4 million all in the fourth quarter of fiscal year 2015. The recording of this valuation allowance resulted in recording a tax expense of $850,000 on the 2015 fiscal year financial statements. See Note 9 to the consolidated financial statements as well as "Critical Accounting Policies and Estimates – Deferred Income Tax Assets" for more information regarding the valuation allowance and its impact on the effective tax rate for 2016.

Net Loss

Net loss for fiscal year 2016 was $1.9 million, compared to $2.3 million for the year ended June 30, 2015. Our 2016 results include a $745,000 non-cash deferred tax asset valuation allowance offsetting all but $65,000 in tax benefit for the year, $770,000 severance expense, and $270,000 non-cash inventory write off, as discussed above. In fiscal year 2015, the net loss included a non-cash deferred tax asset valuation allowance of $1.4 million and $840,000 in non-cash inventory write off in excess of our allowance.

Net Loss Applicable to Common Shareholders

Net loss applicable to common shareholders was $2.3 million or $0.84 per share, compared to $4.4 million, or $1.73 per share for the year ended June 30, 2015. Fiscal year 2015 included a deemed dividend of $2.1 million associated with a beneficial conversion feature triggered by the sale of our Series A Preferred to affiliates of Prettybrook as detailed in our report filed on form 10-K for the fiscal year ended June 30, 2015. Also included in the net loss applicable to common shareholders in fiscal year 2015 was a valuation allowance against deferred tax assets of $1.4 million.

In fiscal year 2016, the net loss applicable to common shareholders included a valuation allowance against deferred tax assets of approximately $745,000. Fiscal year 2016 also included recognition of dividends paid on our Series A Preferred of $372,000 compared to $1,000 in fiscal year 2015. The dividends paid in fiscal year 2016, equate to approximately $0.13 per share.

LIQUIDITY AND CAPITAL RESOURCES

We have financed operations through cash from operations and available cash reserves. Working capital decreased by $1.9 million to $5.8 million as of June 30, 2016, inclusive of the current portion of long-term obligations and credit facilities, compared to working capital of $7.7 million as of June 30, 2015. As of June 30, 2016 the Company did not have in place a working capital line of credit. However, a $1.0 million working capital line of credit facility was put in place in September of 2016 and is fully available to the Company. Current assets were 63.9% of total assets as of June 30, 2016 and 69.5% of total assets as of June 30, 2015.

Cash and Cash Equivalents

Our cash and cash equivalents position as of June 30, 2016, was approximately $1.0 million, compared to cash and cash equivalents of $3.9 million as of June 30, 2015. During the course of the year, we retired our line of credit in the amount of $1.9 million, which payoff constituted a significant use of cash during the year ended June 30, 2016. The balance of the cash used related to operations and implementation of strategic objectives. During September 2016, we entered into a new $1.0 million line of credit, which expires September 2017 (See Note 6 to the consolidated financial statements for more information regarding the line of credit).

During the current and prior year we incurred significant operating losses and negative cash flows from operations. We believe that our existing revenue stream, current capital resources, together with the working capital line of credit initiated in September 2016 will be sufficient to fund operations through September 30, 2017.

To fully execute on our business strategy of acquiring other entities, we will need to raise additional capital. Absent additional financing, we will not have the resources to execute our acquisition strategies.

Accounts Receivable

Trade accounts receivable, net of allowance for doubtful accounts, increased approximately $175,000, or 5.3%, to $3.5 million as of June 30, 2016, compared to $3.3 million as of June 30, 2015. Trade accounts receivable represent amounts due from our customers including medical practitioners, clinics, hospitals, colleges and universities and sports teams as well as dealers and distributors that purchase our products for redistribution. 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, decreased $425,000, or 7.8%, to $5.0 million as of June 30, 2016, compared to $5.4 million as of June 30, 2015. During fiscal year 2016, we recorded a $270,000 non-cash write off of inventory, of which $150,000 was based on non-performing inventory related to our Amerinet GPO contract and defective products rejected for quality purposes. Inventory levels may fluctuate based on the timing of large inventory purchases from overseas suppliers.

Accounts Payable

Accounts payable decreased approximately $600,000, or 24.0%, to $1.9 million as of June 30, 2016, from $2.5 million as of June 30, 2015. We continue to take advantage of available early payment discounts when offered by our vendors.

Line of Credit

In March 2016, we retired our working capital line of credit. That line of credit has been reinstated effective September 2016, in the amount of $1.0 million. Interest on the line of credit is based on the prime rate plus 5%. It is collateralized by our inventory and accounts receivable. Borrowing limitations are based on 85% of eligible accounts receivable and $700,000 of eligible inventory. Our current borrowing base on the line of credit would be approximately $3.4 million. Presently the line of credit is on stand-by status. We pay $2,000 per month as a minimum access fee to the line of credit. If we determine to activate the line we are required to provide the lender with 45 days' notice of our intent to begin borrowing. The line of credit has a maturity date of September 2017. The line of credit has no negative loan covenants. However, once the line of credit is activated there are affirmative covenants to provide regular accounts receivable reports and financial statements within 90 days of month end.

Debt

Long-term debt, excluding current installments decreased approximately $100,000 to approximately $550,000 as of June 30, 2016, compared to approximately $650,000 as of June 30, 2015. Our long-term debt is primarily comprised of the mortgage loan on our office and manufacturing facility in Tennessee. The principal balance on the mortgage loan is approximately $600,000, of which $500,000 is classified as long-term debt, with monthly principal and interest payments of $13,278. Our mortgage loan matures in 2021.

As discussed above, in conjunction with the sale and leaseback of our corporate headquarters in August 2014, we entered into a $3.8 million lease for a 15-year term with an investor group. That sale generated a profit of $2.3 million which is being recorded monthly over the life of the lease at $12,500 per month, or approximately $150,000 per year. The building lease is recorded as a capital lease with the related amortization being recorded on a straight line basis over 15 years at approximately $250,000 per year. Lease payments of approximately $27,000 are payable monthly increasing at a rate of approximately 2% per year over the life of the lease. Total accumulated amortization related to the leased building is approximately $480,000 at June 30, 2016. Imputed interest for the fiscal year ended June 30, 2016, was approximately $200,000. Future minimum gross lease payments required under the capital lease as of June 30, 2016 are as follows: 2017, $334,950; 2018, $341,648; 2019, $348,478; 2020, $355,450; 2021, $362,566 and $3,245,126 thereafter. Included in the above lease payments is $1.4 million of imputed interest.

Inflation

Our revenues and net income have not been unusually affected by inflation or price increases for raw materials and parts from vendors.

