DYNATRONICS CORP
Form 10QSB
February 14, 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 DECEMBER 31, 2002.

[ ] TRANSITION REPORT UNDER SECTION 13 OR 15(D) OF THE EXCHANGE ACT FOR THE TRANSITION PERIOD FROM __________ TO __________

Commission File Number: 0-12697

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

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

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

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

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

The number of shares outstanding of the issuer's common stock, no par value, as of February 12, 2002 is 8,869,335.

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

DYNATRONICS CORPORATION
TABLE OF CONTENTS

Page Number

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements..1

Unaudited Condensed Balance Sheets
December 31, 2002 and June 30, 2002..1

Unaudited Condensed Statements of Income
Three and Six Months Ended December 31, 2002 and 2001........................2

Unaudited Condensed Statements of Cash Flows
Six Months Ended December 31, 2002 and 2001..................................3

Notes to Unaudited Condensed Financial Statements............................4

Item 2. Management's Discussion and Analysis or Plan of Operation............10

Item 3. Controls and Procedures..19

PART II. OTHER INFORMATION

Item 4. Submission of Matters to a Vote of Security Holders.................19

Item 5. Other Information...20

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

DYNATRONICS CORPORATION
Condensed Balance Sheets
(Unaudited)

Assets	December 31, 2002
Current assets:	
Cash	$ 213,054
Trade accounts receivable, less allowance for doubtful accounts of $191,557 December 31, 2002 and $165,763 at June 30, 2002	3,209,786
Other receivables	21,574
Inventories	4,085,652
Prepaid expenses	466,627
Deferred tax asset-current	276,905
Total current assets	8,273,598
Property and equipment, net	3,318,656
Goodwill, net of accumulated amortization of $649,752 at December 31, 2002 and at June 30, 2002	789,422
Other assets	296,864
	$ 12,678,540

Liabilities and Stockholders' Equity

Current liabilities:	
Current installments of long-term debt	$ 206,136
Line of credit	1,003,389
Accounts payable	773,082
Accrued expenses	486,708
Accrued payroll and benefit expenses	197,324
Income tax payable	25,005
Total current liabilities	2,691,644
Long-term debt, excluding current installments	1,859,449
Deferred compensation	293,941
Deferred tax liability - noncurrent	99,160
Total liabilities	4,944,194
Stockholders' equity:	
Common stock, no par value. Authorized 50,000,000 shares; issued 8,869,335 shares at December 31, 2002 and 8,928,774 shares at June 30, 2002	2,478,981
Treasury stock, zero common shares at cost at December 31, 2002 and 59,439 at June 30, 2002	-
Retained earnings	5,255,365
Total stockholders' equity	7,734,346
	$ 12,678,540

See accompanying notes to financial statements.

DYNATRONICS CORPORATION
Condensed Statements Of Income
(Unaudited)

	Three Months Ended December 31		
	2002	2001	20
Net sales	$ 4,125,089	3,956,430	8,2

Cost of sales	2,534,141	2,360,452	4,9
Gross profit	1,590,948	1,595,978	3,2
Selling, general, and administrative expenses	1,227,316	1,285,179	2,4
Research and development expenses	242,023	164,654	4
Operating income	121,609	146,145	3
Other income (expense):			
Interest income	856	873	
Interest expense	(43,794)	(74,145)	(
Other income, net	1,827	2,159	
Total other income (expense)	(41,111)	(71,113)	(
Income before income taxes	80,498	75,032	2
Income tax expense	30,992	28,512	
Net income	$ 49,506	46,520	1
Basic and diluted net income per common share	$ 0.01	0.01	
Weighted average basic and diluted common shares outstanding (note 2)			
Basic	8,869,335	8,854,335	8,8
Diluted	8,869,335	8,883,477	8,8

See accompanying notes to condensed financial statements.

DYNATRONICS CORPORATION
Statements of Cash Flows
(Unaudited)

	Six M De 2002
Cash flows from operating activities:	
Net income	$ 157,7
Adjustments to reconcile net income to net cash provided by (used in) operating activities:	
Depreciation and amortization of property and equipment	167,0
Other amortization	3,6
Provision for doubtful accounts	36,0
Provision for inventory obsolescence	120,0
Provision for warranty reserve	105,6
Provision for deferred compensation	11,7
Change in operating assets and liabilities:	
Receivables	(52,7
Inventories	(368,9
Prepaid expenses and other assets	(118,5
Accounts payable and accrued expenses	443,6
Income taxes payable	(5,7
Net cash provided by operating activities	499,4
Cash flows from investing activities:	
Capital expenditures	(140,6
Cash flows from financing activities:	
Principal payments on long-term debt	(110,3
Net change in line of credit	(432,3
Proceeds from sale of common stock	
Net cash used in financing activities	(542,6
Net increase (decrease) in cash	(183,7
Cash at beginning of period	396,8

