DYNATRONICS CORP
Form 10QSB
May 15, 2003

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

FORM 10-QSB

(Mark One)

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

For the quarterly period ended March 31, 2003.

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

For the transition period from _________ to _________

Commission File Number: 0-12697

Dynatronics Corporation

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

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

7030 Park Centre Drive, Salt Lake City, UT 84121
(Address of principal executive offices)

(801) 568-7000
(Issuer's telephone number)

The number of shares outstanding of the issuer's common stock, no par value, as of May 10, 2003 is 8,869,335.

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

DYNATRONICS CORPORATION
FORM 10-QSB
MARCH 31, 2003
TABLE OF CONTENTS

Page Number

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements...1

Unaudited Balance Sheets
March 31, 2003 and June 30, 2002..1

Unaudited Statements of Income
Three and Nine Months Ended March 31, 2003 and 2002...........................2

Unaudited Statements of Cash Flows
Nine Months Ended March 31, 2003 and 2002.....................................3

Notes to Unaudited Financial Statements.......................................5

Item 2. Management's Discussion and Analysis or Plan of Operation............12

Item 3. Controls and Procedures..20

PART II. OTHER INFORMATION

Item 5. Other Information..20

Item 6. Exhibits and Report on Form 8-K......................................20

DYNATRONICS CORPORATION
Balance Sheets
(Unaudited)

Assets	March 31, 2003	J
Current assets:		
Cash	$ 427,934	
Trade accounts receivable, less allowance for doubtful accounts of $187,156 March 31, 2003 and $165,763 at June 30, 2002	3,102,706	
Other receivables	14,450	
Inventories	4,244,445	
Prepaid expenses	516,291	
Prepaid income taxes	104	
Deferred tax asset-current	276,905	
Total current assets	8,582,731	

Property and equipment, net	3,250,750
Goodwill, net of accumulated amortization of $649,752 at March 31, 2003 and at June 30, 2002	789,422
Other assets	300,484
	$ 12,923,387

Liabilities and Stockholders' Equity

Current liabilities:	
Current installments of long-term debt	$ 191,721
Line of credit	1,411,176
Accounts payable	570,980
Accrued expenses	496,528
Accrued payroll and benefit expenses	280,254
Income tax payable	-
Total current liabilities	2,950,659
Long-term debt, excluding current installments	1,816,171
Deferred compensation	299,797
Deferred tax liability - noncurrent	99,160
Total liabilities	5,165,787
Stockholders' equity:	
Common stock, no par value. Authorized 50,000,000 shares; issued 8,869,335 shares at March 31, 2003 and 8,928,774 shares at June 30, 2002	2,478,981
Treasury stock at cost, zero common shares at March 31, 2003 and 59,439 at June 30, 2002	-
Retained earnings	5,278,619
Total stockholders' equity	7,757,600
	$ 12,923,387

See accompanying notes to financial statements.

DYNATRONICS CORPORATION
Statements Of Income
(Unaudited)

	Three Months Ended March 31,		Ni
	2003	2002	2003
Net sales	$ 4,163,291	4,159,244	12,404
Cost of sales	2,568,237	2,539,529	7,552
Gross profit	1,595,054	1,619,715	4,851
Selling, general, and administrative expenses	1,245,921	1,250,614	3,707
Research and development expenses	271,344	171,891	725
Operating income	77,789	197,210	418
Other income (expense):			
Interest income	973	800	1
Interest expense	(41,921)	(66,492)	(131
Other income, net	795	1,241	5
Total other income (expense)	(40,153)	(64,451)	(124
Income before income taxes	37,636	132,759	294
Income tax expense	14,383	49,837	113
Net income	$ 23,253	82,922	181
Basic and diluted net income per common share	$ 0.00	0.01	
Weighted average basic and diluted common shares outstanding (note 2)			
Basic	8,869,335	8,865,835	8,869
Diluted	8,869,335	8,898,061	8,869

See accompanying notes to financial statements.

