APPFOLIO INC
Form 4
May 11, 2017

FORM 4

Check this box if no longer subject to Section 16. Form 4 or Form 5 obligations may continue. *See* Instruction 1(b).

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

STATEMENT OF CHANGES IN BENEFICIAL OWNERSHIP OF SECURITIES

Filed pursuant to Section 16(a) of the Securities Exchange Act of 1934, Section 17(a) of the Public Utility Holding Company Act of 1935 or Section 30(h) of the Investment Company Act of 1940

OMB APPROVAL

OMB Number:	3235-0287
Expires:	January 31, 2005
Estimated average burden hours per response...	0.5

(Print or Type Responses)

1. Name and Address of Reporting Person *
OBERNDORF WILLIAM E

(Last) (First) (Middle)

615 FRONT STREET

(Street)

SAN FRANCISCO, CA 94111

(City) (State) (Zip)

2. Issuer Name **and** Ticker or Trading Symbol
APPFOLIO INC [APPF]

3. Date of Earliest Transaction (Month/Day/Year)
05/09/2017

4. If Amendment, Date Original Filed(Month/Day/Year)

5. Relationship of Reporting Person(s) to Issuer

(Check all applicable)

_____ Director __X__ 10% Owner
_____ Officer (give title below) _____ Other (specify below)

6. Individual or Joint/Group Filing(Check Applicable Line)
___ Form filed by One Reporting Person
_X_ Form filed by More than One Reporting Person

Table I - Non-Derivative Securities Acquired, Disposed of, or Beneficially Owned

1.Title of Security (Instr. 3)	2. Transaction Date (Month/Day/Year)	2A. Deemed Execution Date, if any (Month/Day/Year)	3. Transaction Code (Instr. 8)		4. Securities Acquired (A) or Disposed of (D) (Instr. 3, 4 and 5)			5. Amount of Securities Beneficially Owned Following Reported Transaction(s) (Instr. 3 and 4)	6. Ownership Form: Direct (D) or Indirect (I) (Instr. 4)	7. Nature of Indirect Beneficial Ownership (Instr. 4)
			Code	V	Amount	(A) or (D)	Price			
Class A common stock	05/09/2017		S		3,250	D	$ 27	850	I	See Footnote (1)
Class A common stock								506,171	D (2)	
Class A common stock								185,269	I	See Footnote (3)
Class A common stock								631,086	I	See Footnote (4)

Class A common stock	10,700	I	See Footnote (5)
Class A common stock	30	I	See Footnote (6)
Class A common stock	8,612	I	See Footnote (7)

Reminder: Report on a separate line for each class of securities beneficially owned directly or indirectly.

Persons who respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB control number.

SEC 1474 (9-02)

Table II - Derivative Securities Acquired, Disposed of, or Beneficially Owned
(*e.g.*, puts, calls, warrants, options, convertible securities)

1. Title of Derivative Security (Instr. 3)	2. Conversion or Exercise Price of Derivative Security	3. Transaction Date (Month/Day/Year)	3A. Deemed Execution Date, if any (Month/Day/Year)	4. Transaction Code (Instr. 8)		5. Number of Derivative Securities Acquired (A) or Disposed of (D) (Instr. 3, 4, and 5)		6. Date Exercisable and Expiration Date (Month/Day/Year)		7. Title and Amount of Underlying Securities (Instr. 3 and 4)		8. Price of Derivative Security (Instr. 5)	9. Nu Deriv Secur Bene Owne Follo Repo Trans (Instr
				Code	V	(A)	(D)	Date Exercisable	Expiration Date	Title	Amount or Number of Shares		

Reporting Owners

Reporting Owner Name / Address	Relationships			
	Director	10% Owner	Officer	Other
OBERNDORF WILLIAM E 615 FRONT STREET SAN FRANCISCO, CA 94111		X		
OBERNDORF PETER CALDWELL 615 FRONT STREET SAN FRANCISCO, CA 94111		X		

Signatures

/s/ Gary Scheier, Gary Scheier, as Attorney-in-Fact for William E. Oberndorf	05/11/2017
**Signature of Reporting Person	Date
/s/ Gary Scheier, Gary Scheier, as Attorney-in-Fact for Peter C. Oberndorf	05/11/2017
**Signature of Reporting Person	Date

Explanation of Responses:

* If the form is filed by more than one reporting person, *see* Instruction 4(b)(v).

** Intentional misstatements or omissions of facts constitute Federal Criminal Violations. *See* 18 U.S.C. 1001 and 15 U.S.C. 78ff(a).

(1) These shares are directly owned by William E. Oberndorf's ("WEO") child, Peter C. Oberndorf, and may be deemed to be indirectly beneficially owned by WEO. WEO disclaims beneficial ownership of these shares except to the extent of his pecuniary interest therein.

(2) These shares are held in the self-directed Individual Retirement Account of WEO

(3) These shares are owned directly by the Bill & Susan Oberndorf Foundation, a California corporation ("Oberndorf Foundation"), and may be deemed to be indirectly beneficially owned by WEO as a controlling person of Oberndorf Foundation. WEO disclaims beneficial ownership of these shares except to the extent of his pecuniary interest therein.

(4) These shares are owned directly by Oberndorf Investments LLC, a Delaware limited liability company ("OBI"), and may be deemed to be indirectly beneficially owned by WEO as the sole controlling person of OBI. WEO disclaims beneficial ownership of these shares except to the extent of his pecuniary interest therein.

(5) These shares are owned directly by the Peter Oberndorf Irrevocable Trust, dated 6/30/89 ("PCO Trust"), and may be deemed to be indirectly beneficially owned by WEO in his capacity as trustee for the PCO Trust. WEO disclaims beneficial ownership of these shares except to the extent of his pecuniary interest therein.

(6) These shares are directly owned by WEO's aunt, Caroline G. Oberndorf, and may be deemed to be indirectly beneficially owned by WEO in his capacity as an authorized signatory for the account of Caroline G. Oberndorf. WEO disclaims beneficial ownership of these shares except to the extent of his pecuniary interest therein.

(7) These shares are owned directly by the William E. Oberndorf Irrevocable Trust, dated 6/30/89 ("Oberndorf Irrevocable Trust"), and may be deemed to be indirectly beneficially owned by WEO in his capacity as trustee for the Oberndorf Irrevocable Trust. WEO disclaims beneficial ownership of these shares except to the extent of his pecuniary interest therein.

Note: File three copies of this Form, one of which must be manually signed. If space is insufficient, *see* Instruction 6 for procedure.
Potential persons who are to respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB number. ="border-bottom: white;">
Barry Griffiths,

2006

$

124,800

$

55,000

—

—

—

Former Western Area Director

2005

$

79,241

$

52,500

—

252,708

—

2004

$

15,000

—

—

—

—

Curtis Ellis,

2006

$

168,115

$

39,125

—

84,236

—

Midwest Area Director

2005

—

Explanation of Responses:

—

—

—

—

2004

—

—

—

—

—

(1) Fiscal year 2006 consisted of the period from July 1, 2005 to June 30, 2006; fiscal year 2005 consisted of the period from October 1, 2004 through June 30, 2005; and, fiscal year 2004 consisted of the year ended September 30, 2004.
(2) Mr. Scallen served as our Chief Executive Officer during the listed fiscal years and until his resignation effective July 28, 2005.
(3) Represents a $50,000 cash payment in June 2005 to Mr. Scallen in settlement of all accrued but unpaid compensation.
(4) Represents the issuance of 787,100 shares of restricted common stock as compensation associated with the conversion of the outstanding notes payable and accrued interest payable. This transaction was valued at approximately $7,781, which was equal to the “fair value” of the Company’s common stock on the conversion date. The Company relied upon Section 4(2) of the Securities Act of 1933, as amended, for an exemption from registration for this issuance.
(5) Mr. Girard did not begin serving as our CEO until July 28, 2005, but he has served as CEO of our subsidiary and its predecessor company since August 2003. The compensation listed was paid to Mr. Girard by IsoRay or its predecessor company.

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Option/SAR Grants in Last Fiscal Year

The following table sets forth information concerning grants of stock options to the Executive Officers during the fiscal year ended June 30, 2006.