Stock Repurchase Plans

In 2011, our Board of Directors adopted a stock repurchase plan authorizing repurchases of shares in the open market, through block trades or otherwise. Decisions to repurchase shares under this plan are based upon market conditions, the level of our cash balances, general business opportunities, and other factors. The Board periodically approves the dollar amounts for share repurchases under the plan. As of June 30, 2016, approximately $450,000 remained available under the Board's authorization for purchases under the plan. There is no expiration date for the plan. No purchases were made under this plan during the year ended June 30, 2016, or during the past four fiscal years.

CRITICAL ACCOUNTING POLICIES

This 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 GAAP. 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. See Note 15 to our consolidated financial statements for the impact of recent accounting pronouncements.

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 2016, 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 cost (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;
- Strategic marketing and production plans
- 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, 2016, and 2015, our inventory valuation reserve balance, which established a new cost basis, was approximately $415,000 and $360,000, respectively, and our inventory balance was $5.0 million and $5.4 million, net of reserves, respectively.

During fiscal year 2016, we recorded a $270,000 non-cash write off of inventory based on two factors: 1) non-performing inventory related to our Amerinet GPO contract and 2) defective products. We do not anticipate these inventory write offs in the future beyond our current allowance of $120,000 annually.

Revenue Recognition

Our sales force and distributors sell our products to end users, including physical therapists, professional trainers, athletic trainers, chiropractors, and medical doctors. 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 $3.5 million and $3.3 million, net of allowance for doubtful accounts of $390,000 and $415,000, as of June 30, 2016, and 2015, respectively.

Deferred Income Tax Assets

A valuation allowance is required when there is significant uncertainty as to the realizability of deferred tax assets. The realization of deferred tax assets is dependent upon our ability to generate sufficient taxable income within the carryforward periods provided for in the tax law for each tax jurisdiction. We have considered the following possible sources of taxable income when assessing the realization of our deferred tax assets:

- Future reversals of existing taxable temporary differences;
- Future taxable income or loss, exclusive of reversing temporary differences and carryforwards;
- Tax-planning strategies; and
- Taxable income in prior carryback years.

We considered both positive and negative evidence in determining the continued need for a valuation allowance, including the following:

Positive evidence:

- Current forecasts indicate that we will generate pre-tax income and taxable income in the future. However, there can be no assurance that the new strategic plans will result in profitability.
- A majority of our tax attributes have indefinite carryover periods.

Negative evidence:

- We have several years of cumulative losses as of June 30, 2016.

We place more weight on objectively verifiable evidence than on other types of evidence and management currently believes that available negative evidence outweighs the available positive evidence. We have therefore determined that we do not meet the "more likely than not" threshold that deferred tax assets will be realized. Accordingly, a valuation allowance is required. Any reversal of the valuation allowance will favorably impact the Company's results of operations in the period of reversal.

At June 30, 2015, and June 30, 2016, we recorded valuation allowances against our deferred tax assets. In fiscal year 2015, we recorded a full valuation allowance against deferred tax assets. In fiscal year 2016, we recorded a valuation allowance against all but approximately $65,000 of deferred tax assets. The residual tax benefit left in fiscal year 2016 is attributed to reconciliation of all tax accounts at the fiscal year end allowing us to true up the full allowance deemed necessary for the period. Future valuation allowances or recapture of existing allowances will depend on analysis of positive and negative evidence at the time of reporting.

The Company's federal and state income tax returns for June 30, 2013, 2014, and 2015, are open tax years.

BUSINESS PLAN AND OUTLOOK

Over the past 12-months we have been working closely with Prettybrook to execute on our current business plan. We have strengthened the core operations through executive management changes, new product innovations, addition of key sales and administrative personnel and pursued several merger and acquisition candidates. We believe the realization of these initiatives will be manifest during fiscal 2017. Our key objectives in the coming year are as follows:

- Achieve organic sales growth through improved sales management, new product introductions, geographic expansion both domestic and international and expansion into post-acute care markets;
- Identify and act on acquisition opportunities that will further enhance our product offering, distribution coverage and leverage our current sales network to improve gross profit margins; and
- Improve our investor relations efforts in order to better alert the market to our strategic growth objectives.

A key element of our business plan was to bring greater emphasis to our sales efforts. In March 2016, we hired Thomas J. (Jeff) Gephart as Senior Vice President of Sales. Mr. Gephart spent almost a decade as Vice President of Sales for Chattanooga Group, our largest competitor, managing their extensive sales network. Subsequently, he worked as Director of Sales and Marketing in the US market for Zimmer MedizinSystems, a German manufacturer of rehabilitation products and, most recently, as Director of Sales and Marketing for Gebauer Corporation, where he supervised sales, marketing and customer service for their worldwide operations. He brings to the Company both market expertise and significant experience in building sales organizations. Enhancing our sales network is critical for our success as we acquire companies and build the platform. We are confident that he is the right leader to strengthen both the sales and marketing organization.

In addition to Jeff's management expertise, other key hires have been made to push sales growth. A new Eastern Sales Region was created and we hired a new sales manager to manage that territory. This hire was previously a regional sales manager for one of our largest competitors, DJO Global. He brings significant experience, product knowledge and customer relationships to the job. We also hired a new director to head up international sales for the Company in light of the pending retirement of the Company's founder who had previously been managing International Sales on a part-time basis. Our new director of international sales established a global training program for sales representatives at DJO Global and Chattanooga Group. Over the past 10 years he led the technical sales support effort globally and is certified as a Lean and Kaizen facilitator.

We will release several new product innovations during fiscal 2017 to strengthen our current product offering and to expand our product portfolio. In August 2016, we completed the release of our upgraded Dynatron Solaris® Plus and 25 SeriesTM product lines as well as the release in September 2016, of the Dynatron® 125B stand-alone ultrasound. We believe these innovations will have a meaningful contribution to our performance in the next 12-months.

In the last several months we have announced restructuring changes to the core Dynatronics management team. In June 2016, Larry K. Beardall, Executive Vice President of Marketing and Strategic Planning and member of the Board of Directors left Dynatronics. His duties have been assumed by Mr. Gephart who has extensive experience in marketing and strategic planning. In July 2016, Bob Cardon, Vice President of Administration announced his retirement. In August 2015, we hired a new director to manage the Company's business development strategy. These changes in executive management are designed to more effectively pursue the corporate strategies articulated in this business plan – particularly the business development strategies.

We are actively pursuing an acquisition strategy to consolidate other small manufacturers and distributors in our core markets (i.e. physical therapy, athletic training, and chiropractic). We are primarily seeking candidates that fall into the following categories:

- Manufacturers that extend our product portfolio
- Distributors that extend geographic reach or provide different channel access
- Tuck-in manufacturers / distributors in adjacent markets (i.e. Orthopedics, Sports Medicine, Podiatry, etc.)

