DYNATRONICS CORP
Form 10-Q
May 16, 2011

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

FORM 10-Q

(Mark One)

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2011

or

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _________ to _________

Commission File Number: 0-12697

Dynatronics Corporation
(Exact name of registrant as specified in its charter)

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

7030 Park Centre Drive, Cottonwood Heights, UT 84121
(Address of principal executive offices, Zip Code)

(801) 568-7000
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. [X] Yes [ ] No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). [ ] Yes [ ] No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer [ ]   Accelerated filer [ ]

Non-accelerated filer [ ]   Smaller reporting company [X]
(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). [ ] Yes [X] No

The number of shares outstanding of the registrant's common stock, no par value, as of May 9, 2011 is 13,074,774.

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DYNATRONICS CORPORATION
Condensed Consolidated Balance Sheets
(Unaudited)

	March 31, 2011	June 30, 2010
Assets		
Current assets:		
Cash and cash equivalents	$ 248,202	383,756
Trade accounts receivable, less allowance for doubtful accounts of $321,779 as of March 31, 2011 and $254,664 as of June 30, 2010	3,882,665	3,735,251
Other receivables	15,161	70,919
Inventories, net	5,549,503	5,766,800
Prepaid expenses and other	292,335	262,577
Prepaid income taxes	32,553	-
Current portion of deferred income tax assets	464,337	390,510
Total current assets	10,484,756	10,609,813
Property and equipment, net	3,560,245	3,561,271
Intangible assets, net	390,153	452,558
Other assets	297,293	314,790
Deferred income tax assets, net of current portion	-	151,897
Total assets	$ 14,732,447	15,090,329
Liabilities and Stockholders' Equity		
Current liabilities:		
Current portion of long-term debt	$ 365,278	381,841
Line of credit	2,664,663	2,768,492
Warranty reserve	186,022	186,022
Accounts payable	1,563,154	1,404,022
Accrued expenses	508,613	462,641
Accrued payroll and benefits expense	364,004	427,326
Income and franchise tax payable	-	55,936
Total current liabilities	5,651,734	5,686,280
Long-term debt, net of current portion	2,329,481	2,604,772
Deferred income tax liability	113,633	-
Total liabilities	8,094,848	8,291,052
Commitments and contingencies		
Stockholders' equity:		
Common stock, no par value: Authorized 50,000,000 shares; issued 13,341,832 shares as of March 31, 2011 and 13,591,152 shares as of June 30, 2010	7,508,460	7,872,250
Accumulated deficit	(870,861)	(1,072,973)
Total stockholders' equity	6,637,599	6,799,277

Total liabilities and stockholders' equity	$ 14,732,447	15,090,329

See accompanying notes to condensed consolidated financial statements.

DYNATRONICS CORPORATION
Condensed Consolidated Statements of Income
(Unaudited)

	Three Months Ended March 31		Nine M
	2011	2010	2011
Net sales	$ 8,383,842	8,235,060	24,502,4
Cost of sales	5,159,450	5,119,797	15,156,8
Gross profit	3,224,392	3,115,263	9,345,6
Selling, general and administrative expenses	2,640,053	2,647,417	7,774,8
Research and development expenses	339,258	222,062	1,045,5
Operating income	245,081	245,784	525,2
Other income (expense):			
Interest income	10,735	1,986	14,8
Interest expense	(70,964)	(99,947)	(224,4
Other income, net	9,985	13,082	21,9
Net other expense	(50,244)	(84,879)	(187,6
Income before income tax provision	194,837	160,905	337,6
Income tax provision	(77,577)	(64,806)	(135,5
Net income	$ 117,260	96,099	202,1
Basic and diluted net income per common share	$ 0.01	0.01	0.
Weighted-average basic and diluted common shares outstanding:			
Basic	13,419,612	13,606,888	13,413,6
Diluted	13,457,483	13,638,340	13,428,3

See accompanying notes to condensed consolidated financial statements.

DYNATRONICS CORPORATION
Condensed Consolidated Statements of Cash Flows
(Unaudited)

	Nine Months Ended March 31 2011	2010
Cash flows from operating activities:		
Net income	$ 202,112	353,022
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of property and equipment	270,820	217,001
Amortization of intangible assets	62,405	66,984
Stock-based compensation expense	37,096	38,547
Change in deferred income tax assets	191,703	19,101
Provision for doubtful accounts receivable	81,000	81,000
Provision for inventory obsolescence	60,000	90,000
Change in operating assets and liabilities:		
Receivables	(172,656)	57,307
Inventories	157,297	374,671
Prepaid expenses and other assets	(65,625)	22,263
Accounts payable and accrued expenses	141,782	(186,315)
Income tax payable	(35,125)	269,290
Net cash provided by operating activities	930,809	1,402,871
Cash flows from investing activities:		
Capital expenditures	(269,794)	(236,979)
Net cash used in investing activities	(269,794)	(236,979)
Cash flows from financing activities:		
Proceeds from issuance of long-term debt	-	18,630
Principal payments on long-term debt	(291,854)	(248,960)
Net decrease in line of credit	(103,829)	(713,086)
Redemption of common stock	(400,886)	(97,378)
Net cash used in financing activities	(796,569)	(1,040,794)
Net change in cash and cash equivalents	(135,554)	125,098
Cash and cash equivalents at beginning of period	383,756	141,714

Cash and cash equivalents at end of period	$ 248,202	266,812
Supplemental disclosures of cash flow information:		
Cash paid for interest	$ 225,858	352,958
Cash paid for income and franchise taxes	51,517	9,241
Supplemental disclosure of non-cash investing and financing activities:		
Capital lease obligations incurred for property and equipment	-	102,313

See accompanying notes to condensed consolidated financial statements.

