DYNATRONICS CORP
Form 10-Q
February 13, 2015

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended December 31, 2014

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. þ 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 (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). þ 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 ¨ (Do not check if a smaller reporting company)	Smaller reporting company þ

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

The number of shares outstanding of the registrant's common stock, no par value, as of February 10, 2015 is 2,520,389.

DYNATRONICS CORPORATION
FORM 10-Q
QUARTER ENDED DECEMBER 31, 2014

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DYNATRONICS CORPORATION
Condensed Consolidated Balance Sheets
(Unaudited)

Assets	December 31, 2014	June 30, 2014
Current assets:		
Cash and cash equivalents	$ 199,593	332,800
Trade accounts receivable, less allowance for doubtful accounts of $373,150 as of December 31, 2014 and $325,355 as of June 30, 2014	2,957,485	3,165,396
Other receivables	9,983	15,594
Inventories, net	5,980,659	6,157,848
Prepaid expenses and other	640,060	298,370
Current portion of deferred income tax assets	453,775	408,919
Total current assets	10,241,555	10,378,927
Property and equipment, net	5,280,003	2,980,677
Intangible assets, net	213,122	235,440
Other assets	698,090	396,456
Deferred income tax assets, net of current portion	1,243,978	303,644
Total assets	$ 17,676,748	14,295,144
Liabilities and Stockholders' Equity		
Current liabilities:		
Current portion of long-term debt	$ 122,760	302,274
Current portion of capital lease	168,588	-
Current portion of deferred gain	150,448	-
Line of credit	1,522,691	3,521,209
Warranty reserve	152,520	157,753
Accounts payable	2,031,767	2,433,534
Accrued expenses	348,764	342,716
Accrued payroll and benefits expense	309,178	243,394
Income tax payable	575,948	30,452
Total current liabilities	5,382,664	7,031,332
Long-term debt, net of current portion	718,795	1,255,133
Capital lease, net of current portion	3,552,737	-
Deferred gain, net of current portion	2,056,121	-
Capital Lease Timing Differental	16,460	-
Total liabilities	11,726,777	8,286,465

Commitments and contingencies		
Stockholders' equity:		
Common stock, no par value: Authorized 50,000,000 shares; 2,520,389 shares issued and outstanding for both December 31, 2014 and June 30, 2014	7,183,723	7,149,812
Accumulated deficit	(1,233,752)	(1,141,133)
Total stockholders' equity	5,949,971	6,008,679
Total liabilities and stockholders' equity	$ 17,676,748	14,295,144

See accompanying notes to condensed consolidated financial statements.

DYNATRONICS CORPORATION
Condensed Consolidated Statements of Operations
(Unaudited)

	Three Months Ended December 31		Six Months Ended December 31	
	2014	2013	2014	2013
Net sales	$7,303,189	7,146,787	14,519,513	14,202,215
Cost of sales	4,839,578	4,469,256	9,488,330	8,943,615
Gross profit	2,463,611	2,677,531	5,031,183	5,258,600
Selling, general, and administrative expenses	2,379,720	2,315,463	4,631,349	4,694,833
Research and development expenses	234,674	238,711	451,500	553,534
Operating income (loss)	(150,783)	123,357	(51,666)	10,233
Other income (expense):				
Interest income	1,280	34	3,601	38
Interest expense	(79,736)	(56,045)	(128,029)	(115,958)
Other income, net	3,113	6,238	6,455	10,762
Net other income (expense)	(75,343)	(49,773)	(117,973)	(105,158)
Income (loss) before income taxes	(226,126)	73,584	(169,639)	(94,925)
Income tax benefit (provision)	92,583	(29,489)	77,020	31,236
Net income (loss)	$(133,543)	44,095	(92,619)	(63,689)
Basic and diluted net loss per common share	$(0.05)	0.02	(0.04)	(0.03)
Weighted-average common shares outstanding:				
Basic	2,520,389	2,518,904	2,520,389	2,518,904
Diluted	2,520,389	2,521,242	2,520,389	2,518,904

See accompanying notes to condensed consolidated financial statements.