In summary, based on our defined strategic initiatives we are focusing our resources in the following areas:

- Updating and improving our selling and marketing efforts including new sales management, new reporting tools, and focusing our sales and marketing efforts into our core markets;
- Seeking to improve distribution of our products through recruitment of additional qualified sales representatives and dealers attracted by the many new products being offered and expanding the availability of proprietary combination therapy device;
- Improving gross profit margins by, among other initiatives, increasing market share of manufactured capital products by promoting sales of our state-of-the-art Dynatron® ThermoStim probe, Dynatron Solaris® Plus and 25 SeriesTM products;
- Maintaining our position as a technological leader and innovator in our markets through the introduction of new products during the new fiscal year;
- Increasing international sales by (1) leveraging the CE Mark approval in Europe and other countries by identifying appropriate distributors for the approved products, (2) Finalizing regulatory approvals in countries such as China, Mexico, Peru and other countries in Southeast Asia, and (3) further developing relationships with existing distributors in countries such as Japan in order to increase sales in those countries where products are approved;
- Exploring strategic business acquisitions. This will leverage and complement our competitive strengths, increase market reach and allow us to potentially expand into broader medical markets; and
- Attending strategic conferences to make investors aware of our strategic plans, attract new capital to support the business development strategy and identify other acquisition targets

Market Information

As of September 22, 2016, we had approximately 2,846,678 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 sales prices for our common stock as quoted on the NASDAQ system for the quarterly periods indicated.

Fiscal Year Ended June 30:	*2016*		*2015*	
	High	Low	High	Low
1st Quarter Jul-Sep	$4.44	$2.65	$5.00	$3.69
2nd Quarter Oct-Dec	$3.36	$2.76	$5.76	$3.34
3rd Quarter Jan-Mar	$3.09	$2.56	$3.89	$2.78
4th Quarter Apr-Jun	$3.21	$2.55	$3.51	$2.70

Stockholders

As of September 22, 2016, we had approximately 520 shareholders of record. This number does not include beneficial owners of shares held in "nominee" or "street" name by a bank, broker or other holder of record. In addition to the shareholders of record, we estimate that there are a total of 1,500 beneficial owners of our common stock.

Dividends

We currently have approximately 1.6 million shares of Series A Preferred outstanding. Dividends payable on these shares accrue at the rate of 8% per year and are payable quarterly in stock or cash. The formula for paying this dividend in common stock can change the effective yield on the dividend to more or less than 8% depending on the price of the stock at the time of issuance.

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, if any, in order to finance the development of the business.

Purchases of Equity Securities

In February 2011, the Board of Directors approved $1,000,000 for open market share repurchases of the Company's common stock. Approximately $500,000 remained on this authorization as of June 30, 2016. We did not purchase any shares of common stock during the year ended June 30, 2016 or in the prior four fiscal years.

Preferred Stock

In June 2015, we raised approximately $4.0 million in equity financing. The purchasers of these securities included affiliates of Prettybrook Partners, LLC ("Prettybrook") and certain other purchasers (collectively with Prettybrook, the "Preferred Investors"). The Preferred Investors purchased 1,610,000 shares of our Series A Preferred and received (i) A-Warrants, exercisable by cash exercise only, to purchase 1,207,500 shares of our common stock, and (ii) B-Warrants, exercisable by "cashless exercise", to purchase 1,207,500 shares of our common stock. Proceeds from this financing are to be used to promote organic growth of the Company through expansion of our sales distribution channels both domestically and internationally, improve infrastructure and operating systems, and support strategic acquisition opportunities.

BOARD OF DIRECTORS AND STOCKHOLDERS
DYNATRONICS CORPORATION
COTTONWOOD HEIGHTS, UTAH

We have audited the accompanying consolidated balance sheet of Dynatronics Corporation ("Company") as of June 30, 2016 and the related consolidated statements of operations, stockholders' equity, and cash flows for the year 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 audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States) and in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit 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 its 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 also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Dynatronics Corporation at June 30, 2016, and the results of its operations and its cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

/s/ BDO USA, LLP
Salt Lake City, Utah
September 28, 2016

BDO

BOARD OF DIRECTORS AND STOCKHOLDERS
DYNATRONICS CORPORATION
COTTONWOOD HEIGHTS, UTAH

We have audited the accompanying consolidated balance sheet of Dynatronics Corporation and subsidiary as of June 30, 2015 and the related consolidated statements of operations, stockholders' equity, and cash flows for the year 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 audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit 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 its 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, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Dynatronics Corporation as of June 30, 2015, and the results of its operations and cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

/s/ Mantyla McReynolds, LLC
Salt Lake City, Utah
September 28, 2015

Mantyla McReynolds LLC
Certified Public Accountants

Balance Sheets

Years ended June 30:		*2016*	*2015*
Assets			
Current assets:			
Cash and cash equivalents	$	966,183	3,925,967
Trade accounts receivable, less allowance for doubtful accounts of $389,050 as of June 30, 2016 and $471,444 as of June 30, 2015		3,523,731	3,346,770
Other receivables		10,946	6,748
Inventories, net		4,997,254	5,421,787
Prepaid expenses		256,735	273,629
Prepaid income taxes		—	338,108
Total current assets		9,754,849	13,313,009
Property and equipment, net		4,777,565	5,025,076
Intangible asset, net		160,123	190,803
Other assets		580,161	623,342
Total assets	$	**15,272,698**	**19,152,230**
Liabilities and Stockholders' Equity			
Current liabilities:			
Current portion of long-term debt	$	137,283	121,884
Current portion of capital lease		183,302	173,357
Current portion of deferred gain		150,448	150,448
Line of credit		—	1,909,919
Warranty reserve		152,605	153,185
Accounts payable		1,914,342	2,520,327
Accrued expenses		358,787	279,547
Accrued payroll and benefits expenses		1,034,688	263,092
Income tax payable		2,895	—
Total current liabilities		3,934,350	5,571,759
Long-term debt, net of current portion		553,191	651,118
Capital lease, net of current portion		3,281,547	3,464,850
Deferred gain, net of current portion		1,830,449	1,980,897
Deferred rent		85,151	41,150
Deferred income tax liabilities		—	136,128
Total liabilities		9,684,688	11,845,902
Commitments and contingencies		—	—
Stockholders' equity:			
Preferred stock, no par value: Authorized 5,000,000 shares; 1,610,000 shares issued and outstanding at June 30, 2016 and June 30, 2015, respectively		3,708,152	3,728,098
Common stock, no par value: Authorized 50,000,000 shares; 2,805,280 shares and 2,642,389 shares issued and outstanding at June 30, 2016 and June 30, 2015, respectively		7,545,880	6,969,700
Accumulated deficit		(5,666,022)	(3,391,470)
Total stockholders' equity		5,588,010	7,306,328
Total liabilities and stockholders' equity	$	**15,272,698**	**19,152,230**

See accompanying notes to consolidated financial statements.