2

DYNATRONICS CORPORATION
Statements of Cash Flows
(Unaudited)

	Ni
	2003
Cash flows from operating activities:	
Net income	$ 181
Adjustments to reconcile net income to net cash provided by operating activities:	
Depreciation and amortization of property and equipment	262
Other amortization	5
Provision for doubtful accounts	54
Provision for inventory obsolescence	180
Provision for warranty reserve	154
Provision for deferred compensation	17
Change in operating assets and liabilities:	
Receivables	43
Inventories	(587
Prepaid expenses and other assets	(173
Prepaid income tax	
Accounts payable and accrued expenses	284
Income taxes payable	(30
Net cash provided by operating activities	392
Capital expenditures	(168
Cash flows from financing activities:	
Principal payments on long-term debt	(168
Net change in line of credit	(24
Proceeds from sale of common stock	
Net cash used in financing activities	(192
Net increase decrease in cash	31
Cash at beginning of period	396
Cash at end of period	$ 427

3

DYNATRONICS CORPORATION
Statements of Cash Flows (Continued)
(Unaudited)

Supplemental disclosures of cash flow information:		
Cash paid for interest	$	13
Cash paid for income taxes		14
Supplemental disclosure of non-cash investing and financing activities:		
Common stock issued in exchange for cashless exercise of options using mature stock	$	

See accompanying notes to financial statements.

DYNATRONICS CORPORATION
NOTES TO FINANCIAL STATEMENTS
March 31, 2003
(Unaudited)

NOTE 1. PRESENTATION

The financial statements as of March 31, 2003 and June 30, 2002 and for the three and nine months ended March 31, 2003 and 2002 were prepared by the Company without audit pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations. In the opinion of management, all necessary adjustments, which consist only of normal recurring adjustments, to the financial statements have been made to present fairly the financial position and results of operations and cash flows. Certain amounts in the prior period have been reclassified to conform with current period presentation. The results of operations for the respective periods presented are not necessarily indicative of the results for the respective complete years. The Company has previously filed with the SEC an annual report on Form 10-KSB which included audited financial statements for the two years ended June 30, 2002. It is suggested that the financial statements contained in this filing be read in conjunction with the statements and notes thereto contained in the Company's 10-KSB filing.

NOTE 2. NET INCOME PER COMMON SHARE

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

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

In calculating net income per common share, the net income was the same for both the basic and diluted calculation. A reconciliation between the basic and diluted weighted-average number of common shares for the three and nine months ended March 31, 2003 and 2002 is summarized as follows:

	(Unaudited) Three Months Ended March 31,		(Una Nine Mon Marc
	2003	2002	2003
Basic weighted average number of common shares outstanding during the period	8,869,335	8,865,835	8,869,335
Weighted average number of dilutive common stock options outstanding during the period	-	32,226	-
Diluted weighted average number of common and common equivalent shares outstanding during the period	8,869,335	8,898,061	8,869,335

Outstanding options not included in the computation of diluted net income per share for the three month periods ended March 31, 2003 and 2002 total 1,016,627 and 504,238 and for the nine month periods ended March 31, 2003 and 2002 total 1,016,627 and 211,471 respectively, because to do so would have been anti-dilutive.

NOTE 3. COMPREHENSIVE INCOME

For the periods ended March 31, 2003 and 2002, comprehensive income was equal to the net income as presented in the accompanying statements of income.

NOTE 4. INVENTORIES

Inventories consisted of the following:

	March 31, 2003	June 30, 2002
Raw Material	$ 2,454,959	2,555,535
Finished Goods	2,234,662	1,546,908
Inventory Reserve	(445,176)	(265,692
	$ 4,244,445	3,836,751

NOTE 5. PROPERTY AND EQUIPMENT

Property and equipment were as follows:

	March 31, 2003	June 30, 2002
Land	$ 354,743	354
Buildings	2,897,223	2,871
Machinery and equipment	1,680,743	1,603
Office equipment	414,571	352
Vehicles	65,487	61
	5,412,767	5,244
Less accumulated depreciation and amortization	2,162,017	1,899
	$ 3,250,750	3,345

NOTE 6. GOODWILL AND IDENTIFIABLE INTANGIBLE ASSETS

In July 2001, the Financial Accounting Standards Board (FASB), issued Statement of Financial Accounting Standard (SFAS) No. 141, Business Combinations, and SFAS No. 142, Goodwill and Other Intangible Assets. SFAS No. 141 prohibits the use of the pooling-of-interest method of accounting and requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001 and is applicable to all purchase method business combinations completed after June 30, 2001. SFAS No. 141 also specifies that intangible assets acquired in a purchase method business combination must meet certain criteria to be recognized and reported apart from goodwill, noting that any purchase price allocable to an assembled workforce may not be accounted for separately. SFAS No. 142 requires that goodwill and intangible assets with indefinite lives no longer be amortized effective July 1, 2002; rather, these assets must be tested for impairment at least annually in accordance with the provisions of SFAS No. 142. SFAS No. 142 also requires that intangible assets with definite useful lives be amortized over their respective estimated useful lives to their estimated residual values, and reviewed for impairment in accordance with SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets.