Name	Number of Securities Underlying Options	Percent of total options Granted to Employees in Fiscal Year	Exercise Price ($/Share)	Expiration Date
David Swanberg	150,000	23.45%	$ 1.00	8/18/2015
Curtis Ellis	84,236	13.17%	$ 4.15	8/01/2015

Aggregated Option Exercises in Last Fiscal Year and Fiscal Year End Option Values

The following table sets forth the number of shares covered by unexercised stock options held by the Executive Officers as of June 30, 2006, and the value of "in-the-money" stock options, which represents the positive spread between the exercise price of a stock option or warrant and the market price of the shares subject to such option or warrant as of June 30, 2006**.**

			Number of Securities Underlying Unexercised Options at Fiscal Year-End		Value of Unexercised In-the-Money Options at Fiscal Year-End	
Name	Number of Shares Acquired on Exercise	Value Realized	Exercisable	Unexercisable	Exercisable	Unexercisable
Roger Girard	0	$ 0	513,840	0	$ 1,186,970	$ N/A
David Swanberg	0	$ 0	150,000	0	$ 375,000	$ N/A
Barry Griffiths	0	$ 0	84,236	168,472	$ 194,585	$ 389,170
Curtis Ellis	0	$ 0	0	84,236	$ N/A	$ N/A

Employment Agreements

The Company entered into an employment agreement with Roger Girard, its Chief Executive Officer, effective October 6, 2005 (the "Girard Agreement"). The term of the Girard Agreement is through October 6, 2009, and will automatically extend for an additional one year term on each anniversary date unless the term is modified or terminated in accordance with the terms of the Girard Agreement at least ninety days prior to a given anniversary date. The Girard Agreement provides for a base salary of $300,000 which was effective July 1, 2006. Mr. Girard is also entitled to participate in any benefit plans provided to key executives of the Company, and to a bonus at the discretion of the Board of Directors.

The Company has not entered into employment agreements with any other officers as of the date of this filing.

Director Compensation

Since July 28, 2005, we have paid our directors who are not employees of the Company a director’s fee of $1,000 per meeting attended, plus expenses. We also granted each non-employee director immediately exercisable options to purchase 100,000 shares of our common stock during the fiscal year ended June 30, 2006. Robert Kauffman, Thomas

LaVoy and Stephen Boatwright each received 100,000 options at an exercise price of $2.00 per share. Dwight Babcock and Al Smith each received 100,000 options, 50,000 of which are exercisable at $6.30 per share and 50,000 of which are exercisable at $3.80 per share.

The Company's directors did not receive any cash compensation during the nine months ended June 30, 2005 or either of the respective years ended September 30, 2004 or 2003.

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ITEM 11 - SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following tables set forth certain information regarding the beneficial ownership of the Company's common stock and preferred stock as of September 15, 2006 for (a) each person known by the Company to be a beneficial owner of five percent or more of the outstanding common or preferred stock of the Company, (b) each executive officer, director and nominee for director of the Company, and (c) directors and executive officers of the Company as a group. As of September 15, 2006, the Company had 15,802,394 shares of common stock and 122,543 shares of preferred stock outstanding.

Name and Address of Beneficial Owner (1)	Amount of Common Shares Owned	Derivative Securities Exercisable or Convertible Within 60 Days of September 15, 2006	Total Common Shares Beneficially Owned	Percent of Common Shares Owned(2)
Roger Girard, Chief Executive Officer, President and Chairman	368,532	513,840	882,372	5.41%
Jonathan Hunt, Chief Financial Officer	—	—	—	—%
Michael Dunlop, Former Chief Financial Officer	138,050	145,000	283,050	1.77%
David Swanberg, Executive Vice President and Director	324,327	150,000	474,327	2.97%
Robert Kauffman, Director	43,802	150,000	193,802	1.21%
Thomas LaVoy, Director	8,423	150,000	158,423	0.99%
Stephen Boatwright, Director(3)	—	234,236	234,236	1.46%
Dwight Babcock, Director(4)	42,403	150,000	192,403	1.21%
Albert Smith, Director	108,947	150,000	258,947	1.62%
Thomas K. Scallen, Former Chief Executive Officer(5)	317,442	—	317,442	2.01%
MicroCapital Fund LP and MicroCapital Fund Ltd(6)	1,200,000	1,200,000	2,400,000	14.12%
All Officers and Directors as a group (8 persons)	896,434	1,498,076	2,394,510	13.84%

(1) Except as otherwise noted, the address for each of these individuals is c/o IsoRay, Inc., 350 Hills St., Suite 106, Richland, Washington 99354.

(2) Percentage ownership is based on 15,802,394 shares of Common Stock outstanding on September 15, 2006. Shares of Common Stock subject to stock options, warrants or convertible debentures which are currently exercisable/convertible or will become exercisable/convertible within 60 days after September 15, 2006 are deemed outstanding for computing the percentage ownership of the person or group holding such options, but are not deemed outstanding for computing the percentage ownership of any other person or group.

(3) Mr. Boatwright's options include 84,236 options held by an entity controlled by Mr. Boatwright.

(4) Mr. Babcock's common shares include 2,695 shares owned by his spouse.

(5) Mr. Scallen's address is 4701 IDS Center, Minneapolis, MN 55302.

(6) MicroCapital Fund LP and MicroCapital Fund Ltd's address is 1285 Avenue of the Americas, New York, NY 10019.

Preferred Stock Share Ownership as of September 15, 2006

Name and Address of Beneficial Owner	Amount of Preferred Shares Owned	Options or Warrants Exercisable Within 60 Days of August 31, 2006	Total Preferred Shares Beneficially Owned	Percent of Preferred Shares Owned(1)
Aissata Sidibe(2)	35,546	—	35,546	29.01%
Daniel MacKay(3)	18,015	—	18,015	14.70%
John Arvid Forsman(4)	14,218	—	14,218	11.60%
William and Karen Thompson Trust(5)	14,218	—	14,218	11.60%
Jamie Granger(6)	10,529	—	10,529	8.59%
James Hartley(7)	9,479	—	9,479	7.74%
Hostetler Living Trust(8)	9,479	—	9,479	7.74%
Forest Ridge Properties Ltd(9)	6,220	—	6,220	5.08%

(1) Percentage ownership is based on 122,543 shares of Preferred Stock outstanding on August 31, 2006. Shares of Preferred Stock subject to stock options or warrants which are currently exercisable or will become exercisable within 60 days after September 15, 2006 are deemed outstanding for computing the percentage ownership of the person or group holding such options, but are not deemed outstanding for computing the percentage ownership of any other person or group.

(2) The address of Ms. Sidibe is 229 Lasiandra Ct, Richland, WA 99352.

(3) The address of Mr. MacKay is 41 NW Sierra Drive, Camas, WA 98607.

(4) The address of Mr. Forsman is 659 Alden Lane, Livermore, CA 94550.

(5) The address of the William and Karen Thompson Trust is 285 Dondero Way, San Jose, CA 95119.

(6) The address of Jamie Granger is 53709 South Nine Canyon Road, Kennewick, WA 99337.

(7) The address of Mr. Hartley is 1675 April Loop, Richland, WA 99352.

(8) The address of the Hostetler Living Trust is 9257 NE 175th Street, Bothell, WA 98011.

(9) The address of Forest Ridge Properties Ltd is 630 Montreal Street, Apt. 1002, Victoria, BC V8V 4Y2.

No officers or directors beneficially own shares of Preferred Stock.

ITEM 12 - CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Through June 30, 2005, the Company’s former Chief Executive Officer, Thomas K. Scallen, advanced the Company an aggregate of approximately $44,500 to support operations, settle outstanding trade accounts payable and provide working capital. The advance was repayable upon demand and was non-interest bearing and was unsecured. Effective June 30, 2005, with the anticipation of the consummation of the reverse acquisition transaction with IsoRay Medical, Inc., as previously discussed, these advances were forgiven and reclassified as additional paid-in capital in the accompanying financial statements as of that date.