Statements of Operations

Years ended June 30:		*2016*	*2015*
Net sales	$	30,411,757	29,117,528
Cost of sales		20,057,614	20,048,069
Gross profit		10,354,143	9,069,459
Selling, general, and administrative expenses		10,978,606	9,229,405
Research and development expenses		1,070,383	926,954
Operating loss		(1,694,846)	(1,086,900)
Other Income (expense):			
Interest income		2,885	4,920
Interest expense		(289,149)	(330,842)
Other income, net		14,298	13,577
Total other income (expense)		(271,966)	(312,345)
Loss before income tax benefit		(1,966,812)	(1,399,245)
Income tax (provision) benefit		64,551	(851,092)
Net loss	$	(1,902,261)	(2,250,337)
Deemed dividend on 8% convertible preferred stock		—	(2,109,971)
8% Convertible preferred stock dividend, in common stock		(372,291)	—
8% Convertible preferred stock dividend, in cash		—	(882)
Net loss applicable to common stockholders	$	(2,274,552)	(4,361,190)
Basic and diluted net loss per common share	$	(0.84)	(1.73)
Weighted-average basic and diluted common shares outstanding:		2,706,424	2,520,723

See accompanying notes to consolidated financial statements.

Statements of Stockholders' Equity

Years ended June 30, 2016 and 2015

	Common Stock Shares	Common Stock Amount	Preferred Stock Shares	Preferred Stock Amount	Accumulated Deficit	Total Stockholders' Equity
Balances as of July 1, 2014	2,520,389	$ 7,149,812	—	$ —	(1,141,133)	$ 6,008,679
Stock-based compensation	—	66,372	—	—	—	66,372
Issuance of common stock in association with capital raise	122,000	394,060	—	—	—	394,060
Issuance of preferred stock and warrants, net of issuance costs	—	(640,544)	1,610,000	3,728,980	—	3,088,436
Preferred stock dividend, in cash	—	—	—	(882)	—	(882)
Preferred stock beneficial conversion feature	—	—	—	2,109,971	—	2,109,971
Dividend of beneficial conversion feature	—	—	—	(2,109,971)	—	(2,109,971)
Net loss	—	—	—	—	(2,250,337)	(2,250,337)
Balances as of June 30, 2015	2,642,389	$ 6,969,700	1,610,000	$ 3,728,098	(3,391,470)	$ 7,306,328
Stock-based compensation	71,596	203,889	—	—	—	203,889
Issuance of preferred stock and warrants, net of issuance costs	—	—	—	(19,946)	—	(19,946)
Preferred stock dividend, in common stock	91,295	273,375	—	—	(273,375)	—
Preferred stock dividend, in common stock, to be issued	—	98,916	—	—	(98,916)	—
Net loss	—	—	—	—	(1,902,261)	(1,902,261)
Balances as of June 30, 2016	**2,805,280**	**7,545,880**	**1,610,000**	**3,708,152**	**(5,666,022)**	**5,588,010**

See accompanying notes to consolidated financial statements.

Statements of Cash Flows

Years ended June 30:		*2016*	*2015*
Cash flows from operating activities:			
Net loss	$	(1,902,261)	(2,250,337)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation and amortization of property and equipment		229,930	350,959
Amortization of intangible assets		30,680	44,637
Amortization of other assets		51,372	51,372
Amortization of building lease		251,934	230,939
Gain on sale of assets		4,703	—
Stock-based compensation expense		203,889	66,372
Change in deferred income taxes		(136,128)	848,691
Change in provision for doubtful accounts receivable		(28,394)	92,089
Change in provision for inventory obsolescence		57,213	23,190
Deferred gain on sale/leaseback		(150,448)	(137,910)
Change in operating assets and liabilities:			
Receivables, net		(152,765)	(264,617)
Inventories, net		367,320	712,871
Prepaid expenses		16,894	(265,968)
Other assets		(8,191)	(278,258)
Income tax payable		2,895	(368,560)
Prepaid income taxes		341,003	—
Accounts payable and accrued expenses		285,377	79,022
Net cash used in operating activities		(534,977)	(1,065,508)
Cash flows from investing activities:			
Purchase of property and equipment		(195,946)	(66,333)
Proceeds from sale of property and equipment		—	3,800,000
Net cash provided by (used in) investing activities		(195,946)	3,733,667
Cash flows from financing activities:			
Principal payments on long-term debt		(125,638)	(784,405)
Principal payments on long-term capital lease		(173,358)	(161,793)
Net change in line of credit		(1,909,919)	(1,611,290)
Proceeds from issuance of preferred stock, net		(19,946)	3,482,496
Net cash provided by (used in) financing activities		(2,228,861)	925,008
Net change in cash and cash equivalents		(2,959,784)	3,593,167
Cash and cash equivalents at beginning of the period		3,925,967	332,800
Cash and cash equivalents at end of the period		**966,183**	**3,925,967**
Supplemental disclosures of cash flow information:			
Cash paid for interest		307,644	324,314
Cash paid for income taxes		—	356,151
Supplemental disclosures of non-cash flow investing and financing activities:			
Capital lease - building		—	3,800,000
Capital lease and note payable obligations incurred to acquire property and equipment		43,110	—
8% preferred stock dividend, in common stock		372,291	—
Deemed dividend on 8% convertible preferred stock		—	2,109,971
Preferred stock issuance costs paid in common stock		—	394,060

See accompanying notes to consolidated financial statements.

NOTES TO 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 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 and treatment tables to an expanding market of physical therapists, podiatrists, orthopedists, chiropractors, 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. The consolidated financial statements are prepared in conformity with accounting principles generally accepted in the United States of America (U.S. GAAP). 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. The Company periodically reviews the value of items in inventory and provides write-downs or write-offs of inventory based on its assessment of slow moving or obsolete inventory. Write-downs and write-offs are charged against the reserve.

(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 less accumulated depreciation. Depreciation is computed using the straight line method over the estimated useful lives of the assets. Buildings and their component parts are being depreciated over their estimated useful lives that range from 5 to 31.5 years. Machinery, office equipment, computer equipment and software and vehicles are being depreciated over their estimated useful lives that 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 20 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 Loss per Common Share

Net 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. Convertible preferred stock and stock options and warrants are considered to be common stock equivalents. The computation of diluted net loss per common share does not assume exercise or conversion of securities that would have an anti-dilutive effect.