Beginning July 1, 2002, the Company adopted the provisions of SFAS No. 142. In connection with SFAS No. 142's transitional goodwill impairment evaluation, the Company performed an assessment of whether there is an indication that goodwill is impaired as of the date of adoption. The Company has determined that it has one reporting unit. The Company determined its fair value using an independent appraisal firm and compared it to its book value. As of July 1, 2002, the fair value of the Company exceeded the book value of the Company; therefore, there was not an indication of impairment. However, the publicly traded value, one of the indicators of the fair value of the Company, has decreased since July 1, 2002. If the publicly traded value of the Company does not increase prior to the Company's annual assessment date in the fourth quarter, impairment may be

indicated. If upon the Company's annual assessment of the fair value of goodwill, an impairment is indicated, the Company will be required to perform the second step of the impairment test. In the second step, the Company must compare the implied fair value of goodwill with the carrying amount of the Company's goodwill. The implied fair value of goodwill is determined by allocating the fair value of the Company to all of the assets (recognized and unrecognized) and liabilities of the Company in a manner similar to a purchase price allocation in accordance with SFAS No. 141. The residual fair value after this allocation is the implied fair value of the goodwill.

Goodwill. The cost of acquired companies in excess of the fair value of the net assets and purchased intangible assets at acquisition date is recorded as goodwill. As of June 30, 2002, the Company had goodwill, net, of $789,422 from the acquisition of Superior Orthopaedic Supplies, Inc on May 1, 1996 and the exchange of Dynatronics Laser Corporation common stock for a minority interest in Dynatronics Marketing Corporation on June 30, 1983. Through June 30, 2002, goodwill was amortized over a period of 15 and 30 years, respectively, on a straight-line basis. The following table sets forth reported net income and basic and diluted net income per share, as adjusted, to exclude amortization of goodwill which would not have been recorded under SFAS No. 142:

		Three months ended March 31, 2002
Net income, as reported	$	82,922
Amortization expense of goodwill, net of tax		14,255
Net income, as adjusted	$	97,177
Basic net income per share, as reported	$	0.01
Diluted net income per share, as reported		0.01
Amortization expense of goodwill basic and diluted shares		-
Basic net income per share, as adjusted		0.01
Diluted net income per share, as adjusted		0.01

		Year ended Jun 2002
Net income, as reported	$	316,101
Amortization expense of goodwill, net of tax		57,018
Net income, as adjusted	$	373,119
Basic net income per share, as reported	$	0.04
Diluted net income per share, as reported		0.04
Amortization expense of goodwill per basic and diluted share		0.01
Basic net income per share, as adjusted		0.04
Diluted net income per share, as adjusted		0.04

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

		As of March 31, 2003	As of June 30, 2002
Gross carrying amount	$	73,240	73,240
Accumulated amortization		18,921	13,427
Net carrying amount	$	54,319	59,813

Amortization expense associated with the license agreement was $1,831 and $5,493, respectively, for the three and nine months ended for both March 31, 2003 and 2002. Estimated amortization expense for the existing license agreement is expected to be $7,324 for each of the fiscal years ending June 30, 2003 through June 30, 2010.

NOTE 7. PRODUCT WARRANTY RESERVE

The Company adopted the provisions of FASB Interpretation No. 45, Guarantors' Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, for the quarter ended March 31, 2003. The Company accrues the estimated costs to be incurred in connection with the Company's product warranty programs as products are sold based on historical warranty rates. A reconciliation of the changes in the warranty liability is as follows:

		Three months ended March 31, 2003	T
Beginning product warranty reserve balance	$	148,000	
Warranty repairs		(43,296)	
Warranties issued		59,951	
Changes in estimated warranty costs		(10,655)	
Ending product warranty reserve balance	$	154,000	

		Nine months ended March 31, 2003	
Beginning product warranty reserve balance	$	136,000	
Warranty repairs		(136,960)	
Warranties issued		178,620	
Changes in estimated warranty costs		(23,660)	
Ending product warranty reserve balance	$	154,000	

NOTE 8. COMMON STOCK.

During the nine months ended March 31, 2003 the Company canceled 59,439 shares of treasury stock.