Mr. Stephen Boatwright, a Company director, has been actively involved in providing various legal services to the Company, IsoRay Medical, Inc. and IsoRay Medical, Inc.’s predecessors through the law firms of Gammage and Burnham and Keller Rohrback, PLC. From September 2004 until January 2005, Gammage and Burnham received approximately $141,000 as payment for legal services performed for IsoRay Medical, Inc. and its predecessors. From February 2005 though June 30, 2005, IsoRay Medical, Inc. paid Keller Rohrback, PLC approximately $144,000 for legal services. During the fiscal year ended June 30, 2006, the Company paid Keller Rohrback, PLC approximately

$390,000 for legal services. In addition, the Company had accrued at June 30, 2006 approximately $77,000 in legal fees to be paid. In exchange for consulting services including providing advice to IsoRay Medical, Inc. as to the structure of organization and compensation arrangements with employees and also in connection with developing various policies and procedures, Quatsch Ventures, LLC, an entity controlled by Mr. Boatwright, received options to purchase 84,236 shares of our common stock in 2004.

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IsoRay Medical, Inc.'s patent rights to its Cesium-131 process were acquired from Lane Bray, a shareholder of the Company, and are subject to a 1% royalty on gross profits and certain contractual restrictions. Pursuant to the royalty agreement, the Company must also pay a royalty of 2% of Gross Sales, as defined, for any sub-assignments of the aforesaid patented process to any third parties. The royalty agreement will remain in force until the expiration of the patents on the assigned technology, unless earlier terminated in accordance with the terms of the underlying agreement. To date, there have been no product sales incorporating the technology and there is no royalty due pursuant to the terms of the agreement.

On January 16, 2005, in addition to certain other shareholders, the following officers and directors of the Company were awarded shares of common stock for guaranteeing a loan with the Benton Franklin Economic Development District ("BFEDD") in the amount of $230,000, which was funded in December 2004, and a line of credit with Columbia River Bank in the amount of $395,000: Michael Dunlop guaranteed $15,000 of the BFEDD loan and $30,000 of the Columbia River Bank line of credit, for which he received 12,888 post-merger shares; Roger Girard guaranteed $20,000 of the BFEDD loan, for which he received 5,728 post-merger shares; John Hrobsky guaranteed $15,000 of the Columbia River Bank line of credit, for which he received 4,296 post merger shares; and David Swanberg guaranteed $30,000 of the Columbia River Bank line of credit, for which he received 8,592 post-merger shares. During fiscal year 2006, certain original guarantors, including John Hrobsky, declined to continue guaranteeing the loans and forfeited the shares which had been granted to them. Due to this the following officers agreed to increase the amount of their guarantees as follows: Michael Dunlop guaranteed an additional $5,000 of the Columbia River Bank line of credit, for which he received an additional 1,432 common shares; and Roger Girard guaranteed an additional $105,000 of the Columbia River Bank line of credit, for which he received an additional 30,072 common shares.

On May 27, 2005, the Company, Century Park Transitory Subsidiary, Inc., a Delaware corporation, Thomas Scallen and Anthony Silverman (shareholders of the Company), and IsoRay Medical, Inc., a Delaware corporation, entered into a Merger Agreement. Pursuant to the Merger Agreement, Century Park Transitory Subsidiary, Inc. was merged with and into IsoRay Medical, Inc. and IsoRay Medical, Inc. became a wholly-owned subsidiary of the Company. The Merger Agreement was subject to the satisfaction of certain conditions, including the granting of certain "piggy-back" and demand registration rights to the purchasers of certain convertible debentures of IsoRay Medical, Inc., Anthony Silverman and certain other affiliates of the Company; the agreements of the officers and directors of IsoRay Medical, Inc. to lock-up the shares of common stock of the Company they received in the merger for a period of one year from the closing of the merger; the agreements of Thomas Scallen and Anthony Silverman to escrow certain shares of common stock of the Company; and the receipt by IsoRay Medical, Inc. from Anthony Silverman or his associates of one million dollars as the purchase price of certain securities of IsoRay Medical, Inc. before the closing. These conditions were satisfied prior to the closing of the merger, which occurred on July 28, 2005.

The Board voted on July 28, 2005 to compensate each of the independent Directors $1,000 per meeting for their attendance at the Board meetings. On July 28, 2005, the Company's Board of Directors granted 100,000 options to purchase common stock to each of its three independent Directors: Thomas Lavoy, Stephen Boatwright, and Robert Kauffman. On March 31, 2006 and June 30, 2006, the Company's Board of Directors granted a total of 100,000 options to purchase common stock to its new independent Directors: Albert Smith and Dwight Babcock. Directors who are also serving as management of the Company were not granted stock options for Director service, and will not be paid for attendance at Board meetings.

During 2005, IsoRay Medical, Inc. paid or accrued $5,600 for accounting services performed by a company owned by a member of the Board of Directors of IsoRay Medical, Inc.

Patent and Know-How Royalty License Agreement

Effective August 1, 1998, Pacific Management Associates Corporation (PMAC) transferred its entire right, title and interest in an exclusive license agreement with Donald Lawrence to IsoRay, LLC (a predecessor company) in exchange for a membership interest. The terms of the license agreement require the payment of a royalty based on the Net Factory Sales Price, as defined in the agreement, of licensed product sales. Because the licensor's patent application was ultimately abandoned, only a 1% "know-how" royalty based on Net Factory Sales Price, as defined, remains applicable. To date, there have been no product sales incorporating the licensed technology and there is no royalty due pursuant to the terms of the agreement. The Company believes that because this technology is not presently being used and believes it will not be used in the future that no royalties will be paid under this agreement.

ITEM 13 - EXHIBITS AND REPORTS ON FORM 8-K

(except as otherwise indicated, all exhibits were previously filed)

Exhibit #	Description
2.1	Merger Agreement dated as of May 27, 2005, by and among Century Park Pictures Corporation, Century Park Transitory Subsidiary, Inc., certain shareholders and IsoRay Medical, Inc. incorporated by reference to the Form 8-K filed on August 3, 2005.
2.2	Certificate of Merger, filed with the Delaware Secretary of State on July 28, 2005 incorporated by reference to the Form 8-K filed on August 3, 2005.
3.1	Articles of Incorporation and By-Laws are incorporated by reference to the Exhibits to the Company's Registration Statement of September 15, 1983.
3.2	Certificate of Designation of Rights, Preferences and Privileges of Series A and B Convertible Preferred Stock, filed with the Minnesota Secretary of State on June 29, 2005 incorporated by reference to the Form 8-K filed on August 3, 2005.
3.3	Restated and Amended Articles of Incorporation incorporated by reference to the Form 10-KSB filed on October 11, 2005.
4.2	Form of Lock-Up Agreement for Certain IsoRay Medical, Inc. Shareholders incorporated by reference to the Form 8-K filed on August 3, 2005.
4.3	Form of Lock-Up Agreement for Anthony Silverman incorporated by reference to the Form 8-K filed on August 3, 2005.
4.4	Form of Registration Rights Agreement among IsoRay Medical, Inc., Century Park Pictures Corporation and the other signatories thereto incorporated by reference to the Form 8-K filed on August 3, 2005.
4.5	

	Form of Escrow Agreement among Century Park Pictures Corporation, IsoRay Medical, Inc. and Anthony Silverman incorporated by reference to the Form 8-K filed on August 3, 2005.
4.6	Form of Escrow Agreement among Century Park Pictures Corporation, IsoRay Medical, Inc. and Thomas Scallen incorporated by reference to the Form 8-K filed on August 3, 2005.
4.7	Amended and Restated 2005 Stock Option Plan incorporated by reference to the Form S-8 filed on August 19, 2005.
4.8	Amended and Restated 2005 Employee Stock Option Plan incorporated by reference to the Form S-8 filed on August 19, 2005.
4.9	Form of Registration Right Agreement among IsoRay Medical, Inc., Meyers Associates, L.P. and the other signatories thereto, dated October 15, 2004, incorporated by reference to the Form SB-2 filed on November 10, 2005.
4.10	Form of Registration Rights Agreement among IsoRay, Inc., Meyers Associates, L.P. and the other signatories thereto, dated February 1, 2006, incorporated by reference to the Form SB-2/A1 filed on March 24, 2006.
4.11	Form of IsoRay, Inc. Common Stock Purchase Warrant, incorporated by reference to the Form SB-2/A1 filed on March 24, 2006.