Basic net loss per common share is the amount of net loss for the year available to each weighted-average share of common stock outstanding during the year. Diluted net loss per common share is the amount of net 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, 2016 and 2015, is summarized as follows:

	2016	2015
Basic weighted-average number of common shares outstanding during the year	2,706,424	2,520,723
Weighted-average number of dilutive common stock equivalents outstanding during the year	—	—
Diluted weighted-average number of common and common equivalent shares outstanding during the year	2,706,424	2,520,723

Outstanding common stock equivalents not included in the computation of diluted net loss per common share totaled 4,127,814 as of June 30, 2016 and 4,105,290 as of June 30, 2015. 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. Accounting standards require the consideration of a valuation allowance for deferred tax assets if it is "more likely than not" that some component or all of the benefits of deferred tax assets will not be realized. 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.

As of June 30, 2016, the Company has approximately $716,000 in cash and cash equivalents in excess of the FDIC limits. The Company has not experienced any losses in such accounts.

(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 markets. As such, the Company has only one reportable operating segment.

Physical medicine products made up 92% of net sales for the year ended June 30, 2016 and 91% for the year ended June 30, 2015. Chargeable repairs, billable freight and other miscellaneous revenues account for the remaining 8% and 9% of net sales for the years ended June 30, 2016 and 2015, 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 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, 2016 and 2015 was approximately $100,900 and $93,700, respectively.

(2) INVENTORIES

Inventories consist of the following as of June 30:

		2016	2015
Raw materials	$	2,059,048	2,086,411
Finished goods		3,353,964	3,693,921
Inventory reserve		(415,758)	(358,545)
	$	**4,997,254**	**5,421,787**

Included in cost of goods sold for the years ended June 30, 2016 and 2015, is a write off of slow moving and obsolete inventory totaling $270,000 and $952,212, respectively. The $270,000 non-cash charge during fiscal year 2016 is based on non-performing inventory related to our Amerinet GPO contract and defective product rejected for quality purposes. The $952,212 non-cash charge reflects a write off of inventory related to strategic decisions made during the fourth quarter of fiscal 2015 resulting in some product lines being discontinued, re-evaluated or de-emphasized. These decisions created additional obsolescence that upon analysis warranted the inventory write off.

(3) PROPERTY AND EQUIPMENT

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

		2016	2015
Land	$	30,287	30,287
Buildings		5,603,859	5,586,777
Machinery and equipment		1,686,386	1,635,386
Office equipment		275,977	273,420
Computer equipment		2,102,005	1,984,046
Vehicles		253,513	247,571
		9,952,027	9,757,487
Less accumulated depreciation and amortization		(5,174,462)	(4,732,411)
	$	**4,777,565**	**5,025,076**

Depreciation expense for the years ended June 30, 2016 and 2015 was $229,930 and $350,959, respectively.

Included in the above caption, "Buildings" at June 30, 2016 and 2015 are assets held under a capital lease obligation totaling $3,800,000 (gross). The net balance of the capital lease as of June 30, 2016 and 2015 was $3,317,127 and $3,569,061, respectively. Building amortization under the capital lease for the years ended June 30, 2016 and 2015 was $251,934 and $230,939, respectively.

(4) INTANGIBLE ASSETS

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

		2016	2015
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
Total identifiable intangibles		700,000	700,000
Less accumulated amortization		(539,877)	(509,197)
Net carrying amount	$	**160,123**	**190,803**

Amortization expense associated with the intangible assets was $30,680 and $44,637 for the fiscal years ended June 30, 2016 and 2015, respectively. Estimated amortization expense for the identifiable intangibles is expected to be as follows: 2017, $30,680; 2018, $26,430; 2019, $26,430; 2020, $26,430; 2021, $20,420 and thereafter $29,733.

(5) WARRANTY RESERVE

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

		2016	2015
Beginning warranty reserve balance	$	153,185	157,753
Warranty repairs		(143,934)	(145,698)
Warranties issued		141,009	145,267
Changes in estimated warranty costs		2,345	(4,137)
Ending warranty reserve	$	**152,605**	**153,185**

(6) LINE OF CREDIT

In March 2016, the Company retired its working capital line of credit. That line of credit has been re-instated effective September 2016 in the amount of $1.0 million. Interest on the line of credit is based on the prime rate plus 5%. It is collateralized by inventory and accounts receivable. Borrowing limitations are based on 85% of eligible accounts receivable and $700,000 of eligible inventory. The current borrowing base on the line of credit would be approximately $3.4 million. Presently the line of credit is on stand-by status. The Company will pay $2,000 per month as a minimum access fee to the line of credit. If the Company determines to activate the line it is required to provide the lender with 45 days' notice of intent to begin borrowing. The line of credit has a maturity date of September 2017. The line of credit has no negative loan covenants. However, once the line of credit is activated there are affirmative covenants to provide regular accounts receivable reports and financial statements within 90 days of month end.

(7) LONG TERM DEBT

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

		2016	2015
6.44% promissory note secured by trust deed on real property, maturing January 2021, payable in monthly installments of $13,278	$	630,901	745,562
5.99% promissory note secured by a vehicle, payable in monthly installments of $833 through December 2020		39,355	—
Promissory note secured by a vehicle, payable in monthly installments of $639 through February 2019		20,218	27,168
13.001% promissory note secured by equipment, payable in monthly installments of $70 through October 2015		—	272
		690,474	773,002
Less current portion		(137,283)	(121,884)
	$	**553,191**	**651,118**

The aggregate maturities of long term debt for each of the years subsequent to June 30, 2016 are as follows: 2017, $137,283; 2018, $146,094; 2019, $153,559; 2020, $157,646 and 2021, $95,892.

(8) LEASES

Operating Leases

The Company leases vehicles under noncancelable operating lease agreements. Lease expense for the years ended June 30, 2016 and 2015, was $14,430 and $16,106, respectively. Future minimum lease payments required under noncancelable operating leases that have initial or remaining lease terms in excess of one year as of 2016 is as follows: 2017, $8,001; 2018, $8,001 and 2019, $6,001.

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, 2016 and 2015 was $186,882 and $188,498, respectively. Future minimum rental payments required under operating leases that have a duration of one year or more as of June 30, 2016 are as follows: 2017, $54,852; 2018, $5,088 and 2019, $2,544.

During fiscal year 2015, the office and warehouse spaces in Detroit, Michigan 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 July 2007. The leases are related-party transactions with two employee/stockholders. The expense associated with these related-party transactions totaled $70,800 expense for both fiscal years ended June 30, 2016 and 2015.

Capital Leases

On August 8, 2014, the Company sold the property that houses its operations in Utah and leased back the premises for a term of 15 years. The sale price was $3.8 million. Proceeds from the sale were primarily used to reduce debt obligations of the Company. The sale of the building resulted in a $2,269,255 gain, which is recorded in the consolidated balance sheet as deferred gain and will be recognized in selling, general and administrative expense over the 15 year life of the lease.