NOTE 9. EMPLOYEE STOCK COMPENSATION

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

		Three months ended March 31, 2003
Net income as reported	$	23,253
Less: pro forma adjustment for stock-based compensation, net of income tax		(8,622)
Pro forma net income	$	14,631
Basic net income per share:		
As reported		-
Effect of pro forma adjustment		-
Pro forma		-
Diluted net income per share:		
As reported		-
Effect of pro forma adjustment		-
Pro forma		-

	Nine months ended March 31, 2003
Net income as reported	$ 181,025
Less: pro forma adjustment for stock-based compensation, net of income tax	(27,931)
Pro forma net income	$ 153,094
Basic net income per share:	
As reported	0.02
Effect of pro forma adjustment	-
Pro forma	0.02
Diluted net income per share:	
As reported	0.02
Effect of pro forma adjustment	-
Pro forma	0.02

The per share weighted-average fair value of stock options granted for the three months ended March 31, 2003 and 2002 was $.52 and $.83 per share, and for the nine months ended March 31, 2003 and 2002 was $.56 and $.89 per share, respectively, on the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions:

	Three months ended March 31, 2003	Three months ended March 31, 2002
Expected dividend yield	0%	0%
Risk-free interest rate	3.46 - 3.66%	4.34 - 5.14%
Expected volatility	89-90%	94 - 95%
Expected life	5 & 7 years	5 & 7 years

	Nine months ended March 31, 2003	Nine months ended March 31, 2002
Expected dividend yield	0%	0%
Risk-free interest rate	3.46 - 4.42%	4.34 - 5.14%
Expected volatility	89-90%	90 - 95%
Expected life	5 & 7 years	5 & 7 years

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the Financial Statements (unaudited) and Notes thereto appearing elsewhere in this report on Form 10-QSB.

Results of Operations

Over the past two years, our national economy has faced difficult times. The rate of economic growth in the United States has slowed dramatically, and in many sectors, even declined. In assessing the situation, we realized that we could either continue with the status quo, or we could make a bold move to grow the Company. We decided on the latter. Our major focus this fiscal year centers around an aggressive research and development (R&D) campaign to develop several new products including powered therapy tables, a low-power laser, an infrared light therapy device, the STSi combination device, proprietary iontophoresis products, proprietary cold pack products and most importantly a redesign of our primary line of electrotherapy and ultrasound therapy devices.

The powered therapy tables were introduced in the first quarter of the current fiscal year. The STSi device was introduced in November 2002. This device combines our innovative STS chronic pain technology with our well-established interferential acute pain modality in order to target a much broader segment of the pain market. In late June 2003, we plan to introduce "Solaris", our new line of advanced technology electrotherapy/ultrasound products including an available infrared light therapy probe. The Solaris Series of products will also be capable of powering a low power laser probe that is scheduled for submission to the FDA prior to the end of June 2003. Low power lasers have been used in medical applications for decades throughout Europe and Asia. Only recently has the FDA allowed low-power lasers to be marketed in the United States. By adding laser technology and light therapy to our five new Solaris Series products, we expect the Solaris line to quickly gain acceptance and popularity in the physical medicine market and increase our share of sales in that market.

During the quarter ended March 31, 2003, net sales were $4,163,291, compared to $4,159,244 during the same quarter of the previous year. During the nine months ended March 31, 2003, net sales were $12,404,150, 1% higher than the $12,282,961 in net sales generated during the nine months ended March 31, 2002.

During the quarter ended March 31, 2003 total gross profit was $1,595,054 or 38.3% of net sales compared to $1,619,715 or 38.9% of net sales in the quarter ended March 31, 2002. Gross profit for the nine months ended March 31, 2003 was $4,851,604 or 39.1% of net sales compared to $4,947,632 or 40.3% of net sales in the quarter ended March 31, 2002. The decrease in gross margin as a percent of net sales in the quarter and nine-month periods reflects lower sales of high margin aesthetic products and increased sales of treatment tables, exercise products and supplies that carry lower margins. The introduction of new products is expected to push margins higher in the near future.

Selling, general and administrative (SG&A) expenses for the quarter ended March 31, 2003, were $1,245,921 or 29.9% of net sales compared to $1,250,614 or 30.1% of net sales in the quarter ended March 31, 2002. SG&A expenses for the nine months ended March 31, 2003 decreased to $3,707,654 or 29.9% of net sales compared to $3,869,262 or 31.5% of net sales for the nine months ended March 31, 2002. The decreases in SG&A expenses reflect our efforts since January 2002 to

reduce operating expenses through our `Back to Basics' program. Through this program, we have realized reductions in overhead and labor expenses as well as certain selling expenses. Also, the adoption of Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and Other Intangible Assets," which was required as of July 1, 2002, reduced the expense associated with the amortization of goodwill and intangible assets for the three and nine-months ended March 31, 2003, to $1,831 and $5,493 respectively compared to $23,635 and $70,905, for the same periods in 2002. This resulted in savings of $21,804 and $65,412 for the current reporting periods in 2003. For a more complete discussion of the effects of Standard No. 142, including the potential future impact of goodwill impairment assessments, please refer to Note 6 in the accompanying financial statements.