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DYNATRONICS CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 1. PRESENTATION

The condensed consolidated balance sheets as of March 31, 2011 and June 30, 2010, the condensed consolidated statements of income for the three and nine months ended March 31, 2011 and 2010, and the condensed consolidated statements of cash flows for the nine months ended March 31, 2011 and 2010 were prepared by Dynatronics Corporation (the "Company") without audit pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). Certain information and disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles 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 Company's financial position, results of operations and cash flows. The results of operations for the three and nine months ended March 31, 2011 are not necessarily indicative of the results of operations for the fiscal year ending June 30, 2011. The Company has previously filed with the SEC an annual report on Form 10-K which included audited financial statements for each of the two years ended June 30, 2010 and 2009. It is suggested that the financial statements contained in this Form 10-Q be read in conjunction with the financial statements and notes thereto contained in the Company's most recent Form 10-K.

NOTE 2. NET INCOME PER COMMON SHARE

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

Basic net income per common share is the amount of net income for the period available to each weighted-average 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 weighted-average share of common stock outstanding during the reporting period and to each common stock equivalent

outstanding during the period, unless inclusion of common stock equivalents would have an anti-dilutive effect.

The reconciliations between the basic and diluted weighted-average number of common shares outstanding for the three and nine months ended March 31, 2011 and 2010 are as follows:

	Three Months Ended March 31		Nine M Ma
	2011	2010	2011
Basic weighted-average number of common shares outstanding during the period	13,419,612	13,606,888	13,413,6
Weighted-average number of dilutive common stock options outstanding during the period	37,871	31,452	14,7
Diluted weighted-average number of common and common equivalent shares outstanding during the period	13,457,483	13,638,340	13,428,3

Outstanding options for common shares not included in the computation of diluted net income per common share, because they were anti-dilutive, for the three-month periods ended March 31, 2011 and 2010 totaled 781,120 and 753,748, respectively, and for the nine-month periods ended March 31, 2011 and 2010 totaled 868,178 and 900,810, respectively.

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NOTE 3. STOCK-BASED COMPENSATION

Stock-based compensation cost is measured at the grant date, based on the estimated fair value of the award, and is recognized over the employee's requisite service period. The Company recognized $13,020 and $12,863 in stock-based compensation expense during the three months ended March 31, 2011 and 2010, respectively, and recognized $37,096 and $38,547 in stock-based compensation expense during the nine months ended March 31, 2011 and 2010, respectively. These expenses were recorded as selling, general and administrative expenses in the condensed consolidated statements of income.

Stock Options. The Company maintains a 2005 equity incentive plan for the benefit of employees. Incentive and nonqualified stock options, restricted common stock, stock appreciation rights, and other share-based awards may be granted under the plan. Awards granted under the plan may be performance-based. As of March 31, 2011, there were 787,595 shares of common stock authorized and reserved for issuance, but not granted under the terms of the 2005 equity incentive plan, as amended.

The following table summarizes the Company's stock option activity during the nine-month period ended March 31, 2011.

	Number of Options	Weighted-Average Exercise Price

Outstanding at beginning of period	932,805	$ 1.32
Granted	83,444	.85
Exercised	-	-
Cancelled	(32,628)	.85
Outstanding at end of period	983,621	1.31
Exercisable at end of period	542,336	1.65

The Black-Scholes option-pricing model is used to estimate the fair value of options granted under the Company's stock option plan. The weighted-average fair values of stock options granted under the plan for the nine months ended Mach 31, 2011 and 2010 were based on the following assumptions at the date of grant as follows:

	Nine Months Ended March 31,	
	2011	2010
Expected dividend yield	0%	0%
Expected stock price volatility	60 - 64%	58 - 59%
Risk-free interest rate	2.50 - 3.43%	3.31 - 3.72%
Expected life of options	10 years	10 years
Weighted-average grant date fair value	$ 0.53	$0.59

Expected option lives and volatilities are based on historical data of the Company. The risk-free interest rate is based on the U.S. Treasury Bills rate on the grant date for constant maturities that correspond with the option life. Historically, the Company has not declared dividends and there are no future plans to do so.

As of March 31, 2011, there was $99,736 of unrecognized stock-based compensation cost related to grants under the stock option plan that will be expensed over a weighted-average period of 4.4 years. There was $87,369 of intrinsic value for options outstanding as of March 31, 2011.