DYNATRONICS CORPORATION
Condensed Consolidated Statements of Cash Flows
(Unaudited)

	Six Months Ended December 31	
	2014	2013
Cash flows from operating activities:		
Net income (loss)	$(92,619)	(63,689)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization of property and equipment	175,318	214,289
Amortization of intangible	152,976	41,525
Stock-based compensation expense	33,911	35,647
Change in deferred income tax assets	(985,190)	(31,236)
Provision for doubtful accounts receivable	48,000	48,000
Provision for inventory obsolescence	60,000	60,000
Deferred gain on UT building	(62,686)	-
Change in operating assets and liabilities:		
Receivables	165,522	203,381
Inventories	117,189	(220,839)
Prepaid expenses and other assets	(632,399)	(187,348)
Other assets	(327,320)	-
Prepaid income taxes	-	20,248
Income tax payable	545,496	-
Accounts payable and accrued expenses	(318,708)	22,599
Net cash provided by (used in)operating activities	(1,120,510)	142,577
Cash flows from investing activities:		
Purchase of property and equipment	(19,652)	(45,500)
Proceeds from sale of property and equipment	3,800,000	-
Net cash provided by (used in) investing activities	3,780,348	(45,500)
Cash flows from financing activities:		
Principal payments on long-term debt	(715,852)	(160,951)
Principal payments on long-term capital lease	(78,675)	-
Net change in line of credit	(1,998,518)	180,202
Net cash provided by (used in) financing activities	(2,793,045)	19,251
Net change in cash and cash equivalents	(133,207)	116,328
Cash and cash equivalents at beginning of the year	332,800	302,050
Cash and cash equivalents at end of the year	$199,593	418,378
Supplemental disclosure of cash flow information:		
Cash paid for interest	$85,469	116,619

Cash paid for income taxes	356,151	-
Supplemental disclosure of non-cash investing and financing activities:		
Capital lease	3,800,000	-

See accompanying notes to condensed consolidated financial statements.

DYNATRONICS CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
December 31, 2014

NOTE 1. PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation
The condensed consolidated balance sheets as of December 31, 2014 and June 30, 2014, and the condensed consolidated statements of operations and cash flows for the three and six months ended December 31, 2014 and 2013 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 six months ended December 31, 2014 are not necessarily indicative of the results of operations for the fiscal year ending June 30, 2015. The Company previously filed with the SEC an annual report on Form 10-K, as amended, which included audited financial statements for each of the two years ended June 30, 2014 and 2013. 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.

Reverse Stock Split
On December 19, 2012, the Company completed a 1-for-5 reverse split of its common stock. All common stock share and per share information in the accompanying condensed consolidated interim financial statements and notes thereto have been adjusted to reflect retrospective application of the reverse stock split, except for par value per share and the number of authorized shares, which were not affected by the reverse stock split.

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the period. Actual results could differ from those estimates. Some of the more significant estimates relate to inventory, allowance for doubtful accounts, stock-based compensation and valuation allowance for deferred income taxes.

Significant Accounting Policies

There have been no significant changes to the Company's significant accounting policies as described in the Company's Annual Report on Form 10-K, as amended, for the fiscal year ended June 30, 2014.

NOTE 2. NET INCOME (LOSS) PER COMMON SHARE

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

Basic net income (loss) per common share is the amount of net income (loss) for the period available to each weighted-average share of common stock outstanding during the reporting period. Diluted net income (loss) per common share is the amount of net income (loss) 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 six months ended December 31, 2014 and 2013 are as follows:

	Three Months Ended December 31		Six Months Ended December 31	
	2014	2013	2014	2013
Basic weighted-average number of common shares outstanding during the period	2,520,389	2,518,904	2,520,389	2,518,904
Weighted-average number of dilutive common stock options outstanding during the period	-	2,338	-	-
Diluted weighted-average number of common and common equivalent shares outstanding during the period	2,520,389	2,521,242	2,520,389	2,518,904

Outstanding options for common shares not included in the computation of diluted net income (loss) per common share, because they were anti-dilutive, for the three months ended December 31, 2014 and 2013 totaled 139,610 and 145,607, respectively, and for the six months ended December 31, 2014 and 2013 totaled 139,610 and 152,726, respectively.