As a result of our focus on developing a record number of new products this fiscal year, research and development expenses during the quarter ended March 31, 2003 increased 58% to $271,344, compared to $171,891 in the quarter ended March 31, 2002. R&D expenses during the nine months ended March 31, 2003 increased 46% to $725,426 compared to $497,981 for the same period in 2002. Our increased R&D efforts are allowing us to introduce several new high-tech products such as the Solaris Series product line featuring low-power laser and light therapy capability and low-tech products such as powered therapy tables and proprietary cold packs. R&D expenses are expected to peak in the fourth quarter of the current fiscal year and then begin to decline each quarter thereafter.

Pre-tax profit for the quarter ended March 31, 2003 was $37,636 compared to $132,759 during the same period of the prior year. Pre-tax profit for the nine months ended March 31, 2003 was $294,176 compared to $368,073 in the same period in 2002. The large increase in R&D expenses was the primary reason for decreased profits for the quarter and nine-month periods in 2003.

Income tax expense for the three months ended March 31, 2003 was $14,383 compared to $49,837 in the three months ended March 31, 2002. The effective tax rate for the quarter ended March 31, 2003 was 38.2% compared to 37.5% in the quarter ended March 31, 2002. Income tax expense for the nine months ended March 31, 2003 was $113,151 compared to $141,787 in the nine months ended March 31, 2002. The effective tax rate for the nine months ended March 31, 2003 and 2002 was 38.5%.

Net income for the quarter ended March 31, 2003, was $23,253 (approximately $.00 per share), compared to $82,922 (approximately $.01 per share) in the same quarter in 2002. Net income for the nine months ended March 31, 2003, was $181,025 (approximately $.02 per share), compared to $226,286 (approximately $.03 per share) during the nine months ended March 31, 2002. The decline in net income per share is due primarily to increased R&D expense during the current period. We expect the heavy R&D expenditures associated with the new product introductions will fuel increased sales and profits in the coming quarters.

Liquidity and Capital Resources

The Company has financed its operations through available borrowings under its credit line facility and from cash provided by operations. The Company had working capital of $5,632,072 at March 31, 2003, inclusive of the current portion of long-term obligations and credit facilities, as compared to working capital of $5,484,168 at June 30, 2002. The increase in working capital is primarily attributable to the increased turns on inventories and the continued

profitability from operations.

Management has focused over the past year on the reduction of inventory and accounts receivable, which have a combined decrease of over $800,000 from March 31, 2002 to March 31, 2003. These improvements, together with other cash flows generated from operations, helped reduce the outstanding balance on our line of credit facility from $2.5 million to $1.4 million during the past year. As a result, interest expense was reduced by approximately $24,500 during the quarter ended March 31, 2003.

We expect that cash flows from operations, together with amounts available under an existing bank line of credit will be adequate to meet working capital needs related to our business and planned capital expenditures for the next 12 months.

The current ratio at March 31, 2003 and June 30, 2002 was 2.9 to 1. Current assets represent 66% of total assets at March 31, 2003.

Net accounts receivable at March 31, 2003 were $3,102,706 compared to $3,156,436 at June 30, 2002. The days of net sales outstanding in accounts receivable improved to 67 days at March 31, 2003 compared to 71 days at June 30, 2002. Accounts receivable are mostly from the dealer network and are generally considered to be within term.

All accounts payable are within term. We continue to take advantage of available early payment discounts when offered.

We maintain a revolving line of credit facility with a commercial bank in the amount of $4,500,000. Borrowing limitations are based on 30% of eligible inventory and up to 80% of eligible accounts receivable. The outstanding balance on the line of credit at March 31, 2003 was $1,411,176 compared to $1,435,689 at June 30, 2002. The line of credit is secured by inventory and accounts receivable and bears interest at the bank's prime rate, which was 4.25% per annum at March 31, 2003. This line is subject to annual renewal and matures on December 1, 2003. Accrued interest is payable monthly.