NOTE 4. COMPREHENSIVE INCOME

For the three and nine months ended March 31, 2011 and 2010, comprehensive income was equal to the net income as presented in the accompanying condensed consolidated statements of income.

NOTE 5. INVENTORIES

Inventories consisted of the following:

	March 31, 2011	June 30, 2010
Raw materials	$ 2,315,416	2,256,197
Finished goods	3,679,009	3,841,674
Inventory obsolescence reserve	(444,922)	(331,071)
	$ 5,549,503	5,766,800

NOTE 6. RELATED-PARTY TRANSACTIONS

The Company leases office and warehouse space in Girard, Ohio; Detroit, Michigan; Hopkins, Minnesota; and Pleasanton, California from four significant stockholders and former independent distributors on an annual basis under operating lease arrangements. Management believes the lease agreements are on an arms-length basis and the terms are equal to or more favorable than would be available to third parties. The expense associated with these related-party transactions totaled $57,000 and $51,300 for the three months ended March 31, 2011 and 2010, respectively, and $171,300 and $153,952 for the nine months ended March 31, 2011 and 2010, respectively.

NOTE 7. RECENT ACCOUNTING PRONOUNCEMENTS

Recent Accounting Pronouncements

In October 2009, the FASB issued Accounting Standards Update No. 2009-14 (FASB ASU 09-14), Certain Revenue Arrangements That Include Software Elements--a consensus of the FASB Emerging Issues Task Force, that reduces the types of transactions that fall within the current scope of software revenue recognition guidance. Existing software revenue recognition guidance requires that its provisions be applied to an entire arrangement when the sale of any products or services containing or utilizing software when the software is considered more than incidental to the product or service. As a result of the amendments included in FASB ASU 09-14, many tangible products and services that rely on software will be accounted for under the multiple-element arrangements revenue recognition guidance rather than under the software revenue recognition guidance. Under this new guidance, the following components would be excluded from the scope of software revenue recognition guidance: the tangible element of the product, software products bundled with tangible products where the software components and non-software components function together to deliver the product's essential functionality, and undelivered components that relate to software that are essential to the tangible product's functionality. FASB ASU 09-14 also provides guidance on how to allocate transaction consideration when an arrangement contains both deliverables within the scope of software revenue guidance (software deliverables) and deliverables not within the scope of that guidance (non-software deliverables). This guidance was effective for revenue arrangements entered into or materially modified in the fiscal year beginning on July 1, 2010. The adoption of this pronouncement had no significant effect on the Company's financial statements.

NOTE 8. SUBSEQUENT EVENTS

On April 13, 2011, the Company received notification from NASDAQ that Dynatronics Corporation had regained compliance with Listing Rule 5550(a)(2) since its stock price had been at $1.00 per share or greater for more than 10 consecutive days during the period March 30, 2011 through April 12, 2011.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Overview

Our principal business is the design, manufacture, marketing, distribution and sale of physical medicine and aesthetic products. We manufacture and distribute a broad line of medical equipment including therapy devices, medical supplies and soft goods, treatment tables and rehabilitation equipment. Our

physical medicine and rehabilitation products are sold to and used primarily by physical therapists, chiropractors, and sports medicine practitioners. Our line of aesthetic products includes aesthetic massage, microdermabrasion and light therapy devices, as well as skin care products. These products are sold to and used primarily by aestheticians, plastic surgeons, dermatologists, and other aesthetic services providers.

We have a fiscal year ending June 30. For example, reference to fiscal year 2011 refers to the year ending June 30, 2011.

Recent Developments

In January and February 2011, we announced the signing of contracts with three group purchasing organizations ("GPOs"): Premier, Inc., Amerinet and First Choice. A GPO is an entity formed by a group of businesses, primarily hospitals and integrated health care delivery networks, to leverage their collective purchasing power with vendors and service providers to obtain better pricing. These new contracts provide us access to tens of thousands of healthcare facilities across the United States that are members of these buying groups. We estimate that annual purchases of physical medicine products by members associated with these GPOs exceed $50 million. These contracts became effective March 1, 2011 and permit us to now solicit the business from the members of these GPOs. We expect sales under these contracts will begin to have an effect on revenues and net profits in the fourth quarter of fiscal year 2011 with the most material benefits coming in the next fiscal year beginning July 1, 2011.

Results of Operations

The following discussion and analysis of our financial condition and results of operations for the three and nine months ended March 31, 2011, should be read in conjunction with the condensed consolidated financial statements and notes thereto appearing in Part I, Item 1 of this report, and our Annual Report on Form 10-K for the year ended June 30, 2010, which includes our annual audited financial statements for the year then ended. Results of operations for the three and nine months ended March 31, 2011, are not necessarily indicative of the results that will be achieved for the full fiscal year ending June 30, 2011.

Net Sales

Net sales increased to $8,383,842 in the quarter ended March 31, 2011, compared to $8,235,060 in the quarter ended March 31, 2010. The 1.8% increase was reflective of increases with legacy customers. Although the GPO contracts began on March 1, 2011, they did not contribute materially to sales during this quarter. We did begin the process of introducing Dynatronics' branded products to GPO member facilities in March 2011. While the process of converting business to our brand will take time, management is optimistic about the potential of this new market for the Company.