Cash at end of period	$	213,0
Supplemental disclosures of cash flow information:		
Cash paid for interest	$	94,0
Cash paid for income taxes		104,5
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 CONDENSED FINANCIAL STATEMENTS
December 31, 2002
(Unaudited)

NOTE 1. PRESENTATION

The financial statements as of December 31, 2002 and June 30, 2002 and for the six months ended December 31, 2002 and 2001 were prepared by the Company without audit pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations. In the opinion of management, all necessary adjustments, which consist only of normal recurring adjustments, to the financial statements have been made to present fairly the financial position and results of operations and cash flows. The results of operations for the respective periods presented are not necessarily indicative of the results for the respective complete years. The Company has previously filed with the SEC an annual report on Form 10-KSB which included audited financial statements for the two years ended June 30, 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 six months ended December 31, 2002 and 2001 is summarized as follows:

	(Unaudited) Three Months Ended December 31,		(Una Six Mon Decem
	2002	2001	2002
Basic weighted average number of common shares outstanding during the period	8,869,335	8,854,335	8,869,335
Weighted average number of dilutive common stock options outstanding during the period	-	29,142	-
Diluted weighted average number of common and common equivalent shares outstanding during the period	8,869,335	8,883,477	8,869,335

Outstanding options not included in the computation of diluted net income per share for the three and six month periods ended December 31, 2002 and 2001 total 978,005 and 211,471 respectively, because to do so would have been anti-dilutive.

NOTE 3. COMPREHENSIVE INCOME

For the periods ended December 31, 2002 and 2001, comprehensive income was equal to the net income as presented in the accompanying condensed statements of income.

NOTE 4. INVENTORIES

Inventories consisted of the following:

	December 31, 2002	June 30, 2002
Raw Material	$ 2,752,307	2,555,535
Finished Goods	1,719,037	1,546,908
Inventory Reserve	(385,692)	(265,692)

	$ 4,085,652	3,836,751

NOTE 5. PROPERTY AND EQUIPMENT

Property and equipment were as follows:

	December 31, 2002	June 30, 2002
Land	$ 354,743	354,743
Buildings	2,896,928	2,871,286
Machinery and equipment	1,647,631	1,603,963
Office equipment	413,435	352,502
Vehicles	72,148	61,771
	5,384,885	5,244,265
Less accumulated depreciation and amortization	2,066,229	1,899,206
	$ 3,318,656	3,345,059

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 December 31, 2001		Six Dec
Net income, as reported	$	46,520	
Amortization expense of goodwill, net of tax		13,518	
Net income, as adjusted	$	60,038	
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 June 30, 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 December 31, 2002	Ju
Gross carrying amount	$ 73,240	
Accumulated amortization	17,090	
Net carrying amount	$ 56,150	

Amortization expense associated with the license agreement was $1,831 and $3,662, respectively, for the three and six months ended for both December 31, 2002 and 2001. 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 December 31, 2002. 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 December 31, 2002	Th D
Beginning product warranty reserve balance	$ 142,000	
Warranty repairs	(46,254)	
Warranties issued	59,401	
Changes in estimated warranty costs	(7,147)	
Ending product warranty liability balance	$ 148,000	

	Six months ended December 31, 2002	D
Beginning product warranty reserve balance	$ 136,000	
Warranty repairs	(93,664)	
Warranties issued	118,668	
Changes in estimated warranty costs	(13,004)	
Ending product warranty liability balance	$ 148,000	

NOTE 8. COMMON STOCK.

During the six months ended December 31, 2002 the Company canceled 59,439 shares of treasury stock.

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 Condensed Financial Statements (unaudited) and Notes thereto appearing elsewhere in this report on Form 10-QSB.

Results of Operations

During the second fiscal quarter ended December 31, 2002, sales increased 4% to $4,125,089, compared to $3,956,430 during the same quarter of the previous year. During the six months ended December 31, 2002, sales rose to $8,240,858, 1% higher than the $8,123,717 in sales during the six months ended December 31, 2001. Net income increased 6% during the quarter ended December 31, 2002, to $49,506, compared to $46,520 in the same quarter in 2001. Net income increased 10% during the six months ended December 31, 2002, to $157,772, up from $143,364 in the prior year period.