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 $16,457 and $17,728 in stock-based compensation expense during the three months ended December 31, 2014 and 2013, respectively, and recognized $33,911 and $35,647 in stock-based compensation expense during the six months ended December 31, 2014 and 2013, respectively. These expenses were recorded as selling, general and administrative expenses in the condensed consolidated statements of operations.

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 stock-based awards may be granted under the plan. Awards granted under the plan may be performance-based. As of December 31, 2014, there were 120,508 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 six-month period ended December 31, 2014.

	Number of Options	Weighted-Average Exercise Price
Outstanding at beginning of period	155,604	$ 6.45

Granted	-	-
Exercised	-	-
Cancelled	(2,620)	4.93
Outstanding at end of period	152,984	6.48
Exercisable at end of period	145,935	6.86

The Black-Scholes option-pricing model is used to estimate the fair value of options granted under the Company's stock option plan. There were no options granted during the six months ended December 31, 2014.

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 December 31, 2014, there was $369,594 of unrecognized stock-based compensation cost related to grants under the stock option plan that is expected to be expensed over a weighted-average period of four to ten years. There was $9,868 of intrinsic value for options outstanding as of December 31, 2014.

NOTE 4. COMPREHENSIVE INCOME (LOSS)

For the six months ended December 31, 2014 and 2013, comprehensive income (loss) was equal to the net income (loss) as presented in the accompanying condensed consolidated statements of operations.

NOTE 5. INVENTORIES

Inventories consisted of the following:

	December 31, 2014	June 30, 2014
Raw materials	$ 2,641,942	2,783,306
Finished goods	3,699,900	3,709,897
Inventory obsolescence reserve	(361,183)	(335,355)
	$ 5,980,659	6,157,848

NOTE 6. RELATED-PARTY TRANSACTIONS

The Company currently leases office and warehouse space in Detroit, Michigan and Hopkins, Minnesota from two shareholders 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 $17,700 and $17,250 for the three months ended December 31, 2014 and 2013, respectively, $35,400 and $34,500 for the six months ended December 31, 2014 and 2013, respectively.

NOTE 7. LINE OF CREDIT

The outstanding balance on our line of credit decreased $1,998,518 to $1,522,691 as of December 31, 2014, compared to $3,521,209 as of June 30, 2014. This reduction was made possible by the sale and leaseback of our Cottonwood Heights, Utah facilities in which we generated approximately $2,100,000 in net cash to pay down our line of credit. Interest on the line of credit is based on the 90-day LIBOR rate (0.26% as of December 31, 2014) plus 3.5%. 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 approximately $2,400,000. The maximum borrowing limit on our line of credit facility was reduced in August 2014 from $4,500,000 to $2,400,000 to reflect the reduction achieved through the previously reported payment of $2,100,000 on the line from the sale-leaseback of our Utah facilities. Interest payments on the line are due monthly. All borrowings under the line of credit are presented as current liabilities in the accompanying consolidated balance sheet.

The line of credit agreement includes covenants requiring us to maintain certain financial ratios. As of December 31, 2014, we were not in compliance with all loan covenants. The line of credit matured on January 31, 2015. The bank has agreed to leave the line open until February 28, 2015 to allow us to replace the line of credit with a new credit facility with another lender. We are working with a new lender who has agreed in principle to pay off the bank by the end of February. The terms of this new credit facility are not as favorable as our bank line of credit had been. We expect that when fees are considered together with interest payable under the new line of credit agreement, the effective interest rate on borrowed money will be approximately 10%, compared to the rate payable on the bank line of credit which was approximately 4% per annum. The lending limit on the new line of credit will be approximately $3,000,000. Should we be unable to obtain this financing, we have offers from other lenders to provide financing. We believe that amounts available under the new line of credit with the new lender as well as cash generated from operating activities will continue to be sufficient to meet our annual operating requirements. Failure to obtain replacement financing would have a material adverse effect on our business operations and would raise doubt in regards to our ability to continue our normal business operations.