Inventory levels, net of reserves, totaled $4,244,445 at March 31, 2003, compared to $3,836,751 at June 30, 2002. The increase in inventory levels is primarily related to the timing of purchases of overseas manufactured components as well as a planned build up of 50 Series Plus products to carry through several months while manufacturing focuses on the new Solaris Series product line. We expect inventory levels will increase moderately in future quarters as the new products, including the Solaris product line, are introduced.

Long-term debt excluding current installments totaled $1,816,171 at March 31, 2003, compared to $1,950,309 at June 30, 2002. Long-term debt is comprised primarily of the mortgage loans on our office and manufacturing facilities in Utah and Tennessee. The principal balance on the mortgage loans is approximately

$1.8 million with monthly principal and interest payments of $21,409.

Critical Accounting Policies

We have identified the policies below as critical to our business operations and the understanding of our results of operations. The impact and any risks related to these policies on our business operations are discussed in Management's Discussion and Analysis or Plan of Operations where such policies affect our reported and expected financial results. For a detailed discussion of the

application of these and other accounting policies, see Notes to the Financial Statements (Note 1) included in our Annual Report on Form 10-KSB for the year ended June 30, 2002. In all material respects, the accounting principles that are utilized conform to generally accepted accounting principles in the United States of America.

The preparation of this quarterly report on Form 10-QSB requires us to make significant estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. By their nature, these judgments are subject to an inherent degree of uncertainty. On an on-going basis, we evaluate these estimates, including those related to bad debts, inventories, intangible assets, warranty obligations, product liability, revenue, and income taxes. We base our estimates on historical experience and other facts and circumstances that are believed to be reasonable, and the results form the basis for making judgments about the carrying value of assets and liabilities. The actual results may differ from these estimates under different assumptions or conditions.

Inventory Reserves

The nature of our business requires that we maintain sufficient inventory on hand at all times to meet the requirements of our customers. We record finished goods inventory at the lower of standard cost, which approximates actual costs (first-in, first-out) or market. Raw materials are stated 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; and
- Technological innovations.

Any modifications to estimates of inventory valuation reserves are reflected in the cost of goods sold within the statements of income during the period in which such modifications are determined necessary by management. At March 31, 2003 and June 30, 2002, our inventory valuation reserve balance was $445,176 and $265,692, respectively and our inventory balance was $4,244,445 and $3,836,751 net of reserves, respectively.

15

Revenue Recognition

Our products are sold primarily through a network of independent distributors. Sales revenues are generally recorded when products are shipped under an agreement with a distributor or customer, risk of loss and title have passed and collection of any resulting receivable is reasonably assured. The distributors, who sell the products to other customers, take title to the products, have no special rights of return, and assume the risk for credit and obsolescence.

Allowance for Doubtful Accounts

We must make estimates of the collectibility of accounts receivable. In doing so, we analyze accounts receivable and historical bad debts, 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 $3,102,706 and $3,156,436, net of allowance for doubtful accounts of $187,156 and $165,763, at March 31, 2003 and June 30, 2002, respectively.

Business Plan

Over the past five years, Dynatronics' annual net sales have grown 60 percent from $10.2 million in fiscal year 1997 to $16.3 million in fiscal year 2002. During fiscal year 2003, we are focusing our efforts on fueling and sustaining future growth through the introduction of several new products for the rehabilitation markets while, at the same time, strengthening our channels of distribution and improving operating efficiencies.

To enhance our position in the core physical medicine market, we have introduced several new products this fiscal year and plan to introduce more new products before the end of calendar 2003, including a low-power laser accessory to the Solaris Series devices. In the early 1980's we attempted to gain FDA approval for a low-power laser device, but were unsuccessful. At that time the laser device was the only product we offered - a fact reflected in the original name of the Company, Dynatronics Laser Corporation. When we were unable to obtain approval for the low-power laser device, we began pursuing the development of other physical medicine modalities and subsequently changed our name to Dynatronics Corporation.

A recent change in the regulatory landscape now allows the introduction of low-power laser devices for the treatment of pain. We plan to first introduce an infrared light therapy accessory device in conjunction with the new Solaris Series line of advanced technology electrotherapy/ ultrasound products. This new product line is expected to quickly become our top selling line. By the end of June 2003, we expect to have submitted to FDA an application for approval of a low power laser accessory to the Solaris Series products.

As a result of our concentrated R&D effort, we will incur more research and development expense in fiscal year 2003 than at any time since the early days of seeking FDA approval for our first low-power laser product. All of these efforts are designed to increase market share and improve profitability in the coming years.