The building lease is recorded as a capital lease with the related amortization being recorded on a straight line basis over 15 years. Total accumulated amortization related to the leased building at June 30, 2016 was $482,873 reflecting amortization charges of $251,934 in fiscal 2016 and $230,939 in fiscal 2015. The difference in amortization reflects the fact that fiscal 2015 was only 11 months, being the first year of the lease. Future minimum gross lease payments required under the capital lease as of June 30, 2016 are as follows: 2017, $334,950; 2018, $341,648; 2019, $348,478; 2020, $355,450; 2021, $362,566 and $3,245,126 thereafter. Included in the above lease payments is $1,438,211 of imputed interest.

(9) ACCRUED PAYROLL AND BENEFITS EXPENSE

As of June 30, 2016 accrued payroll and benefits expense was $1,034,688 as compared to $263,092 for the year ended June 30, 2015. Included in fiscal 2016 was $767,786 of accrued severance for two executive management officers.

(10) INCOME TAXES

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

		Current	Deferred	Total
2016:				
U.S. federal	$	—	40,245	40,245
State and Local		—	24,306	24,306
	$	—	**64,551**	**64,551**
2015:				
U.S. federal	$	(16,981)	(678,953)	(695,934)
State and Local		14,580	(169,738)	(155,158)
	$	**(2,401)**	**(848,691)**	**(851,092)**

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:

		2016	2015
Expected tax benefit	$	668,716	475,743
State taxes, net of federal tax benefit		63,844	58,661
R&D tax credit		86,659	28,916
Valuation allowance		(744,724)	(1,447,247)
Incentive stock options		(6,105)	(3,322)
Other, net		(3,839)	36,157
	$	**64,551**	**(851,092)**

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

		2016	2015
Net deferred income tax assets (liabilities) – non-current:			
Inventory capitalization for income tax purposes	$	57,079	67,324
Inventory reserve		162,146	139,832
Warranty reserve		59,516	59,742
Accrued product liability		5,875	9,918
Allowance for doubtful accounts		151,730	162,803
Property and equipment, principally due to differences in depreciation	$	(71,038)	(67,158)
Research and development credit carryover		304,669	133,393
Other intangibles		(62,448)	(68,970)
Deferred gain on sale lease back		863,370	874,235
Operating loss carry forwards		721,074	—
Valuation allowance		(2,191,973)	(1,447,247)
Total deferred income tax assets (liabilities) – non-current	$	—	(136,128)

A valuation allowance is required when there is significant uncertainty as to the realizability of deferred tax assets. The ability to realize deferred tax assets is dependent upon the Company's ability to generate sufficient taxable income within the carryforward periods provided for in the tax law for each tax jurisdiction. The Company has considered the following possible sources of taxable income when assessing the realization of its deferred tax assets:

- future reversals of existing taxable temporary differences;
- future taxable income or loss, exclusive of reversing temporary differences and carryforwards;
- tax-planning strategies; and
- taxable income in prior carryback years.

The Company considered both positive and negative evidence in determining the need for a valuation allowance, including the following:

Positive evidence:

- Current forecasts indicate that the Company will generate pre-tax income and taxable income in the future. However, there can be no assurance that the new strategic plans will result in profitability.
- A majority of the Company's tax attributes have indefinite carryover periods.

Negative evidence:

- The Company has several years of cumulative losses as of June 30, 2016.

The Company places more weight on objectively verifiable evidence than on other types of evidence and management currently believes that available negative evidence outweighs the available positive evidence. Management has therefore determined that the Company does not meet the "more likely than not" threshold that deferred tax assets will be realized. In accordance with accounting rules, management has implemented a full valuation allowance against all but approximately $65,000 of the tax benefit for fiscal year 2016. The benefit left remaining is the result of certain adjustments to the deferred tax assets in the fourth quarter to true up all tax asset accounts. Any reversal of the valuation allowance will favorably impact the Company's results of operations in the period of reversal.

The Company's federal and state income tax returns for June 30, 2013, 2014 and 2015 are open tax years. The anticipated NOL carry ward from fiscal 2016 is $1,780,000. The Company has not uncertain tax positions as of June 30, 2016.

(11) MAJOR CUSTOMERS AND SALES BY GEOGRAPHIC LOCATION

During the fiscal years ended June 30, 2016 and 2015, 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 $850,200 or 2.8% of net sales, for the fiscal year ended June 30, 2016 compared to $880,500, or 3% of net sales, for the fiscal year ended June 30, 2015.

(12) COMMON STOCK AND COMMON STOCK EQUIVALENTS

For the year ended June 30, 2016, the Company granted 36,174 shares of restricted common stock to directors in connection with compensation arrangements and 35,422 shares to employees. For the year ended June 30, 2015, the Company granted no restricted common stock to directors or officers in connection with compensation arrangements.

On June 30, 2015, the Company issued 122,000 shares of restricted common stock to the exclusive placement agent and the financial advisor in conjunction with the $4 million capital raise.

The Company maintained a 2005 equity incentive plan for the benefit of employees, on June 29, 2015 the shareholders approved a new 2015 equity incentive plan setting aside 500,000 shares. The 2015 plan was filed with the SEC on September 3, 2015. 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. As of June 30, 2015, 405,404 shares of common stock were authorized and reserved for issuance, but were not granted under the terms of the 2015 equity incentive plan.

The Company granted 95,000 options under its 2015 equity incentive plan during fiscal year 2016. There were no options granted during fiscal year 2015. 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:

	2016
Expected dividend yield	0%
Expected stock price volatility	63%–65%
Risk-free interest rate	1.83%–2.04%
Expected life of options	10 years

The weighted average fair value of options granted during fiscal year 2016 was $2.10.

The following table summarizes the Company's stock option activity during the reported fiscal years:

	2016 Number of shares	*2016 Weighted average exercise price*	*Weighted average remaining contractual term*	*2015 Number of shares*	*2015 Weighted average exercise price*
Options outstanding at beginning of the year	91,152	$ 5.07	3.56 years	155,604	$ 6.45
Options granted	95,000	3.27		—	—
Options exercised	—	—		—	—
Options canceled or expired	(64,595)	4.74		(64,452)	8.41
Options outstanding at end of the year	121,557	3.84	2.80 years	91,152	5.07
Options exercisable at end of the year	63,940	4.75		90,520	5.48
Range of exercise prices at end of the year		$ 1.75 – 5.55			$ 1.75 – 7.10

The Company recognized $203,889 and $66,372 in stock-based compensation for the years ended June 30, 2016 and 2015, 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. Included in the $203,889 stock-based compensation was $79,333 which was related to severance payments due to changes in executive management.

As of June 30, 2015 there was $293,564 of unrecognized stock-based compensation cost that is expected to be expensed over periods of four to eight years.

No options were exercised during the fiscal years 2016 and 2015. The aggregate intrinsic value of the outstanding options as of June 30, 2016 and 2015 was $3,816 and $3,289, respectively.