NOTE 8. SALE OF UTAH FACILITY AND LEASE COMMITMENTS

The Company entered into a lease agreement on August 8, 2014 for the sale-leaseback of its Utah facility which houses its executive offices and manufacturing facility. The agreement provided for the sale of the Utah facility for a purchase price of $3,800,000 and the subsequent leaseback for 180 monthly payments starting at $26,917 with an annual increase of two percent. The Company recorded a deferred gain of approximately $2,250,000 that will be amortized into income over the term of the lease. The cash proceeds from the sale were used primarily to pay down the Company's line of credit.

The lease is accounted for under the capital lease method of accounting and is being amortized over the 15-year term of the lease. The capital lease required a 5-year security deposit of $323,000 which is classified as an "other asset." The deferred gain also triggered an increase in the deferred income tax. The actual lease payments will be split between interest expense and the capital lease payable. Annual future maturities of the capital lease (per FAS 13) are as follows: 2016, $173,357; 2017, $183,302; 2018, $193,818; 2019, $204,937; 2020, $216,694 and thereafter $2,666,097.

NOTE 9. RECENT ACCOUNTING PRONOUNCEMENTS

In August 2014, the Financial Accounting Standards Board (FASB) issued Accounting Stand Update (ASU) 2014-15, Presentation of Financial Statements – Going Concern: Disclosure of Uncertainties About an Entity's Ability to Continue as a Going Concern. This ASU requires management to assess an entity's ability to continue as a going concern by incorporating and expanding upon certain principles that are currently in U.S. auditing standards, but not currently in GAAP. Specifically, the amendments (1) provide a definition of the term substantial doubt, (2) require an evaluation every reporting period including interim periods, (3) provide principles for considering the mitigating effect of management's plans, (4) require certain disclosures when substantial doubt is alleviated as a result of consideration of management's plans, (5) require an express statement and other disclosures when substantial doubt is not alleviated, and (6) require an assessment for a period of one year after the date that the financial statements are issued (or available to be issued). This ASU is effective for the annual period ending after December 15, 2016, and for annual periods and interim periods thereafter. Early application is permitted. The Company is currently evaluating the impact that this ASU will have on its financial statements and believes no additional footnote disclosure will be required when adopted.

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standard Update (ASU) 2014-09 – Revenue from Contracts with Customers, which provides a single, comprehensive revenue recognition model for all contracts with customers. The core principal of this ASU is that an entity should recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This ASU also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to obtain or fulfill a contract. This ASU is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2016. Early adoption is not permitted and companies can transition to the new standard under the full retrospective method or the modified retrospective method. The Company does not believe adoption of this ASU will have a material impact on its financial statements.

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

Overview

Dynatronics Corporation ("Company," "Dynatronics," "we") designs, manufactures, distributes, markets and sells physical medicine and aesthetic products. We offer a broad line of medical equipment including therapy devices, medical supplies and soft goods, treatment tables and rehabilitation equipment. Our line of aesthetic products includes aesthetic massage and microdermabrasion devices, as well as skin care products. We market and sell our products primarily to physical therapists, chiropractors, sports medicine practitioners, podiatrists, plastic surgeons, dermatologists and aestheticians. We operate on a fiscal year ending June 30. For example, reference to fiscal year 2015 refers to the year ending June 30, 2015.

Business Outlook

In the last three years we have released more new and innovative products than during any other similar period in our history. The introduction of the Solaris Plus family of combination electrotherapy/ultrasound/phototherapy units, the 25 Series combination electrotherapy/ultrasound units, the line of Ultra treatment tables, and the ThermoStim probe make up most of these innovative new products.