Net sales for the nine months ended March 31, 2011 decreased 2.1% to $24,502,477, compared to $25,018,960 for the same period in 2010. The decrease in sales for the nine-month period is a reflection of lower sales of capital equipment during the first half of the fiscal year. This slight diminishment in sales of capital equipment is attributable to lower demand associated with ongoing general economic weakness. Historically, uncertain economic times limit growth and expansion that typically create the demand for capital equipment. Better comparative sales of capital equipment in the last three months may be an indicator that demand is increasing.

Gross Profit

Gross profit increased to $3,224,392, or 38.5% of net sales, in the quarter ended March 31, 2011, compared to $3,115,263, or 37.8% of net sales, in

the quarter ended March 31, 2010. The 3.5% increase in gross profit during the current quarter is the result of higher net sales discussed above, as well as the mix of sales favoring exercise and therapy equipment together with high-margin revenue from the Company's new Stream software service. We expect sales of higher margin capital equipment will increase along with a corresponding improvement in gross profit margins as product sales begin to GPO members and as general economic conditions improve in the United States. Gross profit was $9,345,666, or 38.1% of net sales, for the nine months ended March 31, 2011, compared to $9,621,982, or 38.5% of net sales, for the nine months ended March 31, 2010. This decline in gross profit for the nine-month period is due to the lower net sales in the period, as indicated above together with an increase in sales of non-capital medical supplies which carry lower gross margins as a percentage of sales compared to capital equipment products.

Selling, General and Administrative Expenses

Selling, general and administrative ("SG&A") expenses decreased $7,364 to $2,640,053, or 31.5% of net sales, in the quarter ended March 31, 2011, from $2,647,417, or 32.1% of net sales, in the quarter ended March 31, 2010. For the nine-month period ended March 31, 2011, SG&A expenses decreased $284,295, to $7,774,848, or 31.7% of net sales, compared to $8,059,143, or 32.2% of net sales, for the nine months ended March 31, 2010. The reduction in SG&A expenses in the third quarter of 2011 resulted from the following factors:

- $129,628 in lower selling expenses;
- $4,154 in lower general expenses.

These improvements were offset, in part, by $126,418 of higher labor, medical insurance and depreciation expenses in the period.

The following factors contributed to the reduction in SG&A expenses for the nine months ended March 31, 2011:

- $362,052 in lower selling expenses;
- $201,487 in lower general expenses primarily related to lower professional fees.

These lower expenses were offset, in part, by $279,244 of higher labor, medical insurance and depreciation expenses during the nine months ended March 31, 2011 compared with the same period in the prior fiscal year.

Research and Development Expenses

Research and development ("R&D") expenses increased 52.8% or $117,196 to $339,258, or 4.0% of sales, in the quarter ended March 31, 2011, compared to $222,062, or 2.7% of sales in the quarter ended March 31, 2010. R&D expenses increased $400,661, or 62.1%, to $1,045,573 for the nine months ended March 31, 2011, from $644,912 for the nine months ended March 31, 2010. We are developing a number of important new products that are expected to be introduced during calendar 2011 and early calendar 2012. These development efforts are directly responsible for the increase in R&D expenses. It is anticipated that R&D expenses will continue to exceed prior year levels for the next three quarters. We believe that developing new products is a key element in our growth strategy. R&D costs are expensed as incurred.

Income Before Income Tax Provision

Pre-tax income for the quarter ended March 31, 2011, increased 21.1% to $194,837 compared to $160,905 for the quarter ended March 31, 2010. We believe that generating a 21.1% increase in pre-tax income for the quarter ended March 31, 2011, despite the sizeable increase in R&D expense is indicative of the significant improvement in base operating results during the quarter. Pre-tax income also improved, in part, due to a $28,983 reduction in interest expense resulting from reducing borrowings on our line of credit by $1,200,000 over the past year.

Pre-tax income for the nine months ended March 31, 2011, totaled $337,615 compared to $612,881 for the nine months ended March 31, 2010. This reduction in pre-tax income for the nine-month period is due to lower net sales in the period as well as the significant increase in R&D expense related to our new products. We expect to bring those products to market by the end of calendar 2011 or early calendar 2012, which we expect will improve net sales.

Income Tax Provision

The income tax provision was $77,577 for the quarter ended March 31, 2011, compared to $64,806 for the quarter ended March 31, 2010. The income tax provision was $135,503 for the nine months ended March 31, 2011, compared to $259,859 for the nine months ended March 31, 2010. The effective tax rate for the third quarter of fiscal year 2011 was 39.8% compared to 40.3% for the same period in fiscal year 2010. The effective tax rate for the nine months ended March 31, 2011, was 40.1% compared to 42.4% for the prior year nine-month period. The difference in the effective tax rates is attributable to certain permanent book to tax differences. While these items are not significant, substantive changes in the tax rate can occur based on our level of profitability.