4.12	2006 Director Stock Option Plan, incorporated by reference to the Form S-8 filed on August 18, 2006.
4.13	Form of Registration Rights Agreement among IsoRay, Inc. and the other signatories thereto, dated August 9, 2006, incorporated by reference to the Form 8-K filed on August 18, 2006.
4.14	Form of IsoRay, Inc. Common Stock Purchase Warrant, dated August 9, 2006, incorporated by reference to the Form 8-K filed on August 18, 2006.
10.2	Universal License Agreement, dated November 26, 1997 between Donald C. Lawrence and William J. Stokes of Pacific Management Associates Corporation, incorporated by reference to the Form SB-2 filed on November 10, 2005.
10.3	Royalty Agreement of Invention and Patent Application, dated July 12, 1999 between Lane A. Bray and IsoRay LLC, incorporated by reference to the Form SB-2 filed on November 10, 2005.
10.4	Tri-City Industrial Development Council Promissory Note, dated July 22, 2002, incorporated by reference to the Form SB-2/A2 filed on April 27, 2006.
10.5	Section 510(k) Clearance from the Food and Drug Administration to market Lawrence CSERION Model CS-1, dated March 28, 2003, incorporated by reference to the Form SB-2 filed on November 10, 2005.
10.6	Battelle Project No. 45836 dated June 20, 2003, incorporated by reference to the Form SB-2/A2 filed on April 27, 2006.
10.7	Applied Process Engineering Laboratory APEL Tenant Lease Agreement, dated April 23, 2001 between Energy Northwest and IsoRay, LLC, incorporated by reference to the Form SB-2/A2 filed on April 27, 2006.
10.8	Work for Others Agreement No. 45658, R2, dated April 27, 2004 between Battelle Memorial Institute, Pacific Northwest Division and IsoRay Products LLC, incorporated by reference to the Form SB-2/A2 filed on April 27, 2006.
10.9	Development Loan Agreement for $230,000, dated September 15, 2004 between Benton-Franklin Economic Development District and IsoRay Medical, Inc., incorporated by reference to the Form SB-2/A2 filed on April 27, 2006.
10.10	Registry of Radioactive Sealed Sources and Devices Safety Evaluation of Sealed Source, dated September 17, 2004, incorporated by reference to the Form SB-2/A2 filed on April 27, 2006.
10.11	CRADA PNNL/245, "Y-90 Process Testing for IsoRay", dated December 22, 2004 between Pacific Northwest National Laboratory and IsoRay Medical Inc., including Amendment No. 1, incorporated by reference to the Form SB-2/A2 filed on April 27, 2006.
10.12	Intentionally Omitted

10.13	Amendment 1 to Agreement 45658, dated February 23, 2005 between Battelle Memorial Institute Pacific Northwest Division and IsoRay Medical, Inc., incorporated by reference to the Form SB-2/A2 filed on April 27, 2006.
10.14	Equipment Lease Agreement dated April 14, 2005 between IsoRay Medical, Inc. and Nationwide Funding, LLC, incorporated by reference to the Form SB-2/A2 filed on April 27, 2006.
10.15	Lease Agreement, Rev. 2, dated November 1, 2005 between Pacific EcoSolutions, Inc. and IsoRay Medical, Inc., incorporated by reference to the Form SB-2/A2 filed on April 27, 2006.
10.16	Master Lease Agreement Number 5209, dated May 7, 2005 between VenCore Solutions LLC and IsoRay Medical, Inc., incorporated by reference to the Form SB-2/A2 filed on April 27, 2006.
10.17	Contract #840/08624332/04031 dated August 25, 2005 between IsoRay, Inc. and the Federal State Unitary Enterprise << Institute of Nuclear Materials >>, Russia, incorporated by reference to the Form SB-2 filed on November 10, 2005.
10.18	State of Washington Radioactive Materials License dated October 6, 2005, incorporated by reference to the Form SB-2 filed on November 10, 2005.

10.19	Express Pricing Agreement Number 219889, dated October 5, 2005 between FedEx and IsoRay Medical, Inc., incorporated by reference to the Form 10-QSB filed on November 21, 2005.
10.20	Girard Employment Agreement, dated October 6, 2005 between Roger E. Girard and IsoRay, Inc., incorporated by reference to the Form 10-QSB filed on November 21, 2005.
10.21	Contract Modification Quality Class G, dated October 25, 2005 to Contract Number X40224 between Energy Northwest and IsoRay, Inc., incorporated by reference to the Form 10-QSB filed on November 21, 2005.
10.22	Agreement dated August 9, 2005 between the Curators of the University of Missouri and IsoRay Medical, Inc., incorporated by reference to the Form SB-2/A2 filed on April 27, 2006 (confidential treatment requested).
10.23	SICAV ONE Securities Purchase Agreement, dated December 7, 2005, by and between IsoRay, Inc. and Mercatus & Partners, Ltd., incorporated by reference to the Form 8-K filed on December 12, 2005.
10.24	SICAV TWO Securities Purchase Agreement, dated December 7, 2005, by and between IsoRay, Inc. and Mercatus & Partners, Ltd., incorporated by reference to the Form 8-K filed on December 12, 2005.
10.25	Economic Development Agreement, dated December 14, 2005, by and between IsoRay, Inc. and the Pocatello Development Authority, incorporated by reference to the Form 8-K filed on December 20, 2005.
10.26	License Agreement, dated February 2, 2006, by and between IsoRay Medical, Inc. and IBt SA, incorporated by reference to the Form 8-K filed on March 24, 2006 (confidential treatment requested).
10.27	Benton Franklin Economic Development District Loan Covenant Waiver Letter, dated as of March 31, 2005, incorporated by reference to the Form SB-2/A3 filed on May 12, 2006.
10.28	Service Agreement between IsoRay, Inc. and Advanced Care Medical, Inc., dated March 1, 2006, incorporated by reference to the Form SB-2/A2 filed on April 27, 2006.
10.29	Business Loan Agreement between IsoRay Medical, Inc. and Columbia River Bank, dated March 1, 2006, incorporated by reference to the Form SB-2/A4 filed on May 26, 2006.
10.30	Letter from HAEIFC to IsoRay Medical, Inc. dated April 26, 2006, incorporated by reference to the Form SB-2/A5 filed on June 6, 2006.
10.31	Loan Agreement, dated June 15, 2006, by and between IsoRay Medical, Inc. and the Hanford Area Economic Investment Fund Committee, incorporated by reference to the Form 8-K filed on June 21, 2006.

10.32	Commercial Security Agreement, dated June 15, 2006, by and between IsoRay Medical, Inc. and the Hanford Area Economic Investment Fund Committee, incorporated by reference to the Form 8-K filed on June 21, 2006.
10.33	Common Stock and Warrant Purchase Agreement among IsoRay, Inc. and the other signatories thereto, dated August 9, 2006, incorporated by reference to the Form 8-K filed on August 18, 2006.
10.34	Benton Franklin Economic Development District Loan Covenant Waiver Letter, dated September 26, 2006, filed herewith.
16.1	Letter from S.W. Hatfield, CPA to the SEC dated December 13, 2005, incorporated by reference to the Form 8-K filed on December 14, 2005.
21.1	Subsidiaries of the Company, incorporated by reference to the Form 10-KSB filed on October 11, 2005.
31.1	Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 - Chief Executive Officer, filed herewith.
31.2	Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 - Chief Financial Officer, filed herewith.
32.1	Certifications Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, filed herewith.

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Reports on Form 8-K

On April 6, 2006, the Company filed a Current Report on Form 8-K announcing the expansion of the Board of Directors to seven members and appointing Albert Smith and Dwight Babcock as directors.

On May 2, 2006, the Company filed a Current Report on Form 8-K/A amending its March 26, 2006 Form 8-K filing.

On May 9, 2006, the Company filed a Current Report on Form 8-K providing notice that certain previously filed consolidated financial statements were to be restated.

On June 21, 2006, the Company filed a Current Report on Form 8-K announcing its entry into a loan agreement with the Hanford Area Economic Investment Fund Committee ("HAEIFC") for a $1.4 million loan facility.