The improved results of operations during the three and six months ended December 31, 2002 reflect the efforts of our Back to Basics initiatives. For the past year, management has been evaluating and refining the company's manufacturing processes in order to reduce costs and permit more competitive pricing on certain products. As a result, manufacturing efficiencies are improving for several product lines due to better material and component sourcing, in-house manufacturing of certain high-volume products and automation of key manufacturing processes. The focus of these manufacturing improvements has been primarily on medical supply products and treatment tables, which carry lower margins than our therapy devices and aesthetic products. Increased sales objectives are starting to be realized and manufacturing efficiencies are still improving. To the extent sales of these lower margin products increases more rapidly than higher margin products, there is a corresponding effect of decreasing gross margins as occurred in the current reporting period. Management expects margins to show improvement as new higher margin products are introduced over the coming quarters and ongoing improvements in operating efficiencies are realized further improving margins.

During the quarter ended December 31, 2002, we completed development of and introduced the Dynatron STSi device. This device combines the company's new STS chronic pain technology with its well-established interferential acute pain modality in order to target a much broader segment of the pain market. Because it carries a lower selling price than previous STS technology devices, the STSi will allow the introduction of the STS technology to a broader segment of the physical medicine market. Shipments of the new device began the end of November, 2002 with approximately 70 units sold in the first five weeks.

Another focus of management over the past year has been the reduction of inventory and accounts receivable, which have a combined decrease of approximately $900,000 from December 31, 2001 to December 31, 2002. These improvements, together with other cash flows generated from operations, helped reduce the outstanding balance on our line of credit facility from $2.9 million to $1 million during the past year. As a result, interest expense was reduced by approximately $30,000 during the quarter ended December 31, 2002. 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 six-months ended December 31, 2002, to $1,831 and

$3,662 respectively compared to $23,635 and $47,270, for the same periods in 2001. This resulted in savings of $21,804 and $43,608 for the current reporting periods in 2002. 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.

During the quarter ended December 31, 2002 total gross profit was $1,590,948 or 38.6% of sales compared to $1,595,978 or 40.3% of sales in the quarter ended December 31, 2001. Gross profit for the six months ended December 31, 2002 was $3,256,549 or 39.5% of sales compared to $3,327,917 or 41.0% of sales in the quarter ended December 31, 2001. The decrease in gross margin as a percent of sales in the quarter and six month periods reflects a shift in product mix due to increased sales of treatment tables and supplies which carry lower margins compared to therapy and aesthetic devices. Going forward, we believe gross profit as a percentage of sales will improve as a result of our strategic initiatives to lower manufacturing costs through the automation of certain manufacturing processes and overseas sourcing of higher-volume products. In addition, we plan to introduce several new, high-margin products during this calendar year, which are expected to increase overall margins.

Selling, general and administrative (SG&A) expenses for the quarter ended December 31, 2002, decreased to $1,227,316 or 29.8% of sales compared to $1,285,179 or 32.5% of sales in the quarter ended December 31, 2001. SG&A expenses for the six-months ended December 31, 2002 were $2,461,732 or 29.9% of sales compared to $2,618,648 or 32.2% of sales for the six months ended December 31, 2001. The decrease in SG&A expenses reflects our efforts during the year to reduce operating expenses through the Back to Basics program. Through this program, we have realized reductions in overhead expenses as well as certain selling expenses. We also realized savings in labor expense related to personnel reductions. In addition, as a result of the adoption of new accounting pronouncements affecting the amortization of goodwill, $21,804 and $43,608, respectively of goodwill expense was eliminated in the three and six months ended December 31, 2002.

Since June 30, 2002, Dynatronics has launched a concentrated research and development (R&D) campaign to develop several new products including a low-power laser device, the STSi combination STS/Interferential device, and a redesign of our primary line of therapy devices. In addition, we have undertaken important clinical research studies related to the STS and laser technologies. R&D expenses during the quarter ended December 31, 2002 totaled $242,023, compared to $164,654 in the quarter ended December 31, 2001, an increase of $77,369 or 47%. R&D expenses during the six-months ended December 31, 2002 increased $127,993 to $454,083 compared to $326,090 for the same period in 2001. R&D expenses for the balance of the fiscal year are expected to continue to show increases over prior periods in accordance with our strategic plans for introducing new products.

Pre-tax profit for the quarter ended December 31, 2002 was $80,498 compared to $75,032 during the same period of the prior year. Pre-tax profit for the six months ended December 31, 2002 was $256,540 compared to $235,314 in 2001. These increases are a result of reduced expenses achieved through the Back to Basics program together with lower interest expense and the elimination of goodwill expense during the current fiscal year periods.