(13) SERIES A 8% CONVERTIBLE PREFERRED STOCK AND COMMON STOCK WARRANTS

On June 30, 2015, the Company completed a private placement with affiliates of Prettybrook Partners, LLC ("Prettybrook") and certain other purchasers (collectively with Prettybrook, the "Preferred Investors") for the offer and sale of shares of the Company's Series A 8% Convertible Preferred Stock (the "Series A Preferred") in the aggregate amount of approximately $4 million. Offering costs incurred in conjunction with the private placement were recorded net of proceeds. The Series A Preferred is convertible to common stock on a 1:1 basis. A Forced Conversion can be initiated based on a formula related to share price and trading volumes as outlined in the terms of the private placement. The dividend is fixed at 8% and is payable in either cash or common stock. This dividend is payable quarterly and equates to an annual payment of $372,291 in cash or a value in common stock based on the trading price of the stock on the date the dividend is declared. Certain redemption rights are attached to the Series A Preferred, but none of the redemption rights for cash are deemed outside the control of the Company. The redemption rights deemed outside the control of the Company require common stock payments or an increase in the dividend rate. The Series A Preferred includes a liquidation preference under which Preferred Investors would receive cash equal to the stated value of their stock plus unpaid dividends. In accordance with the terms of the sale of the Series A Preferred, the Company was required to register the underlying common shares associated with the Series A Preferred and the warrants. That registration statement filed on form S-3 went effective on August 13, 2015.

The Series A Preferred votes on an as-converted basis, one vote for each share of Common Stock issuable upon conversion of the Series A Preferred, provided, however, that no holder of Series A Preferred shall be entitled to cast votes for the number of shares of Common Stock issuable upon conversion of such Series A Preferred held by such holder that exceeds the quotient of (x) the aggregate purchase price paid by such holder of Series A Preferred for its Series A Preferred, divided by (y) the greater of (i) $2.50 and (ii) the market price of the Common Stock on the trading day immediately prior to the date of issuance of such holder's Preferred Stock. The market price of the Common Stock on the trading day immediately prior to the date of issuance was $3.19 per share. Based on a $4,025,000 investment and a $3.19 per share price the number of Common Stock equivalents eligible for voting by Preferred shareholders is 1,261,755.

The Preferred Investors purchased a total of 1,610,000 shares of Series A Preferred Stock, and received in connection with such purchase, (i) A-Warrants, exercisable by cash exercise only, to purchase 1,207,500 shares of common stock, and (ii) B-Warrants, exercisable by "cashless exercise", to purchase 1,207,500 shares of common stock. The warrants are exercisable for 72 months from the date of issuance and carry a Black-Scholes put feature in the event of a change in control. The put right is not subject to derivative accounting as all equity holders are treated the same in the event of a change in control.

The Company's Board of Directors has the authority to cause us to issue, without any further vote or action by the shareholders, up to 3,390,000 additional shares of preferred stock, no par value per share, in one or more series, to designate the number of shares constituting any series, and to fix the rights, preferences, privileges and restrictions thereof, including dividend rights, voting rights, rights and terms of redemption, redemption price or prices and liquidation preferences of such series.

The Series A Preferred includes a conversion right at a price that creates an embedded beneficial conversion feature. A beneficial conversion feature arises when the conversion price of a convertible instrument is below the per share fair value of the underlying stock into which it is convertible. The conversion price is 'in the money' and the holder realizes a benefit to the extent of the price difference. The issuer of the convertible instrument realizes a cost based on the theory that the intrinsic value of the price difference (i.e., the price difference times the number of shares received upon conversion) represents an additional financing cost. The conversion rights associated with the Series A Preferred issued by the Company do not have a stated life and, therefore, all of the beneficial conversion feature amount of $2,109,971 was amortized to dividends on the same date the preferred shares were issued. The $2,109,971 dividend is added to the net loss to arrive at the net loss applicable to common stockholders for purposes of calculating loss per share for the year ended June 30, 2015.

The Company paid dividends in common stock of $273,375 during fiscal 2016 and $882 in cash for fiscal 2015. At June 30, 2016, there was $98,916 in accrued dividends payable for the quarter ended June 30, 2016.

(14) BENEFICIAL CONVERSION FEATURE ADJUSTED AND RECLASSIFICATION

ASC 470-20-30-8 provides that if the intrinsic value of the beneficial conversion feature is greater than the proceeds allocated to the convertible instrument, the amount of the discount assigned to the beneficial conversion feature shall be limited to the amount of the proceeds allocated to the convertible instrument. In the prior year, the Company did not limit the amount of the beneficial conversion feature to the amount of proceeds which resulted in an overstatement of the dividend of the beneficial conversion feature of $748, 916. The Company has corrected this error in the prior year financial statements which resulted in a reduction in net loss applicable to common stockholders from $5,110,106 to $4,361,190 and a decrease in basic and diluted net loss per common share from $2.03 to $1.73. Additionally, certain reclassifications to common stock and preferred stock were done to correct the consolidated balance sheet and consolidated statement of stockholders' equity. These corrections and reclassifications had no impact to net loss, total stockholders' equity or the statement of cash flows. The Company has evaluated the effect of this error and reclassifications, both qualitatively and quantitatively, and concluded that it did not have a material impact on, nor require amendment of, any previously filed annual or quarterly statements.

(15) 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 2016 and 2015, 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 2016 and 2015 were $36,103 and $34,099, respectively. Company matching contributions for future years are at the discretion of the board of directors.

(16) LIQUIDITY AND CAPITAL RESOURCES

As of June 30, 2016, the Company had $966,183 of cash, compared to $3,925,967 as of June 30, 2015. During the current and prior year the Company incurred significant operating losses and negative cash flows from operations. The Company believes that its existing revenue stream, current capital resources, together with the working capital line of credit initiated in September 2016 will be sufficient to fund operations through September 30, 2017. For more information on the line of credit see note #6.

To fully execute on its business strategy of acquiring other entities, the Company will need to raise additional capital. Absent additional financing, the Company will not have the resources to execute its current business plan and may have to curtail its current acquisition strategy.

(17) SUBSEQUENT EVENTS

On July 7, 2016, the Company issued 33,305 shares of common stock as payment for the accrued "Preferred Stock Dividend."

On September 23, 2016, the Company initiated a $1.0 million working capital line of credit. For information on the line of credit see note #6.