On August 10, 2006, the Company filed a Current Report on Form 8-K announcing the return of the Mercatus shares and their cancellation.

On August 18, 2006, the Company filed a Current Report on Form 8-K announcing the sale of unregistered common stock and warrants pursuant to a Common Stock and Warrant Purchase Agreement.

On September 8, 2006, the Company filed a Current Report on Form 8-K announcing a press release of the Company's preliminary financial results for the year ended June 30, 2006 and anticipated first quarter of fiscal year 2007.

On September 11, 2006, the Company filed a Current Report on Form 8-K announcing the resignation of the Company's Chief Financial Officer, the appointment of a new Chief Financial Officer, and the transcript from the Company's presentation at the Roth Capital Conference.

ITEM 14 - PRINCIPAL ACCOUNTANT FEES AND SERVICES

The Company paid or accrued the following fees in each of the prior two fiscal years to its principal accountant, DeCoria, Maichel & Teague, P.S., and to its previous principal accountant, S. W. Hatfield, CPA of Dallas, Texas:

	Year ended June 30, 2006	Nine months ended June 30, 2005	Year ended September 30, 2004
1. Audit fees(1)	$ 72,292	$ 4,663	$ 5,512
2. Audit-related fees	1,150	-	-
3. Tax fees	2,750	-	-
4. All other fees	-	-	-
Totals	$ 76,192	$ 4,663	$ 5,512

(1) Fees for the year ended June 30, 2006 were as follows: $49,125 paid to DeCoria, Maichel & Teague, P.S. and $23,167 paid to S. W. Hatfield, CPA.

As part of its responsibility for oversight of the independent registered public accountants, the Audit Committee has established a pre-approval policy for engaging audit and permitted non-audit services provided by our independent registered public accountants, DeCoria, Maichel & Teague, P.S. In accordance with this policy, each type of audit, audit-related, tax and other permitted service to be provided by the independent auditors is specifically described and each such service, together with a fee level or budgeted amount for such service, is pre-approved by the Audit Committee. The Audit Committee has delegated pre-approval authority to its Chairman to pre-approve additional non-audit services (provided such services are not prohibited by applicable law) up to a pre-established aggregate dollar limit. All services pre-approved by the Chairman of the Audit Committee must be presented at the next Audit Committee meeting for their review and ratification. All of the services provided by DeCoria, Maichel & Teague, P.S. described above were approved by our Audit Committee.

The Company's principal accountant, DeCoria, Maichel & Teague P.S. did not engage any other persons or firms other than the principal accountant's full-time, permanent employees.

IsoRay, Inc.
Index to Financial Statements

Report of Independent Registered Public Accounting Firm

Board of Directors and Shareholders
IsoRay, Inc.
Richland, Washington

We have audited the accompanying consolidated balance sheets of IsoRay, Inc. and Subsidiary ("the Company") (see Note 1) as of June 30, 2006 and 2005, and the related consolidated statements of operations, changes in shareholders' equity (deficit) and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion the financial statements referred to above present fairly, in all material respects, the consolidated financial position of IsoRay, Inc. and Subsidiary as of June 30, 2006 and 2005, and the consolidated results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 3 to the financial statements, certain conditions raise substantial doubt about the Company's ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 3. The accompanying financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/ DeCoria, Maichel & Teague, P.S.

Spokane, Washington
September 26, 2006

IsoRay, Inc. and Subsidiary
Consolidated Balance Sheets

	June 30, 2006	June 30, 2005
ASSETS		
Current assets:		
Cash and cash equivalents	$ 2,207,452	$ 1,653,144
Accounts receivable, net of allowance for doubtful accounts of $85,183 and $17,075, respectively	596,447	49,969
Inventory	161,381	81,926
Prepaid expenses	161,546	181,266
Total current assets	3,126,826	1,966,305
Fixed assets, net of accumulated depreciation	1,642,293	842,323
Deferred financing costs, net of accumulated amortization	274,358	548,837
Licenses, net of accumulated amortization	273,475	18,656
Other assets, net of accumulated amortization	338,987	226,263
Total assets	$ 5,655,939	$ 3,602,384
LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIT)		
Current liabilities:		
Accounts payable and accrued expenses	$ 584,296	$ 695,588
Accrued payroll and related taxes	614,645	157,924
Accrued interest payable	11,986	41,325
Notes payable, due within one year	51,351	43,116
Capital lease obligations, due within one year	183,554	9,604
Convertible debentures payable, due within one year	455,000	-
Total current liabilities	1,900,832	947,557
Notes payable, due after one year	581,557	562,224
Capital lease obligations, due after one year	220,415	19,584
Convertible debentures payable, due after one year	-	3,587,875
Asset retirement obligation	67,425	-
Total liabilities	2,770,229	5,117,240
Shareholders' equity (deficit):		
Preferred stock, $.001 par value; 6,000,000 shares authorized:		
Series A: 1,000,000 shares allocated; no shares issued and outstanding	-	-
Series B: 5,000,000 shares allocated; 144,759 and 1,338,167 shares issued and outstanding	145	1,338

Common stock, $.001 par value; 194,000,000 and 100,000,000 shares authorized; 15,157,901 and 6,163,623 shares issued and outstanding		15,158		6,164
Subscriptions receivable		(6,122,007)		-
Additional paid-in capital		22,538,675		3,805,773
Accumulated deficit		(13,546,261)		(5,328,131)
Total shareholders' equity (deficit)		2,885,710		(1,514,856)
Total liabilities and shareholders' equity (deficit)	$	5,655,939	$	3,602,384

The accompanying notes are an integral part of these financial statements.

IsoRay, Inc. and Subsidiary
Consolidated Statements of Operations

	Year ended June 30, 2006		Year ended June 30, 2005	
Product sales	$	1,994,306	$	201,731
Cost of product sales		3,815,122		1,474,251
Gross loss		(1,820,816)		(1,272,520)
Operating expenses:				
Research and development		450,425		137,532
Sales and marketing expenses		1,420,500		701,822
General and administrative expenses		3,503,522		1,871,325
Total operating expenses		5,374,447		2,710,679
Operating loss		(7,195,263)		(3,983,199)
Non-operating income (expense):				
Interest income		51,744		2,394
Financing expense		(689,100)		(167,493)
Loss on disposal of fixed assets		-		(120,890)
Debt conversion expense (Note 11)		(385,511)		-
Non-operating income (expense), net		(1,022,867)		(285,989)
Net loss	$	(8,218,130)	$	(4,269,188)
Basic loss per share	$	(0.68)	$	(0.78)
Shares used in computing net loss per share:				
Basic		12,051,964		5,470,046

The accompanying notes are an integral part of these financial statements.

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IsoRay, Inc. and Subsidiary
Consolidated Statement of Changes in Shareholders' Equity (Deficit)

	IsoRay, Inc. (MN) [1]				IsoRay, Inc. (WA)		IsoRay Medical, Inc.			
	Series B Preferred Stock		Common Stock		Common Stock [2]		Series B Preferred Stock		Common Stock	
	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount
Balances at June 30, 2004	-	$ -	-	$ -	2,767,700	$ 2,768	-	$ -	8,424	$ 8
Issuance of IsoRay, Inc. (WA) common shares pursuant to exercise of options					71,580	71				
Issuance of IsoRay, Inc. (WA) common shares as compensation					57,025	57				
Issuance of IsoRay Products LLC member shares for cash, net of offering costs										
Merger of IsoRay, Inc (WA) and IsoRay Products LLC into IsoRay Medical, Inc.					(2,896,305)	(2,896)	1,249,832	1,249	5,195,205	5,196
Reversal of dividends accrued by IsoRay Products LLC										
Issuance of IsoRay Medical, Inc. common shares for										

cash pursuant to private placement, net of offering costs			644,828	645
Issuance of IsoRay Medical, Inc. common shares pursuant to exercise of warrants granted in connection with private placement			109,296	109
Issuance of IsoRay Medical, Inc. common shares as inducement for guarantee of debt			177,856	178
Issuance of IsoRay Medical, Inc. common shares as partial payment for laser welding stations			25,526	26
Issuance of Series B preferred shares pursuant to exercise of warrants	90,823	91		
Exchange of Series B preferred shares for IsoRay Medical, Inc. common shares	(2,488)	(2)	2,488	2