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Net Income

Net income increased 22.0% to $117,260 ($.01 per common share) in the quarter ended March 31, 2011, compared to $96,099 ($.01 per common share) in the quarter ended March 31, 2010. The increase in earnings for the quarter ended March 31, 2011 compared to the prior year period was a result of higher sales, improved gross profit margins, and lower interest expense. Management anticipates that the addition of business from the GPO contracts will increase net sales and profits in coming quarters.

Net income decreased to $202,112, or $.02 per common share, for the nine months ended March 31, 2011, compared to $353,022, or $.03 per common share, for the nine months ended March 31, 2010. The lower net income in the nine-month period was caused by lower net sales and increased R&D expense during the period, offset in part by improved gross profit margins, reduced SG&A expenses and lower interest expense. We expect that R&D expense will continue at present or higher levels over the next six to nine months as the development on new products is completed and the products are introduced to the market.

Liquidity and Capital Resources

We have financed operations through available cash reserves and borrowings under a line of credit with a bank. Working capital was $4,833,022 as of March 31, 2011, inclusive of the current portion of long-term obligations and credit facilities, compared to working capital of $4,923,533 as of June 30, 2010.

The current ratio held constant at 1.9 to 1 as of March 31, 2011, the same

level as of June 30, 2010. Current assets represented 71% of total assets as of March 31, 2011 and 70% of total assets as of June 30, 2010.

Accounts Receivable

Trade accounts receivable, net of allowance for doubtful accounts, increased $147,414, or 3.9%, to $3,882,665 as of March 31, 2011, compared to $3,735,251 as of June 30, 2010. 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 $217,297, or 3.8%, to $5,549,503 as of March 31, 2011, compared to $5,766,800 as of June 30, 2010. The amount of inventories we carry fluctuates each period. A main contributor to those fluctuations is inventory purchases from overseas suppliers which are typically larger purchases.

Accounts Payable

Accounts payable increased $159,132, or 11.3%, to $1,563,154 as of March 31, 2011, from $1,404,022 as of June 30, 2010. The increase in accounts payable is a result of the timing of our weekly payments to suppliers and the timing of purchases of product components. Accounts payable are generally not aged beyond the terms of our suppliers. We take advantage of available early payment discounts when offered by our vendors.

Cash and Cash Equivalents

Our cash and cash equivalents position as of March 31, 2011 was $248,202, a decrease of 35.3%, from cash of $383,756 as of June 30, 2010. Our cash position varies from quarter to quarter, but typically stays within a normal range of $150,000 to $400,000. We expect that cash flows from operating activities, together with amounts available through an existing line of credit facility, will be sufficient to cover operating needs in the ordinary course of business for at least the next twelve months. If we experience an adverse operating environment, including a further worsening of the general economy in the United States, or unusual capital expenditure requirements, additional financing may be required. No assurance can be given that additional financing, if required, would be available on terms favorable to us, or at all.

Line of Credit

The outstanding balance on our line of credit was $2,664,663 as of March 31, 2011, compared to $2,768,492 as of June 30, 2010. The current balance on the line of credit is approximately $3,500,000 below its highest point in fiscal year 2009 following the acquisition of six of our dealers in June and July 2007.

Interest on the line of credit is based on the 90-day LIBOR rate (0.30% as of March 31, 2011) plus 4%, with a minimum interest rate of 4.5%. The line of credit is collateralized by accounts receivable and inventories. Borrowing limitations are based on approximately 45% of eligible inventory and up to 80% of eligible accounts receivable, up to a maximum credit facility of $7,000,000.

Interest payments on the line are due monthly. As of March 31, 2011, the borrowing base was approximately $5,190,000, resulting in approximately $1,810,000 available on the line. The line of credit includes covenants requiring us to maintain certain financial ratios. As of March 31, 2011, we were in compliance with the loan covenants. The line of credit expires on December 15, 2012.

Debt

Long-term debt excluding current installments totaled $2,329,481 as of March 31, 2011, compared to $2,604,772 as of June 30, 2010. Long-term debt is comprised primarily of the mortgage loans on our office and manufacturing facilities in Utah and Tennessee. The principal balance on the mortgage loans is approximately $2,500,000 with monthly principal and interest payments of $46,304.

Inflation and Seasonality

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

While our business operations are not materially affected by seasonality factors, our fiscal first quarter which ends September 30th is typically a slower quarter due in part to practitioners taking summer vacations.

Critical Accounting Policies

This Management's Discussion and Analysis of Financial Condition and Results of Operations is based upon our condensed consolidated financial statements. 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.

The following critical accounting policies involve a high degree of judgment and complexity and require significant estimates and judgments used in the preparation of our condensed consolidated financial statements.

Inventory Reserves

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

- Current inventory quantities on hand;
- Product acceptance in the marketplace;
- Customer demand;
- Historical sales;
- Forecast sales;

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

Any modifications to estimates of inventory valuation reserves are reflected in the cost of goods sold within the statement of income during the period in which such modifications are determined necessary by management. As of March 31, 2011 and June 30, 2010, our inventory valuation reserve balance, which established a new cost basis, was $444,922 and $331,071, respectively, and our inventory balance was $5,549,503 and $5,766,800, net of reserves, respectively.