As part of this year's R&D campaign, we introduced the Dynatron STSi combination therapy device in November 2002. This device provides our STS chronic pain treatment technology together with our interferential therapy for treating patients with acute pain.

In a research study published in the January, 2002 edition of the American Journal of Pain Management, test results showed 85% of STS-treated patients suffering pain associated with peripheral neuropathies realized some reduction of pain, with 50% of the patients becoming totally pain-free. We believe that the fact these results were achieved with patients who had suffered on average for eight years with their chronic pain condition further attests to the effectiveness of this therapy.

As with many new medical therapies or technologies, insurance reimbursement may influence the rate of growth of the STS technology. Presently, limited reimbursement is available for STS treatments or home units. Most are reviewed

on a case-by-case basis. However, as medical practitioners experience positive outcomes and further research supports the efficacy of this therapy, it is anticipated that reimbursements will be more broadly established. It will take time, perhaps years, to obtain broad acceptance and reimbursement for this new therapy. While the potential for a non-invasive, non-addictive, safe alternative for the treatment of chronic pain would seem to be vast, the realities of accessing that market will demand vigilance over the coming years to fully exploit that potential.

R&D efforts have not been limited to high tech products alone. In the prior quarter, Dynatronics introduced new, more price competitive powered therapy tables. Demand for these tables quickly outstripped supply and by January 2003, these tables were on backorder. Increased manufacturing efforts have now eliminated that backlog and are now keeping up with demand. In addition, Dynatronics will introduce a new line of proprietary cold packs before the end of fiscal year 2003. These new cold packs will be higher quality than the packs previously purchased from another vendor and will carry better gross margins.

Going forward, we will continue to strengthen our manufacturing capabilities with the goal of improving margins and competitive pricing capability. To that end, some products previously contracted to other manufacturers are being converted to in-house manufacturing. Other products are being contracted for overseas manufacturing or moved to more competitive domestic manufacturers.

Another important part of our strategic plan is the expansion of worldwide marketing efforts. In March 2001, our Salt Lake operation, where all electrotherapy, ultrasound, STS devices and Synergie products are manufactured, was designated an ISO 9001 certified facility. That certification was renewed in July 2002. With this designation, we can market products manufactured in this facility in any country that recognizes the CE Mark. We are now working to establish effective distribution of these products in the European Community.

We continue efforts to promote our line of aesthetic products. Controlling and expanding the channels of distribution for these products is expected to ultimately increase sales of these high margin products and allow us to more fully access the potential of the aesthetics products market. We perceive this market to be both lucrative and expanding, particularly as aging baby boomers continue to look for ways to retain a youthful appearance. Despite the expansion

of the beauty and spa market, this is a segment of our business that seems to be more directly impacted by general economic slow down as spa and beauty services are the purchased with discretionary dollars not as readily available in slower economic times.

Over the past two years, we have undertaken to improve the appearance and application of our corporate website and are researching ways to apply electronic media and Internet solutions to better serve customer needs, access new business opportunities, reduce cost of operations, and stay technologically current in the way business is conducted. Our website may be viewed at www.dynatronics.com. This reference to our website is not intended to incorporate the contents of the website into or as a part of this report.

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

- Reinforce our position in the physical medicine market through an aggressive research and development campaign that will result in

the introduction of several more new products over the coming six months.

- Continue implementation of our Back to Basics program, which evaluates ways to improve margins and competitive pricing through strategic manufacturing processes and alliances as well as controlling expenses.

- Maximize sales of the Dynatron STS technology in the face of limited reimbursement and better educate the medical and insurance communities on the efficacy of STS treatments.

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

- Expand distribution of both rehabilitation and aesthetic products internationally.

- Apply e-commerce solutions to improving overall performance.

Cautionary Statement Concerning Forward-Looking Statements

The statements contained in this report on Form 10-QSB that are not purely historical are "forward-looking statements" within the meaning of Section 21E of the Securities Exchange Act. These statements refer to our expectations, hopes, beliefs, anticipations, commitments, intentions and strategies regarding the future. They may be identified by the use of the words or phrases "believes," "expects," "anticipates," "should," "plans," "estimates," "intends," and "potential," among others. Forward-looking statements include, but are not limited to, statements contained in Management's Discussion and Analysis or Plan of Operation regarding product development, clinical results, market acceptance, financial performance, revenue and expense levels in the future and the sufficiency of its existing assets to fund future operations and capital spending needs. Actual results could differ materially from the anticipated results or other expectations expressed in such forward-looking statements for the reasons detailed in our Annual Report on Form 10-KSB under the headings "Description of Business" and "Risk Factors." The fact that some of the risk

factors may be the same or similar to past reports filed with the Securities and Exchange Commission means only that the risks are present in multiple periods. We believe that many of the risks detailed here and in our other SEC filings are part of doing business in the industry in which we operate and compete and will likely be present in all periods reported. The fact that certain risks are endemic to the industry does not lessen their significance.