Payments to common shareholders in lieu of issuing fractional shares										
Net loss										
Balances at June 30, 2005	-	-	-	-	-	-	1,338,167	1,338	6,163,623	6,164
Merger of IsoRay, Inc. (formerly Century Park Pictures Corporation) and IsoRay Medical, Inc., net of fractional shares paid in cash (see Note 1)	1,338,132	1,338	6,163,518	6,164			(1,338,167)	(1,338)	(6,163,623)	(6,164)
Common stock held by shareholders of Century Park Picture Corporation after the reverse acquisition			2,498,534	2,499						
Issuance of common shares as payment for merger consulting services			168,472	169						
Payments to shareholders in lieu of issuing fractional shares										
Issuance of preferred stock pursuant	8,708	8								

Explanation of Responses:

to exercise of warrants				
Issuance of preferred stock pursuant to exercise of warrants paid by surrending a partial note payable	44,788	45		
Issuance of common stock pursuant to exercise of warrants			84,147	84
Issuance of common stock pursuant to exercise of options			101,284	101
Conversion of preferred stock to common stock	(1,246,869)	(1,246)	1,246,869	1,246
Exchange of convertible debentures payable to common stock			911,271	911
Issuance of warrants pursuant to short-term inducement to convert debentures				
Issuance of warrants as inducement for note payable from shareholder (see Note 9)				
Issuance of common stock pursuant to the October 2005 private placement, net of offering costs			1,500,000	1,500

Issuance of common stock pursuant to the February 2006 private placement, net of offering costs			268,889	269						
Issuance of common stock to Mercatus subject to a subscription receivable agreement			1,748,146	1,748						
Issuance of common stock for payment of invoices			39,007	39						
Issuance of common stock pursuant to the June 2006 warrant exercise solicitation, net of offering costs			427,764	428						
Net loss										
Balances at June 30, 2006	144,759	$ 145	15,157,901	$ 15,158	-	$ -	-	$ -	-	$ -

1. IsoRay, Inc (MN) is the current registrant (formerly Century Park Pictures Corporation) and a Minnesota corporation.

2. IsoRay, Inc. (WA) is a former Washington corporation which was merged into IsoRay Medical, Inc. in fiscal year 2005.

The accompanying notes are an integral part of these financial statements.

IsoRay, Inc. and Subsidiary
Consolidated Statements of Cash Flows

	Year ended June 30, 2006		Year ended June 30, 2005	
CASH FLOWS FROM OPERATING ACTIVITIES:				
Net loss	$	(8,218,130)	$	(4,269,188)
Adjustments to reconcile net loss to net cash used by operating activities:				
Depreciation and amortization of fixed assets		271,060		140,099
Amortization of deferred financing costs and other assets		384,266		82,358
Accretion of asset retirement obligation		4,385		-
Loss on disposal of fixed assets		-		120,890
Merger consulting fees paid by issuance of common stock		330,000		-
Consulting and repair fees paid by issuance of common stock		39,750		57,025
Rent expense paid by issuance of common stock		90,026		-
Debt conversion expense (Note 11)		385,511		-
Changes in operating assets and liabilities:				
Accounts receivable, net		(546,478)		(49,969)
Inventory		(79,455)		(62,200)
Prepaid expenses		41,252		(104,133)
Accounts payable and accrued expenses		(132,646)		566,567
Accrued payroll and related taxes		456,721		99,914
Accrued interest payable		(29,339)		33,090
Net cash used by operating activities		(7,003,077)		(3,385,547)
CASH FLOWS FROM INVESTING ACTIVITIES:				
Purchases of fixed assets		(474,795)		(724,029)
Additions to licenses and other assets		(395,201)		(431,438)
Cash acquired in reverse acquisition (Note 1)		32,587		-
Net cash used by investing activities		(837,409)		(1,155,467)
CASH FLOWS FROM FINANCING ACTIVITIES:				
Proceeds from issuance of notes payable, net of financing costs		646,542		315,000
Proceeds from sales of convertible debentures payable		550,000		3,587,875
Principal payments on notes payable		(592,790)		(23,653)
Principal payments on capital lease obligations		(124,688)		(2,914)
Proceeds from cash sales of common shares pursuant to private placement, net of offering costs		6,516,350		1,847,511
Proceeds from cash sales of preferred stock, pursuant to exercise of warrants		6,985		-
Proceeds from cash sales of common stock, pursuant to exercise of warrants		49,950		-
Proceeds from cash sales of common stock, pursuant to exercise of options		119,577		-
		1,223,602		-

Proceeds from cash sales of common stock, pursuant to June 2006 warrant exercises				
Payments to common shareholders in lieu of issuing fractional shares		(734)		(100)
Net cash provided by financing activities		8,394,794		5,723,719
Net increase in cash and cash equivalents		554,308		1,182,705
Cash and cash equivalents, beginning of period		1,653,144		470,439
CASH AND CASH EQUIVALENTS, END OF PERIOD	$	2,207,452	$	1,653,144
Supplemental disclosures of cash flow information:				
Cash paid for interest	$	361,832	$	57,657
Non-cash investing and financing activities:				
Exchange of convertible debentures payable for shares of common stock	$	3,682,875	$	-
Fixed assets acquired by capital lease obligations		507,947		32,102
Increase in PP&E related to asset retirement obligation		63,040		
Issuance of common shares as partial payment for production equipment		25,248		50,000
Issuance of common shares as partial payment of notes payable		48,313		-
Liabilities acquired in acquisition		21,355		-
Prepaid rent paid by issuance of common stock		120,036		-
Issuance of warrants as an inducement for a note payable		60,000		-
Issuance of preferred shares for debt reduction		-		46,007
Issuance of common shares as compensation for guarantee of debt		-		348,381
Reversal of dividends payable to IsoRay Products LLC members		-		(91,765)

The accompanying notes are an integral part of these financial statements.

IsoRay, Inc.
Notes to Consolidated Financial Statements
For the years ended June 30, 2006 and 2005

1. Organization

Historical Organization

Century Park Pictures Corporation ("Century") was organized under Minnesota law in 1983. Century is a public company subject to the periodic reporting requirements of the Securities Exchange Act of 1934.

Century had no operations since its fiscal year ended September 30, 1999 through June 30, 2005.

Merger Transaction

On May 27, 2005, IsoRay Medical, Inc. ("Medical") entered into a merger agreement with Century to merge with Century's newly-formed, wholly-owned subsidiary.

On July 28, 2005, the merger transaction closed. As a result of the merger, Medical became a wholly-owned subsidiary of Century, which concurrently changed its name to IsoRay, Inc. ("IsoRay" or "the Company").

IsoRay issued shares of its common and preferred stock to the holders of common and preferred stock of Medical at a rate of 0.842362 share of IsoRay's stock for each share of Medical's stock. Options and warrants to purchase common and preferred stock of Medical were also converted at the same rate into options and warrants to purchase common and preferred stock of IsoRay, Inc. On a fully-diluted basis, Medical's shareholders owned approximately 82% of IsoRay's outstanding securities.

Management believes the transaction was structured to qualify as a non-taxable reorganization under Section 368(a)(1)(A) of the Internal Revenue Code of 1986, as amended.

Financial Presentation

Medical, a Delaware corporation, was incorporated effective June 15, 2004 to develop, manufacture and sell isotope-based medical products and devices for the treatment of cancer and other diseases. Medical is headquartered in Richland, Washington.

Medical was formed for the purpose of combining the operations of IsoRay, Inc. (a former Washington corporation) ("IsoRay (WA)") and its subsidiary, IsoRay Products LLC, two companies that shared common ownership and management with Medical. Medical's management initiated a merger transaction effective October 1, 2004, in order to accomplish the combining of operations.

Statement of Financial Accounting Standards (SFAS) No. 141, *Business Combinations*, requires that following a merger the accounting acquirer's financial statements should be used for historical comparisons. Although the legal acquirer was Century, for accounting purposes Medical was the acquirer and as such Medical's historical financial statements are shown for comparative purposes. Also for accounting purposes, the merger was accounted for as though it happened on July 1, 2005.