(18) RECENT ACCOUNTING PRONOUNCEMENTS

The Financial Accounting Standards Board ("FASB") issued Accounting Standard Update ("ASU") 2014-09, 2015-14 and 2016-8 – Revenue from Contracts with Customers, which provides a single, comprehensive revenue recognition model for all contracts with customers. The core principal of the ASUs is that an entity should recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The ASUs also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to obtain or fulfill a contract. In July 2015, the FASB deferred the effective date of this standard. As a result, the standard and related amendments will be effective for the Company for its fiscal year beginning July 1, 2018, including interim periods within that fiscal year. Early application is permitted, but not before the original effective date of June 1, 2017. Entities are allowed to transition to the new standard by either retrospective application or recognizing the cumulative effect. The Company is currently evaluating the guidance, including which transition approach will be applied and the estimated impact it will have on our consolidated financial statements.

In March 2016, the FASB issued ASU No. 2016-09, Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting ("ASU 2016-09"). This ASU amends certain aspects of accounting for share-based payments to employees, including (i) requiring all income tax effects of share-based awards to be recognized in the income statement when the award vests or settles and eliminating APIC pools, (ii) permitting employers to withhold the share equivalent of an employee's maximum tax liability without triggering liability accounting and (iii) allowing companies to make a policy election to account for forfeitures as they occur. ASU 2016-09 is effective for annual reporting periods beginning after December 15, 2016 and early adoption is permitted. The Company is evaluating the impact of adopting ASU 2016-09 on its financial statements, but does not believe the new guidance will have a significant impact on how it accounts for share-based payments.

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842) ("ASU 2016-02"). This ASU primarily provides new guidance for lessees on the accounting treatment of operating leases. Under the new guidance, lessees are required to recognize assets and liabilities arising from operating leases on the balance sheet. ASU 2016-02 also aligns lessor accounting with the revenue recognition guidance in Topic 606 of the Accounting Standards Codification. ASU 2016-02 is effective for annual reporting periods beginning after December 15, 2018 with early adoption permitted and is required to be adopted on a modified retrospective basis, meaning the new leasing model will be applied to the earliest year presented in the financial statements and thereafter. The Company is currently evaluating the impact of adopting this new accounting standard on its financial statements.

In January 2016, the FASB issued ASU 2016-01, Financial Instruments – Overall (Topic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. The objective of this update is to enhance the reporting model for financial instruments to provide users of financial statements with more decision-useful information. The amendments in this update make the following eight improvements to generally accepted accounting principles:

1. Equity investments (except those accounted for under the equity method or that result in consolidation of the investee) are to be measured at fair value with changes in fair value included in net income. However, an entity may choose to measure equity investments without readily determinable fair values at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for identical or similar investments of the same issuer.
2. A qualitative assessment is required for investments without readily determinable fair values in order to identify impairment. If impairment is identified, the investment is to be measured at fair value.
3. The requirement to disclose the fair value of financial instruments measured at amortized cost is eliminated for non-public business entities.
4. The requirement to disclose the method(s) and significant assumptions used to estimate the fair value of financial instruments measured at amortized cost is eliminated for public business entities.
5. Public entities are required to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes.
6. An entity is required to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments.
7. Separate presentation of financial assets and liabilities by measurement category and form of financial asset is required on the balance sheet or accompanying notes.
8. An entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity's other deferred tax assets

For public business entities, the amendments in this update are effective for fiscal years beginning after December 15, 2017. An entity should apply the amendments by means of a cumulative-effect adjustment to the balance sheet as of the beginning of the fiscal year of adoption. The amendments related to equity securities without readily determinable fair values should be applied prospectively to equity investments that exist as of the date of adoption. The Company notes this new guidance will apply to its reporting requirements and will implement the new guidance accordingly and is currently evaluating the impact this new guidance will have on its financials.

In November 2015, the FASB issued ASU 2015-17, Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes. This update, which is part of the FASB's larger Simplification Initiative project aimed at reducing the cost and complexity of certain areas of the accounting codification, requires that deferred tax liabilities and assets be classified as noncurrent in a classified statement of financial position, which eliminates the requirement that an entity separate deferred tax liabilities and assets into current and non-current amounts. This update does not affect the current requirement that deferred tax liabilities and assets of a tax-paying component of an entity be offset and presented as a single amount on the balance sheet. This amendment applies to all entities with a classified statement of financial position. For public business entities, this update is effective for fiscal years beginning after December 15, 2016, and interim periods within those annual periods. The Company notes this guidance will apply to its reporting requirements and has implemented the new guidance effective with the current 2016 fiscal year reports.

In July 2015, the FASB issued ASU 2015-11, Inventory (Topic 330): Simplifying the Measurement of Inventory. This objective of this update is to simplify Topic 330, which currently requires an entity to measure inventory at the lower of cost or market. Market could be replacement cost, net realizable value, or net realizable value less an approximately normal profit margin. The amendments in this update do not apply to inventory that is measured using last-in, first-out (LIFO) or the retail inventory method. The amendments apply to all other inventory, which includes inventory that is measured using first-in, first-out (FIFO) or average cost. An entity should measure inventory within the scope of this update at the lower of cost and net realizable value. Net realizable value is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. The update will be effective for fiscal years beginning after December 15, 2016. The Company currently applies a lower of cost or market and is currently assessing the magnitude of the difference between using market value versus net realizable value; however, it is not anticipated to have a material effect on the Company's financial.

In August 2014, the FASB issued ASU 2014-15 Presentation of Financial Statements—Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern. The new standard provides guidance around management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and to provide related footnote disclosures. The new standard is effective for fiscal years ending after December 15, 2016. Early adoption is permitted. After adoption the Company will assess going concern based on the guidance in this standard

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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, 2016, may be obtained at no charge by sending a written request to:

Mr. Jim Ogilvie, *Director of Business Development and IR*
Dynatronics Corporation
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, and treatment tables to an expanding market of physical therapists, sports medicine practitioners and athletic trainers, chiropractors, podiatrists, orthopedists, and other medical professionals.

OFFICERS AND DIRECTORS

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

David A. Wirthlin
Chief Financial Officer

T. Jeff Gephart
Senior Vice President of Sales

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

Bryan D. Alsop
Vice President of Information Technology

Erin S. Enright
Director

David B. Holtz
Director

Scott A. Klosterman
Director

Brian M. Larkin
Director

R. Scott Ward, PT PhD
Director

ANNUAL MEETING

The company's annual shareholder meeting will be held at Dynatronics' corporate headquarters on December 16, 2016 at 3:00 pm MT.

7030 Park Centre Drive,
Cottonwood Heights, Utah 84121

ACCOUNTANTS, LEGAL COUNSEL AND TRANSFER AGENT

BDO USA, LLP, Salt Lake City, Utah
Independent Registered Public Accounting Firm
Durham Jones & Pinegar, Salt Lake City, Utah
Corporate Legal Counsel
Kirton & McConkie, Salt Lake City, Utah
Intellectual Property Legal Counsel
Interwest Transfer Company
P.O. Box 17136, Salt Lake City, Utah 84117
Transfer Agent

DYNATRONICS CORPORATION HEADQUARTERS

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