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

- Market acceptance of our technologies, particularly our core therapy devices, Synergie AMS/MDA product line, Dynatron STS products, and the new Solaris, laser and light therapy products;

- The ability to hire and retain the services of trained personnel at cost-effective rates;
- Rigorous government scrutiny or the possibility of additional government regulation of the industry in which we market our products;
- Reliance on key management personnel;
- Foreign government regulation of our products and manufacturing practices that may bar or significantly increase the expense of expanding to foreign markets;
- Economic and political risks related to expansion into international markets;
- Failure to sustain or manage growth including the failure to continue to develop new products or to meet demand for existing products;
- Reliance on information technology;
- The timing and extent of research and development expenses;
- The ability to keep pace with technological advances, which can occur rapidly;
- The loss of product market share to competitors;
- Potential adverse effect of taxation;
- The potential continued spread of the SARS outbreak which may affect overseas sales as well as overseas manufacturing;
- Continued terrorist attacks on U.S. interests and businesses; and

- The ability to obtain required financing to meet changes or other risks described above.

Item 3. Controls and Procedures.

Based on their evaluation, as of a date within 90 days of the filing date of this Form 10-Q, our Chief Executive Officer and principal accounting officer have concluded that our disclosure controls and procedures (as defined in Rule 13a-14(c) and 15d-14(c) under the Securities Exchange Act of 1934, as amended) are effective. There have been no significant changes in internal controls or in other factors that could significantly affect these controls subsequent to the date of their evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

PART II. OTHER INFORMATION

Item 5. Other Information.

Nasdaq Listing Maintenance Requirements. On July 29, 2002, we received notice from The Nasdaq Stock Market that for 30 trading days the price of our common stock had closed below the minimum $1.00 per share bid price required for continued listing on the Nasdaq SmallCap Market by Marketplace Rule 4450(a)(5). Under Marketplace Rule 4450(c)(2), we will be provided approximately five quarters, or until October 27, 2003, to regain compliance with the $1.00 minimum bid price requirement. We can regain compliance with the minimum bid price requirement if, at any time before October 27, 2003, the bid price of our common stock closes at $1.00 per share or more for a minimum of 10 consecutive trading days. Should we fail to regain compliance, Nasdaq stated that it would provide us with written notification that our common stock will be delisted from the Nasdaq SmallCap Stock Market. Removal of our common stock from listing on the Nasdaq Stock Market would likely have an adverse impact on the trading price and liquidity of our common stock.

Retirement of Joseph H. Barton. Effective May 9, 2003, Joseph H. Barton, a director and member of the Company's audit and compensation committees, announced his retirement and resignation from the Board of Directors. Under the Bylaws of the Company, the Board of Directors has the power to appoint a replacement to serve the remainder of Mr. Barton's term, which would ordinarily continue until the annual meeting of shareholders, scheduled to be held in November 2003. As of the date of this report the Board had not taken any action to replace Mr. Barton.

Item 6. Exhibits and Report on Form 8-K.

(a) Exhibits

99.1 Certifications Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(b) Reports on Form 8-K. None.

SIGNATURES

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

DYNATRONICS CORPORATION
Registrant

Date 5/14/03

/s/ Kelvyn H. Cullimore, Jr.

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

Date 5/14/03 /s/ Terry M. Atkinson

Terry M. Atkinson
Controller
(Chief Accounting Officer)

21

CERTIFICATIONS

I, Kelvyn H. Cullimore, Jr. certify that:

1. I have reviewed this quarterly report on Form 10-QSB of Dynatronics Corporation;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:

a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the

registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: May 14, 2003

/s/ Kelvyn H. Cullimore, Jr.

Kelvyn H. Cullimore, Jr.
President and Chief Executive Officer

I, Terry M. Atkinson certify that:

1. I have reviewed this quarterly report on Form 10-QSB of Dynatronics Corporation;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:

a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the

equivalent function):

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls

subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: May 14, 2003

/s/ Terry M. Atkinson

Terry M. Atkinson
Controller
(Chief Accounting Officer)