Revenue Recognition

Sales revenues are recorded when products are shipped, title has 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 $3,882,665 and $3,735,251, net of allowance for doubtful accounts of $321,779 and $254,664, as of March 31, 2011 and June 30, 2010, respectively.

Deferred Income Tax Assets

At each reporting date, our management performs an analysis of the deferred income tax assets and their recoverability. Based on several factors, including our strong earnings history of pre-tax profit averaging over $500,000 per year in 18 of the last 21 fiscal years, we believe that it is more likely than not that all of the net deferred income tax assets will be realized. During fiscal year 2010, $501,465 of the deferred income tax assets were utilized to carry back against profits from 2004 and 2005, reducing the deferred income tax asset by 39%.

Business Plan and Outlook

In January and February 2011, we announced the signing of contracts with three GPOs: Premier, Inc., Amerinet and First Choice. These GPOs represent tens of thousands of clinics and hospitals around the nation. With the broader offering of products now available through our catalog and e-commerce website, we are better able to compete for this high volume business. Over the past two years, we have also seen success in becoming the preferred vendor to many national and regional accounts. We believe these contract signings represent important milestones toward our goal of expanding our customer base and increasing our market share.

The contracts with the GPOs represent a license to solicit business directly from the members of the respective GPOs. The GPOs do not order any product directly. They serve the function of negotiating favorable pricing terms on behalf of their members. Most GPO members are loyal to the GPOs in which they

have membership and will not typically consider vendors that are not on contract.

Our contract with Premier, Inc. is to provide products to their members in the "Colleges and Universities and Alternate Markets" category. We expect to realize broader benefits under the agreement, however, as our involvement with the GPO generally will expose our products to all of the GPO's "Healthcare" category members, which we anticipate will create interest and possibilities for additional business. Several Premier Healthcare members are negotiating contracts with us directly to obtain access to our products. Amerinet has placed us on contract for capital equipment, available to all their membership. Capital equipment typically includes non-commodity products over $150 in price. While we are welcome to solicit supply type business from Amerinet customers, we are not under contract to do so. Our contract with First Choice covers all products that we offer. These three contracts present us with significant opportunities for increasing sales that have previously been unavailable to us. Cultivating business through these GPO contracts and seeking additional contracts with other GPOs will be a major focal point for us in the coming year.

In December 2010, we introduced to the physical medicine market a new electronic patient communications platform called Stream. Stream is an automated service that leverages the latest technologies to connect practitioners with their patients via e-mail, text messaging and social networking tools to provide state-of-the-art communications and marketing tools for practitioners. The system reduces patient "no shows," reactivates past patients and generates new patients. In addition, it provides a wide range of analytics and delivers automated appointment reminders - all while improving staff efficiency. The launch of this product has been slower than expected, but the reviews from those who are using the product are mostly very favorable. The continued development of Stream represents an opportunity to significantly improve overall gross margins and profitability for the Company as each sale creates a recurring monthly revenue stream. Our efforts over the next year to work with our partner, Smile Reminder, to refine the presentation and implementation of this very unique and valuable service will be critical to significantly realizing the full potential of this program.

Over the past few years, consolidations in our market have changed the landscape of our industry's distribution channels. At the present time, we believe that there remain only two companies with a national direct sales force selling proprietary and distributed products: Dynatronics and Patterson Medical (through its Sammons Preston subsidiary). All other distribution in our market is directed through catalog companies with no direct sales force, or through independent local dealers. However, the network of local independent dealers is rapidly diminishing due to consolidation in the market and the resulting increased competition from Dynatronics, Sammons Preston and catalog companies. In the past year, we have reinforced our direct sales team to include over 50 direct sales employees and independent sales representatives. In addition to these direct sales representatives, we continue to enjoy a strong relationship with scores of local dealers. We believe we have the best trained and most knowledgeable sales force in the industry. The recent changes within our market provide a unique opportunity for us to grow market share in the coming years through recruitment of high-quality sales representatives and dealers.

To further our efforts to recruit high-quality direct sales representatives and dealers as well as to better appeal to the large GPOs and national customers, we intend to continue to improve efficiencies of our operations and the sales support for the industry. Chief among the steps we are

taking to make these improvements was the introduction of our first true e-commerce solution on July 6, 2010. With the introduction of this e-commerce solution, customers are able to more easily place orders and obtain information about their accounts. Sales representatives are increasing their effectiveness with the abundance of information available to them electronically through our e-quote system which is a companion to the e-commerce solution introduced. Not only is our e-commerce solution easy and efficient to use, it should also facilitate reducing transactional costs thus enabling us to accommodate higher sales without significantly increasing overhead.