The introduction of these products has been a major strategic component of attracting new sales representatives and dealers in order to expand our distribution across North America and into international territories. Adding these new sales reps and dealers along with removing some limitations on who can sell our proprietary products is part of our strategic plan for expanding our distribution reach and strengthening sales.

Our efforts to prudently reduce costs in the face of some economic uncertainty have made us a leaner operation. Over the past two fiscal years, we implemented approximately $1,600,000 in annualized expense reductions. We will continue to be vigilant in maintaining appropriate overhead costs and operating costs while still providing support for sales from our new products.

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

- Increasing market share of manufactured capital products by promoting sales of our state-of-the-art Dynatron ThermoStim probe, SolarisPlus and 25 Series products.

- Seeking to improve distribution of our products through recruitment of additional qualified sales representatives and dealers attracted by the many new products being offered and expanding the availability of proprietary combination therapy devices.

- Developing sales through our contract with Amerinet, Inc., one of the largest health care group purchasing organizations ("GPO") in the United States.

- Continuing to seek ways of increasing business with regional and national accounts including other group purchasing organizations and the U.S. Government.

- Improving operational efficiencies by scaling costs to be reflective of current levels of sales.

- Strengthening pricing management and procurement methodologies.

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Focusing international sales efforts on identifying key distributors and strategic partners who could represent our product line, particularly in China, Japan, Southeast Asia, Central and South America as well as portions of Europe.

· Exploring strategic business alliances that will leverage and complement our competitive strengths, increase market reach and supplement capital resources. We may also consider the acquisition of other businesses and technology.

Results of Operations

The following discussion and analysis of our financial condition and results of operations for the three and six months ended December 31, 2014, 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 fiscal year ended June 30, 2014, as amended, which includes audited financial statements for the year then ended. Results of operations for the second fiscal quarter and six months ended December 31, 2014, are not necessarily indicative of the results that will be achieved for the full fiscal year ending June 30, 2015.

Three Months Ended December 31, 2014

Net Sales

Net sales increased $156,402 or approximately 2.2% to $7,303,189 for the quarter ended December 31, 2014, compared to net sales of $7,146,787 for the quarter ended December 31, 2013. Market conditions began to improve in the fourth quarter of fiscal year 2014 and the improvement continued through the quarter ended December 31, 2014. Sales to Amerinet facilities around the country under the contract that went into effect on July 1, 2014 accounted for the majority of the increase in total sales for the quarter ended December 31, 2014. Specific product categories showing increases included capital exercise products, metal tables, and distributed capital modalities.

Gross Profit

For the fiscal quarter ended December 31, 2014, gross profit decreased approximately $213,920 or about 8.0% to $2,463,611, or 33.7% of net sales. By comparison, gross profit for the quarter ended December 31, 2013 was $2,677,531, or 37.5% of net sales. A significant factor in the decrease in gross profit was product mix. Sales during the quarter ended December 31, 2014 included higher amounts of certain distributed products for which our margins are lower. In addition, the balance of the decrease was attributable to product mix favoring medical supply products, as well as slightly increased cost of sales for manufactured capital products.

Selling, General and Administrative Expenses

Selling, general and administrative ("SG&A") expenses increased $64,257 to $2,379,720, or 32.6% of net sales, for the quarter ended December 31, 2014, from $2,315,463, or 32.4% of net sales, for the quarter ended December 31, 2013. Over the past several months, we engaged in negotiations to acquire a company. However, upon completion of our due diligence in February 2015, we terminated the negotiations. Costs related to the terminated acquisition included legal fees and other acquisition development costs of $143,299 for the quarter ended December 31, 2014.