As part of the reverse merger, Medical acquired cash of $32,587 and accounts payable of $21,355.

2. Summary of Significant Accounting Policies

Consolidation

The accompanying consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary (collectively the “Company”). All significant intercompany accounts and transactions have been eliminated.

Basis of Presentation

During the fourth quarter of fiscal year 2005, Medical’s management determined that Medical had emerged from the development stage, inasmuch as its planned principal operations had commenced. Prior to that time, Medical’s activities had consisted primarily of conducting research and development and soliciting equity and debt financing. Accordingly, the Company’s financial statements are no longer presented as those of a development stage enterprise as they were in prior periods, as prescribed by Statement of Financial Accounting Standards (SFAS) No. 7, *Accounting and Reporting by Development Stage Enterprises*.

Cash Equivalents

The Company considers all highly liquid investments with maturities of three months or less when purchased to be cash equivalents.

Accounts Receivable

Accounts receivable are stated at the amount that management of the Company expects to collect from outstanding balances. Management provides for probable uncollectible amounts through an allowance for doubtful accounts. Additions to the allowance for doubtful accounts are based on management’s judgment, considering historical write-offs, collections and current credit conditions. Balances which remain outstanding after management has used reasonable collection efforts are written off through a charge to the allowance for doubtful accounts and a credit to the applicable accounts receivable. Payments received subsequent to the time that an account is written off are considered bad debt recoveries.

Inventory

Inventory is reported at the lower of cost, determined using the weighted average method, or net realizable value.

Fixed Assets

Fixed assets are carried at the lower of cost or net realizable value. Production equipment with a cost of $2,500 or greater, and other fixed assets with a cost of $1,000 or greater are capitalized. Major betterments that extend the useful lives of assets are also capitalized. Normal maintenance and repairs are charged to expense as incurred. When assets are sold or otherwise disposed of, the cost and accumulated depreciation are removed from the accounts and any resulting gain or loss is recognized in operations.

Depreciation is computed using the straight-line method over the following estimated useful lives:

Production equipment	7 years
Office equipment	5 years
Furniture and fixtures	5 years

Leasehold improvements and capital lease assets are amortized over the shorter of the life of the lease or the estimated life of the asset.

The Company has adopted the provisions of SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. The provisions of SFAS No. 144 require that an impairment loss be recognized when the estimated future cash flows (undiscounted and without interest) expected to result from the use of an asset are less than the carrying amount of the asset. Measurement of an impairment loss is based on the estimated fair value of the asset if the asset is expected to be held and used.

Management of the Company periodically reviews the net carrying value of all of its equipment on an asset by asset basis. These reviews consider the net realizable value of each asset, as measured in accordance with the preceding paragraph, to determine whether an impairment in value has occurred, and the need for any asset impairment write-down.

Although management has made its best estimate of the factors that affect the carrying value based on current conditions, it is reasonably possible that changes could occur which could adversely affect management's estimate of net cash flows expected to be generated from its assets, and necessitate asset impairment write-downs.

<u>Deferred Financing Costs</u>

Financing costs related to the acquisition of debt are deferred and amortized over the term of the related debt using the effective interest method. Deferred financing costs include the fair value of shares issued to certain shareholders for their guarantee of certain Company debt (see Notes 8 and 9). Amortization of deferred financing costs, totaling $296,608 and $76,746 for the years ended June 30, 2006 and 2005, respectively, is included in financing expense on the statements of operations.

<u>Licenses</u>

Amortization of licenses is computed using the straight-line method over the estimated economic useful lives of the assets. In fiscal year 2006, the Company entered into an agreement with IBt, SA, a Belgian company (“IBt”) to use IBt’s proprietary “Ink Jet” production process and paid to IBt $275,000. The IBt license is being amortized over the 15 year term of the license. Amortization of licenses was $20,530 and $2,674 for the years ended June 30, 2006 and 2005, respectively.

The Company periodically reviews the carrying values of licenses in accordance with SFAS No. 144 and any impairments are recognized when the expected future operating cash flows to be derived from such assets are less than their carrying value.

Based on the licenses recorded at June 30, 2006, and assuming no subsequent impairment of the underlying assets, the annual amortization expense for each fiscal year ending June 30th, is expected to be as follows: $20,224 for 2007, $20,224 for 2008, $20,224 for 2009, $18,600 for 2010, and $18,333 for 2011.

<u>Other Assets</u>

Other assets, which include deferred charges and patents, are stated at cost, less accumulated amortization. Amortization of patents is computed using the straight-line method over the estimated economic useful lives of the assets. The Company periodically reviews the carrying values of patents in accordance with SFAS No. 144 and any impairments are recognized when the expected future operating cash flows to be derived from such assets are less than their carrying value.

Based on the patents and other intangible assets recorded in other assets at June 30, 2006, and assuming no subsequent impairment of the underlying assets, the annual amortization expense for each fiscal year ending June 30th, is expected to be as follows: $10,790 for 2007, $4,826 for 2008, $1,843 for 2009, $1,843 for 2010, and $1,843 for 2011.

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Asset Retirement Obligation

SFAS No. 143, *Asset Retirement Obligations*, establishes standards for the recognition, measurement and disclosure of legal obligations associated with the costs to retire long-lived assets. Accordingly, under SFAS No. 143, the fair value of the future retirement costs of the Company's leased assets are recorded as a liability on a discounted basis when it is incurred and an equivalent amount is capitalized to property and equipment. The initial recorded obligation, which has been discounted using the Company's credit-adjusted risk free-rate, will be reviewed periodically to reflect the passage of time and changes in the estimated future costs underlying the obligation. The Company amortizes the initial amount capitalized to property and equipment and recognizes accretion expense in connection with the discounted liability over the estimated remaining useful life of the leased assets.

During the years ended June 30, 2006 and 2005, the asset retirement obligation changed as follows:

		2006
Beginning balance	$	-
New obligations		63,040
Accretion of discount		4,385
Ending balance	$	67,425

Financial Instruments

The Company discloses the fair value of financial instruments, both assets and liabilities, recognized and not recognized in the balance sheet, for which it is practicable to estimate the fair value. The fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties, other than a forced liquidation sale.

The carrying amounts of financial instruments, including cash and cash equivalents; accounts receivable; accounts payable; notes payable; capital lease obligations; and convertible debentures payable, approximated their fair values at June 30, 2006 and 2005.

Revenue Recognition

The Company applies the provisions of SEC Staff Accounting Bulletin ("SAB") No. 104, *Revenue Recognition*. SAB No. 104, which supersedes SAB No. 101, *Revenue Recognition in Financial Statements*, provides guidance on the recognition, presentation and disclosure of revenue in financial statements. SAB No. 104 outlines the basic criteria that must be met to recognize revenue and provides guidance for the disclosure of revenue recognition policies. The Company recognizes revenue related to product sales when (i) persuasive evidence of an arrangement exists, (ii) shipment has occurred, (iii) the fee is fixed or determinable, and (iv) collectibility is reasonably assured.

Revenue for the fiscal years ended June 30, 2006 and 2005 was derived solely from sales of the ^{131}Cs brachytherapy seed, which is used in the treatment of cancer. The Company recognizes revenue once an order has been received and shipped to the customer. Prepayments, if any, received from customers prior to the time that products are shipped are recorded as deferred revenue. In these cases, when the related products are shipped, the amount recorded as deferred revenue is recognized as revenue. The Company accrues for sales returns and other allowances at the time of shipment.

Stock-Based Compensation

SFAS No. 123, *Accounting for Stock-Based Compensation*, as amended by SFAS No. 148, requires companies to recognize stock-based expense based on the estimated fair value of employee stock options. Alternatively, SFAS No.

123 allows companies to retain the current approach set forth in Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* (APB 25), provided that expanded footnote disclosure is presented. The Company has not adopted the fair value method of accounting for stock-based compensation under SFAS No. 123, but provides the pro forma disclosure required when appropriate (see Note 12).

Research and Development Costs

Research and development costs, including salaries, research materials, administrative expenses and contractor fees, are charged to operations as incurred. The cost of equipment used in research and development activities which has alternative uses is capitalized as part of fixed assets and not treated as an expense in the period acquired. Depreciation of capitalized equipment used to perform research and development is classified as research and development expense in the year computed.