Income tax expense for the three months ended December 31, 2002 was $30,992 compared to $28,512 in the three months ended December 31, 2001. The effective tax rate for the quarter ended December 31, 2002 was 38.5% compared to 38.0% in the quarter ended December 31, 2001. Income tax expense for the six months ended December 31, 2002 was $98,768 compared to $91,950 in the six months ended December 31, 2001. The effective tax rate for the six months ended December 31, 2002 was 38.5% compared to 39.1% in the same period in 2001.

Net income increased 6% for the quarter ended December 31, 2002, to $49,506 (approximately $.01 per share), compared to $46,520 (approximately $.01 per share) in the same quarter in 2001. Net income increased 10% for the six months ended December 31, 2002, to $157,772 (approximately $.02 per share), compared to $143,364 (approximately $.02 per share) during the six months ended December 31, 2001. The improvement in profitability is due primarily to reduced overhead expenses, the elimination of goodwill amortization due to changes in accounting rules and the reduction of interest expense. Additionally, management expects that efforts now underway to develop new products and improve operating efficiencies will further contribute to overall performance 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 $5,581,954 at December 31, 2002, inclusive of the current portion of long-term obligations and credit facilities, as compared to working capital of $5,484,167 at June 30, 2002. The increase in working capital is primarily attributable to the increased turns on inventories and the continued payments on current obligations outstanding.

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 December 31, 2002 and June 30, 2002 was 3.1 to 1. Current assets represent 65% of total assets at December 31, 2002.

Net accounts receivable at December 31, 2002 were $3,209,786 compared to $3,156,436 at June 30, 2002. The days of sales outstanding in accounts receivable increased to 72 days at December 31, 2002 compared to 71 days at June 30, 2002. Accounts receivable are 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 payment discounts when possible.

During the quarter, we renewed 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 December 31, 2002 was $1,003,389 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 December 31, 2002. This line is subject to annual renewal and matures on December 1, 2003. Accrued interest is payable monthly.

Inventory levels, net of reserves, totaled $4,085,652 at December 31, 2002, compared to $3,836,751 at June 30, 2002. We expect inventory levels during the latter part of fiscal year 2003 to increase concurrently with the introduction of several new products currently being developed, including a low-power laser device.

Long-term debt excluding current installments totaled $1,859,449 at December 31, 2002, 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 $1.9 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 with 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:

o Current inventory quantities on hand;
o Product acceptance in the marketplace;

o Customer demand;
o Historical sales;
o Forecast sales;
o Product obsolescence; and
o 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 December 31, 2002 and June 30, 2002, our inventory valuation reserve balance was $385,692 and $265,692, respectively and our inventory balance was $4,085,652 and $3,836,751 net of reserves, respectively.

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 $3,209,786 and $3,156,436, net of allowance for doubtful accounts of $191,557 and $165,763, at December 31, 2002 and June 30, 2002, respectively.

Recent Accounting Pronouncements

In December 2002, the Financial Accounting Standards Board ("FASB") issued SFAS No. 148, Accounting for Stock-Based Compensation-Transition and Disclosure an amendment of FASB Statement No. 123. This Statement amends FASB statement No. 123, Accounting for Stock-Based Compensation, to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, this Statement amends the disclosure requirements of Statement 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The Company plans 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. The Company is required and plans to adopt the disclosure provisions of SFAS No. 148 for the quarter ending March 31, 2003.

Business Plan

Over the past five years, 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 will continue to implement a strategy of expanding product lines, strengthening channels of distribution, and developing new products for the rehabilitation and aesthetic markets.

To further strengthen our position in the core physical medicine market, we plan to introduce several new products in the current fiscal year, including a low-power laser device. 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. In support of a planned submission to the Food and Drug Administration to obtain clearance to market the new laser, the company is currently funding a clinical study at multiple

research sites including universities and clinics. The study will evaluate the efficacy of the laser in treating wrist pain such as Carpal Tunnel Syndrome, a claim that FDA has recently allowed for low-power lasers. We believe our device will not only be more affordable, but also technically superior to anything currently sold in the domestic market.

In addition to the low-power laser device, over the next six months we expect to introduce a new line of electrotherapy and ultrasound products incorporating advanced technology features and design. This new line of products is expected to further enhance our share of the electrotherapy and ultrasound market.

Over the past year, we strengthened 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.

During the remainder of fiscal year 2003, we will continue to emphasize our Back to Basics plan. Resources are being allocated to strengthen our core market emphasis and products. We will incur more research and development expense in 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.

In August 2000, we acquired an exclusive license for the patented STS technology for treating chronic pain. Two devices incorporating the new technology - the Dynatron STS clinical unit and the Dynatron STS Rx prescription unit for home use - were introduced in fiscal year 2001. The treatment delivered by these devices is referred to as Sympathetic Therapy or STS Therapy. In November 2002, we introduced the Dynatron STSi combination therapy device. This device provides both the STS chronic pain treatment technology together with interferential therapy for treating patients with acute pain.