The following factors accounted for the $64,257 increase in SG&A expenses for the three months ended December 31, 2014, compared to the three months ended December 31, 2013:

- $86,725 of lower labor and overhead expenses;
- $56,069 of lower selling expenses primarily associated with lower commission expense;
- $143,299 of non-recurring legal and other acquisition-related expenses associated with the terminated acquisition,
- $10,588 of higher amortization expense for the capitalization of the building lease; and
- $53,164 of higher general expenses

In conjunction with the sale and leaseback of our corporate headquarters in August 2014, we entered into a $3.8 million capital lease for a 15-year term with an investor group. Lease payments of approximately $27,000 are payable monthly. However, the lease qualifies as a capital lease and the cost of that lease is reflected in higher interest and amortization expenses. The increase in amortization expenses during the current reporting quarter is reflected above in the explanation of higher SG&A expenses. During the quarter, our interest expense also increased $23,691 which is all attributable to the accounting treatment of the capital lease on the building. Unlike the amortization expense, the increased interest expense is not included in SG&A expense, but is reported as a separate line item on the income statement.

Research and Development Expenses

Research and development (“R&D”) expenses decreased $4,037 to $234,674, or 3.2% of sales, in the quarter ended December 31, 2014, compared to $238,711, or 3.3% of sales in the quarter ended December 31, 2013. The reduction in R&D expenses reflects the fact that last year we were incurring heavier R&D expenses associated with development of the Thermostim probe. With its release in December 2013, and the completion of the development platforms for the Solaris Plus and 25 Series during the prior 12 months, our R&D costs have diminished while we take advantage of building on the platforms we developed.

Over the past three years, we have introduced more new products than any comparable period in our history. The new product introductions include the SolarisPlus line of electrotherapy/ultrasound/ phototherapy units, the Ultra 2 and Ultra 3 motorized treatment tables, the 25 Series line of electrotherapy and ultrasound products, as well as the Dynatron ThermoStim probe. We believe that developing new products is a key element in our strategy and critical to moving purchasing momentum in a positive direction. Current R&D efforts are leveraging the work of the last three years to develop and introduce new products. R&D costs are expensed as incurred and are expected to continue at current levels in the coming year as we have concluded a major R&D investment cycle.

Income (Loss) Before Income Tax

Pre-tax loss for the quarter ended December 31, 2014, was $226,126, compared to a pre-tax profit of $73,584 for the quarter ended December 31, 2013. The decrease in pre-tax profits for the quarter was primarily attributable to lower gross profit generated during the periods and expenses related to the terminated acquisition together with higher interest and amortization expense for the capitalization of the building lease. Without the non-recurring terminated acquisition expenses, we would have had a pre-tax loss from operations for the quarter ended December 31, 2014 of approximately $82,827.

Income Tax

Income tax benefit was $92,583 for the quarter ended December 31, 2014, compared to income tax provision of $29,489 for the quarter ended December 31, 2013. The effective tax rate for the quarter ended December 31, 2014 was 40.9%, compared to 40.1% for the same quarter of the prior year. The difference in the effective tax rates for the six months ended December 31, 2014, compared to the prior year period is attributable to reductions in R&D tax credits and other credits as well as certain permanent book to tax differences.

Net Income (Loss)

Net loss was $133,543 ($.05 per share) for the quarter ended December 31, 2014, compared to net income of $44,095 ($.02 per share) for the quarter ended December 31, 2013. Lower gross profit generated during the quarter ended December 31, 2014, together with acquisition related expenses accounted for the decrease.

Six Months Ended December 31, 2014

Net Sales

For the six months ended December 31, 2014, net sales increased $317,298 or approximately 2.2% to $14,519,513, compared to net sales of $14,202,215 for the same period in the previous year. Market conditions began to improve in the fourth quarter of fiscal year 2014 and the improvement continued through the second fiscal quarter of fiscal year 2015, ended December 31, 2014. Sales under the Amerinet contract that went into effect on July 1, 2014 accounted for the majority of the increase in total sales for the six months ended December 31, 2014. The 2.2% increase in sales for the six months ended December 31, 2014 is a significant increase over the 7% annualized decline in sales experienced for the same period during the prior two years and ends a trend of declining top line performance over the prior 30 months. Based on the trends of the past six months, we expect to see continued improvement in our top line performance.