The passage in 2010 of the Patient Protection and Affordable Care Act along with the Health Care and Educational Reconciliation Act will affect our future operations. The addition of millions to the rolls of the insured will increase demand for services. That increased demand is expected to lead to increased sales of our products. The magnitude of those increases is difficult to assess at this time. A negative impact of this legislation as enacted is its imposition of an excise tax on all manufacturers of medical devices. Our current estimate is that this tax would exceed $500,000 annually for Dynatronics, barring a change in the statute. Because of the phase-in of various provisions in the legislation, the full effects on our business and industry are not expected to be felt until 2013 at the earliest. This makes it difficult to project the full impact this legislation will have on our business in future periods. There is also a possibility that future Congresses will amend the legislation prior to it becoming fully effective. In addition, rule-making under the law is not yet complete. In the meantime, we are working to take full advantage of every opportunity presented by this legislation to increase sales and to offset any negative effects that may accompany those opportunities.

We continue to focus research and development efforts on new product innovation and enhancing existing products. Several products are currently under development and are scheduled for introduction in the latter part of calendar 2011. The commitment to innovation of high-quality products has been a hallmark of Dynatronics and will continue throughout the coming year. This renewed emphasis on R&D has reduced profits during the current fiscal year as R&D costs are expensed as incurred. Through the first three quarters of fiscal year 2011, we have incurred $400,000 more in R&D expenses than in the same period in fiscal year 2010, which contributed in large part to lower profitability in the period. R&D costs for us have been cyclical in nature. The current higher R&D costs are reflective of the fact we are in a more intense part of the development cycle. Once the new products are introduced, R&D costs are expected to cycle back to a lower level until the next new products are further advanced in the development cycle. Management is confident the short term costs associated with the more intense part of the development cycle will yield long-term benefits and are important to assuring that we maintain our reputation for being an innovator and leader in product development in the industry.

Economic pressures from the recent recession in the United States have affected available credit that would facilitate large capital purchases, and have also reduced demand for discretionary services such as those provided by the purchasers of our aesthetic products. As a result, we trimmed back our expenses in the Synergie division. The Synergie Elite aesthetic product line introduced in April 2008 continues to have appeal due to its design and price point. We believe that our aesthetic devices remain the best value on the market and we are seeking innovative ways to market these products, including strategic partnerships, both domestic and international, to help regain sales momentum. As the economy begins to improve, we expect to see increased sales of these higher margin products.

We have long believed that international markets present an untapped

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

Refining our business model for supporting sales representatives and distributors also will be a focal point of operations. We will continue to evaluate the most efficient ways to maintain our satellite sales offices and warehouses. In addition, more emphasis is being placed on pricing management to protect margins for both manufactured and distributed products. The ongoing refinement of this model is expected to yield further efficiencies that will better achieve sales goals while at the same time reduce expenses.

With the sale of our manufactured capital equipment being the largest contributor to margin generation, we have placed renewed emphasis on improving manufacturing operations, including considering more offshore manufacturing of components as well as streamlining manufacturing operations in Utah and Tennessee. Past experience has shown that when recessionary pressures start to subside, there has been a pent up demand for capital equipment which can be significant. Our recent efforts to prudently reduce costs during the difficult times have made us a leaner operation and well positioned for a continued ramp up in demand.

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

- Improving sales by pursuing business opportunities with GPOs and large chains of clinics, including national and regional accounts.

- Pursuing opportunities to introduce the Stream software service to large groups of clinics and buying groups in addition to making it available to individual practitioners.

- Reinforcing distribution through a strategy of recruiting direct sales representatives and working closely with the most successful distributors of capital equipment.

- Using our first e-commerce solution in order to facilitate business opportunities and reduce transactional costs.

- Significantly improving operational efficiencies by lowering manufacturing and transactional costs, automating processes, redefining policies and procedures and working to make every customer a profitable customer.

- Strengthening pricing management and procurement methodologies.

- Minimizing expense associated with the Synergie product line until the economy improves and demand for capital equipment re-emerges, and, in the meantime, seeking additional independent distributors and strategic partnerships.

- Focusing international sales efforts on identifying key distributors and strategic partners who could represent the Company's product line, particularly in Europe.

- Continuing development of new state-of-the-art products, both high-tech and commodity, in fiscal year 2011, for both the rehabilitation and aesthetic markets.

- Exploring strategic business alliances that will leverage and complement our competitive strengths, increase market reach and supplement capital resources.

Cautionary Statement Concerning Forward-Looking Statements

The statements contained in this Form 10-Q, particularly the foregoing discussion in Part I, Item 2, Management's Discussion and Analysis of Financial Condition and Results of Operations, that are not purely historical, are "forward-looking statements" within the meaning of Section 21E of the 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 words or phrases such as "believes," "expects,"

"anticipates," "should," "plans," "estimates," "intends," and "potential," among others. Forward-looking statements include, but are not limited to, statements regarding product development, market acceptance, financial performance, revenue and expense levels in the future and the sufficiency of 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. 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, except as required by law.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We are exposed to various market risks. Market risk is the potential risk of loss arising from adverse changes in market prices and rates. We do not enter into derivative or other financial instruments for trading or speculative purposes. There have been no material changes in our market risk during the quarter ended March 31, 2011, although the general weakness in the U.S. economy is expected to lead to greater discounting market-wide to stimulate sales in a declining economic environment. In addition, further weakening of the economy could result in greater risks of collections of accounts receivable.