15

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. Additional research studies are underway to further validate the efficacy of this innovative technology.

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. Notably, this technology potentially holds the key to not only relieving suffering for many chronic pain patients, but significantly reducing the long-term costs of supporting chronic pain patients through reducing intake of expensive narcotic medications or avoiding costly invasive procedures. We believe that as these potential cost savings are realized, insurance companies should begin to view STS treatments as an economical alternative to the traditional treatments for chronic pain sufferers. STS treatments are not a

panacea and do not help every chronic pain sufferer. However, they seem to be particularly effective with pain conditions that present with a sympathetic bias.

The development of the STS technology as an effective weapon in the treatment of chronic pain remains one of our strategic objectives. We continue to receive reports of chronic pain sufferers who have attained significant, if not total, relief from their pain even after years of suffering. 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.

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.

To take full advantage of the opportunities of the aesthetics market, we will continue to refine our efforts to establish effective distribution for our line of aesthetic products. Our Chairman, Kelvyn H. Cullimore, continues to personally manage the effort to establish this distribution. Controlling and expanding the channels of distribution for these products is expected to ultimately increase sales 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.

Over the past two years, we have allocated resources to enhance our presence in the e-business arena. We have undertaken to improve the appearance and application of our corporate website and we 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 new products over the coming 12 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. This includes conducting additional research and other related activities to

obtain broader support from the medical and insurance communities.

- 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 and Dynatron STS, STSi and Dynatron STS Rx products;
- Clinical outcomes of research studies regarding STS and the laser. Also, obtaining insurance company reimbursement for STS treatments and the home prescription Dynatron STS Rx device;
- 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; and
- The ability to obtain required financing to meet changes or other risks described above.

Item 3. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures. Based upon their review, the company's principal executive officer and principal financial officer have concluded that the current disclosure controls and procedures (as defined in Exchange Act Rules 240.13a-14(c) and 15d-14(c) are effective in providing the material information required to be disclosed in the reports we file or submit under the Exchange Act. Their review was completed as of a date within 90 days before the filing date of this quarterly report Changes in Internal Controls. There have been no significant changes in our internal controls or in other factors that could significantly affect internal controls subsequent to the date we carried out this evaluation.

PART II. OTHER INFORMATION

Item 4. Submission of Matters to a Vote of Security Holders.

At the company's Annual Meeting of Shareholders held on November 19, 2002, the shareholders of the company voted on the following proposals:

Proposal 1 - To elect seven directors, each to serve until the next annual meeting of shareholders and until his successor is elected and shall have qualified. Those nominated were all currently serving as directors of the company, i.e., Kelvyn H. Cullimore, Kelvyn H. Cullimore, Jr., Larry K. Beardall, E. Keith Hansen MD, Joseph H. Barton, Howard L. Edwards and Val J. Christensen.

Proposal 2 - To approve the Audit Committee's selection of KPMG LLP as the company's independent auditors for the year ending June 30, 2003.

Each of the proposals was approved by the requisite majority of the shares cast at the annual meeting. The following table summarizes the voting results:

	For	Against	Abstain
Proposal 1:			
Mr. Cullimore	7,614,919	14,400	60,713
Mr. Cullimore, Jr.	7,626,619	2,700	60,713
Mr. Beardall	7,627,119	2,200	60,713
Dr. Hansen	7,628,119	1,200	60,713
Mr. Christensen	7,626,019	3,300	60,713
Mr. Barton	7,624,619	4,700	60,713
Mr. Edwards	7,624,603	4,716	60,713

	For	Against	Abstain
Proposal 2:			
	7,674,916	11,516	9,600

19

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 one year, or until July 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 July 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.

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.

20

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 2/14/03 /s/ Kelvyn H. Cullimore, Jr.

Kelvyn H. Cullimore, Jr.
President and Chief Executive Officer
(duly authorized officer)

Date 2/14/03 /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 inancial 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

22

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: February 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: February 14, 2003

/s/ Terry M. Atkinson

Terry M. Atkinson
Controller
(Chief Accounting Officer)

EXHIBIT 99.1

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO

SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Dynatronics Corporation on Form 10-QSB for the period ending December 31, 2002, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), Kelvyn H. Cullimore, Jr., Chief Executive Officer and Terry M. Atkinson, Chief Accounting Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/s/ Kelvyn H. Cullimore, Jr.

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

/s/ Terry M. Atkinson

Terry M. Atkinson
Controller
(Chief Accounting Officer)