Gross Profit

Gross profit for the six months ended December 31, 2014 decreased $227,416, or about 4.3% to $5,031,183, or 34.7% of sales. A significant factor in the decrease in gross profit was product mix. Sales during the six months ended

December 31, 2014 included higher amounts of certain distributed products for which our margins are lower. In addition, the balance of the decrease was attributable to product mix favoring medical supply products, as well as slightly increased cost of sales for manufactured capital products. The fact the gross profit margin for the six month period of 34.7% was higher than the 33.7% reported in the current quarter is an artifact of gross margins of 35.6% in the quarter ended September 30, 2014, which more closely approximated gross profit margins of 36.5% reported for fiscal year ended June 30, 2014.

Selling, General and Administrative Expenses

SG&A expenses decreased $63,484 to $4,631,349, or 31.9% of net sales, for the six month period ended December 31, 2014, from $4,694,833, or 33.1% of net sales, for the six months ended December 31, 2013. Costs related to the terminated acquisition included legal fees and other acquisition development costs of $219,873 during the six-month periods ended December 31, 2014. Specific factors that impacted SG&A expenses for the six months ended December 31, 2014, compared to the six months ended December 31, 2013, included the following:

- $86,224 of lower selling expenses primarily associated with lower commission expense;
- $224,861 of lower labor and overhead expenses;
- $219,873 of non-recurring legal and other acquisition-related expenses;
- $17,593 of higher amortization expense for the capitalization of the building lease; and
- $10,135 of higher general expenses.

As mentioned above, the sale and leaseback of our facility in Cottonwood Heights, Utah, resulted in a capital lease. The accounting for a capital lease requires the recognition of imputed interest and amortization costs associated with the lease. As noted above, there was $17,593 in additional amortization costs recognized in the six month period ending December 31, 2014 attributable to the new capital lease on the building. In addition, the increase in interest expense of $12,071 reported in the six month period ended December 31, 2014 over the comparable period ending December 31, 2013 is primarily attributable to the imputed interest associated with the new lease recognized during the current period.

Research and Development Expenses

R&D expenses decreased $102,034 to $451,500, or 3.1% of sales, for the six months ended December 31, 2014, compared to $553,534, or 3.9% of sales in the similar period ended December 31, 2013. The reduction in R&D expenses reflects the fact that last year we were incurring heavier R&D expenses associated with development of the Thermostim probe. With its release in December 2013, and the completion of the development platforms for the Solaris Plus and 25 Series during the prior 12 months, our R&D costs have diminished while we take advantage of building on the platforms we developed.

Over the past three years, we have introduced more new products than any comparable period in our history. The new product introductions include the SolarisPlus line of electrotherapy/ultrasound/phototherapy units, the Ultra 2 and Ultra 3 motorized treatment tables, the 25 Series line of electrotherapy and ultrasound products, as well as the Dynatron ThermoStim probe. We believe that developing new products is a key element in our strategy and critical to moving purchasing momentum in a positive direction. Current R&D efforts are leveraging the work of the last three years to develop and introduce new products. R&D costs are expensed as incurred and are expected to continue at current levels in the coming year as we have concluded a major R&D investment cycle.

Income (Loss) Before Income Tax

Pre-tax loss for the six months ended December 31, 2014, was $169,639, compared to pre-tax loss of $94,925 for the six months ended December 31, 2013. The decrease in pre-tax profits for the six-month period was primarily attributable to lower gross profit generated during the periods and expenses related to the aborted acquisition together with higher interest and amortization expense for the capitalization of the building lease. Without the non-recurring terminated acquisition expenses, we would have had a pre-tax profit from operations for the six months ended December 31, 2014 of approximately $50,234.

Income Tax

Income tax benefit was $77,020 for the six months ended December 31, 2014, compared to a benefit of $31,236 for the six months ended December 31, 2013. The effective tax rate for the six months ended December 31, 2014 was 45.4%, compared to 32.9% for the same period of the prior year. The difference in the effective tax rates for the six months ended December 31, 2014, compared to the prior year period is attributable to reductions in R&D tax credits and other credits as well as certain permanent book to tax differences.

Net Income (Loss)