Our primary market risk exposure is interest rate risk. As of March 31, 2011, approximately $3,829,000 of our debt bore interest at variable rates. Accordingly, our net income is affected by changes in interest rates. For every one hundred basis point change in the average interest rate under our existing debt, our annual interest expense would change by approximately $38,290.

In the event of an adverse change in interest rates, we could take actions to mitigate our exposure. However, due to the uncertainty of the actions that would be taken and their possible effects, this analysis assumes no such actions. Recent efforts to reduce the balances on our operating line of credit have mitigated this risk.

Item 4. Controls and Procedures

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness, as of March 31, 2011, of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act. The purpose of this evaluation was to determine whether as of the evaluation date our disclosure controls and procedures were effective to provide reasonable assurance that the information we are required to disclose in our filings with the Securities and Exchange Commission, or SEC, under the Exchange Act (i) is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and (ii) is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. Based on their evaluation, our management has concluded, that our disclosure controls and procedures were effective as of March 31, 2011.

There has been no change in our internal control over financial reporting during the quarter ended March 31, 2011 that has materially affected, or that is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Purchases of Equity Securities by the Issuer and Affiliated Purchasers

The following table summarizes certain information concerning purchases of our common stock by the Company during the quarter ended March 31, 2011.

Issuer Purchases of Equity Securities

Period	(a) Total number of shares (or units) purchased	(b) Average price paid per share (or unit)	(c) Total number of shares (or units) purchased as part of publicly announced plans or programs	(Maximum number dollar value) of that may yet be p plans or
January 1 to January 31, 2011	51,401	$0.87	51,401	$1,02
February 1 to February 28, 2011	56,300	$0.92	56,300	$972
March 1 to March 31, 2011	197,700	$1.04	197,700	$768
Total	305,401	$0.99	305,401	$768

Item 5. Other Information

NASDAQ Minimum Bid Requirement

On April 13, 2011, we received a Letter of Compliance from the NASDAQ Stock Market, notifying us that the prior deficiency in the minimum bid

requirement has been cured and we are now in compliance with the minimum bid requirement for continued inclusion under Marketplace Rule 4310(c)(4).

Related-Party Transactions

We lease office and distribution facilities in California owned by John Rajala, a stockholder and Territorial Sales Manager. Mr. Rajala also beneficially owns 8.6% of our outstanding common stock. The rental amount paid to Mr. Rajala for the leased facilities is $108,000 per year under a written lease agreement. Management believes the lease agreement is on an arms-length basis and the terms are equal to or more favorable than would be available to a third party. This transaction with a related party has been approved by our Board of Directors.

In addition, we lease office and warehouse space in Girard, Ohio; Detroit, Michigan; and Hopkins, Minnesota; from three stockholders and former independent distributors on an annual basis under operating lease arrangements. Management believes the lease agreements are on an arms-length basis and the terms are equal to or more favorable than would be available to third parties. The expense associated with these related-party transactions totaled $57,000 for the three months ended March 31, 2011.

Item 6. Exhibits

(a) Exhibits

3.1 Articles of Incorporation and Bylaws of Dynatronics Laser Corporation. Incorporated by reference to a Registration Statement on Form S-1 (No. 2-85045) filed with the SEC and effective November 2, 1984

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

3.3 Articles of Amendment dated November 18, 1993 (previously filed)

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10.1 Loan Agreement with Zions Bank (previously filed)

10.2 Amended Loan Agreement with Zions Bank (previously filed)

10.3 1992 Amended and Restated Stock Option Plan (previously filed)

10.4 Dynatronics Corporation 2006 Equity Incentive Award Plan (previously filed as Annex A to the Company's Definitive Proxy Statement on Schedule 14A filed on October 27, 2006)

10.5 Form of Option Agreement for the 2006 Equity Incentive Plan for incentive stock options (previously filed as Exhibit 10.8 to the Company's Annual Report on Form 10-KSB for the fiscal year ended June 30, 2006)

10.6 Form of Option Agreement for the 2006 Equity Incentive Plan for non-qualified options (previously filed as Exhibit 10.9 to the Company's Annual Report on Form 10-KSB for the fiscal year ended June 30, 2006)

10.7 Building Lease Agreement with The Rajala Family Trust dated June 30, 2009

10.8 Executive Employment Agreement (Beardall) (previously filed as exhibit to Current Report on Form 8-K, filed with the Commission on March 7,

2011)

11	Computation of Net Income per Share (included in Notes to Consolidated Financial Statements)
31.1	Certification under Rule 13a-14(a)/15d-14(a) of principal executive officer (filed herewith)
31.2	Certification under Rule 13a-14(a)/15d-14(a) of principal financial officer (filed herewith)
32	Certifications under Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350) (filed herewith)

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

DYNATRONICS CORPORATION
Registrant

Date May 16, 2011 /s/ Kelvyn H. Cullimore, Jr

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

Date May 16, 2011 /s/ Terry M. Atkinson, CPA

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