Advertising and Marketing Costs

Advertising and marketing costs are expensed as incurred except for the cost of tradeshows which are deferred until the tradeshow occurs.

Shipping and Handling Costs

Shipping and handling costs are expensed as incurred and included in cost of product sales.

Legal Contingencies

In the ordinary course of business, the Company is involved in legal proceedings involving contractual and employment relationships, product liability claims, patent rights, and a variety of other matters. The Company records contingent liabilities resulting from asserted and unasserted claims against it, when it is probable that a liability has been incurred and the amount of the loss is reasonably estimable. The Company discloses contingent liabilities when there is a reasonable possibility that the ultimate loss will exceed the recorded liability. Estimating probable losses requires analysis of multiple factors, in some cases including judgments about the potential actions of third-party claimants and courts. Therefore, actual losses in any future period are inherently uncertain. Currently, the Company does not believe any probable legal proceedings or claims will have a material impact on its financial position or results of operations. However, if actual or estimated probable future losses exceed the Company's recorded liability for such claims, it would record additional charges as other expense during the period in which the actual loss or change in estimate occurred.

Income Taxes

Income taxes are accounted for under the liability method. Under this method, the Company provides deferred income taxes for temporary differences that will result in taxable or deductible amounts in future years based on the reporting of certain costs in different periods for financial statement and income tax purposes. This method also requires the recognition of future tax benefits such as net operating loss carryforwards, to the extent that realization of such benefits is more likely than not. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in operations in the period that includes the enactment of the change.

Income (Loss) Per Common Share

The Company accounts for its income (loss) per common share according to SFAS No. 128, *Earnings Per Share*. Under the provisions of SFAS No. 128, primary and fully diluted earnings per share are replaced with basic and diluted earnings per share. Basic earnings per share is calculated by dividing net income (loss) available to common shareholders by the weighted average number of common shares outstanding, and does not include the impact of any potentially dilutive common stock equivalents. Common stock equivalents, including warrants to purchase the Company's common stock and common stock issuable upon the conversion of notes payable, are excluded from the calculations when their effect is antidilutive. Basic weighted average shares outstanding for the year ended June 30, 2005 have been adjusted to reflect the exchange ratio contained in the merger transaction dated July 28, 2005 (see Note 1). At June 30, 2006 and 2005, the calculation of diluted weighted average shares does not include preferred stock, options, or warrants that are potentially convertible into common stock as those would be antidilutive due to the Company's net loss position.

Securities that could be dilutive in the future as of June 30, 2006 and 2005 are as follows:

	2006	2005
Preferred stock	144,759	1,338,167
Preferred stock warrants	179,512	233,008
Common stock warrants	2,502,769	136,158
Common stock options	3,129,692	2,237,802
Convertible debentures	109,639	864,548
Total potential dilutive securities	6,066,371	4,809,683

Use of Estimates

The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires management of the Company to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Accordingly, actual results could differ from those estimates and affect the amounts reported in the financial statements.

Reclassification Entries

Certain reclassifications, primarily the separate disclosure of deferred financing costs and licenses, have been made to the 2005 financial statements to conform to the presentation in the 2006 financial statements.

3. Risks and Uncertainties

The Company's financial statements have been prepared on a going concern basis, which contemplates the realization of assets and settlement of liabilities and commitments in the normal course of business. However, our large operating losses and accumulated deficit, among other things, raise substantial doubt about our ability to continue as a going concern. Management plans to raise additional financing (including the sale of additional equity or borrowings) and grow the revenues of our core product while continually analyzing other market opportunities. However, no assurance can be given that such financing will be completed on terms acceptable to the Company or that the Company will be able to meet its revenue targets. If the Company is unable to obtain additional financing and grow revenues, we may have to curtail our business or cease operations. The financial statements do not include any adjustments relating to the recoverability of assets and classification of liabilities that might be necessary should the Company be unable to continue as a going concern.

4. Inventory

Inventory consists of the following at June 30, 2006 and 2005:

	2006	2005
Raw materials	$ 61,531	$ 27,659
Work in process	67,906	54,267
Finished goods	31,944	-
	$ 161,381	$ 81,926

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The cost of materials and production costs contained in inventory that are not useable due to the passage of time, and resulting loss of bio-effectiveness, are written off to cost of product sales at the time it is determined that the product is not useable. It is not possible to determine what portion of cost of product sales is represented by "spoilage."

5. Prepaid Expenses

Prepaid expenses consist of the following at June 30, 2006 and 2005:

		2006		2005
Prepaid contract work	$	7,913	$	65,328
Prepaid insurance		21,340		15,853
Prepaid rent		30,009		-
Other prepaid expenses		102,284		100,085
	$	161,546	$	181,266

6. Fixed Assets

Fixed assets consist of the following at June 30, 2006 and 2005:

		2006		2005
Production equipment	$	590,908	$	399,448
Office equipment		70,060		31,028
Furniture and fixtures		100,653		7,736
Leasehold improvements		652,404		138,692
Capital lease assets (a)		599,738		34,049
Construction in progress		34,254		366,034
		2,048,017		976,987
Less accumulated depreciation		(405,724)		(134,664)
	$	1,642,293	$	842,323

(a) June 30, 2006 balance includes asset retirement addition of $63,040.

Depreciation and amortization expense related to fixed assets totaled $271,060 and $140,099 for 2006 and 2005, respectively. Accumulated amortization of capital lease assets totaled $55,644 at June 30, 2006.

7. Other Assets

Other assets, net of accumulated amortization, consist of the following at June 30, 2006 and 2005:

		2006		2005
Deferred charges	$	318,885	$	204,649
Patents and trademarks, net of accumulated amortization of $13,831 and $12,318		20,102		21,614
	$	338,987	$	226,263

Deferred charges consist of prepaid legal fees for patents which have not yet been obtained, and prepayments and deposits on fixed assets and contracts. Amortization of patents and trademarks was $1,513 and $2,938 for the years ended June 30, 2006 and 2005, respectively.

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8. Bank Line of Credit

The Company has a $375,000 revolving line of credit with Columbia River Bank that expires on March 1, 2007. Amounts outstanding under the line bear interest at the bank's reference rate (Wall Street Journal Prime Rate, which was 8.25% at June 30, 2006) plus 2.0%. The line of credit is collateralized by all accounts receivable and inventory, and is personally guaranteed by certain shareholders up to $375,000 (see Note 12). The Company had no borrowings under the line of credit at June 30, 2006.

9. Notes Payable

Notes payable consist of the following at June 30, 2006 and 2005:

		2006		2005
Tri-City Industrial Development Council (TRIDEC) note payable (a)	$	10,000	$	20,000
Benton-Franklin Economic Development District (BFEDD) note payable (b)		204,237		222,693
Columbia River Bank note payable (c)		-		43,654
Convertible notes payable (d)		-		318,993
Hanford Area Economic Investment Fund Committee (HAEIFC) note payable (e)		418,671		-
		632,908		605,340
Less amounts due within one year		(51,351)		(43,116)
Amounts due after one year	$	581,557	$	562,224

(a) This is a non-interest bearing note, due in annual installments of $10,000, maturing August 2006. The note payable to TRIDEC bears no interest, but has not been discounted because the note was exchanged solely for cash.

(b) The note payable to BFEDD, which is collateralized by substantially all of the Company's assets, and guaranteed by certain shareholders, was executed pursuant to a Development Loan Agreement. The note contains certain restrictive covenants relating to: working capital; levels of long-term debt to equity; incurrence of additional indebtedness; payment of compensation to officers and directors; and payment of dividends. The note is payable in monthly installments including interest at 8.0% per annum with a final balloon payment due in October 2009. At June 30, 2006, the Company was not in compliance with certain of the covenants. The Company has obtained a waiver from BFEDD, relating to these covenants, through June 30, 2007.

(c) During fiscal year 2006, the Company repaid the note payable to Columbia River Bank from cash on hand.

(d) The merger agreement between Medical, IsoRay (WA), and IsoRay Products LLC (see Note 1) provided the former note holders of IsoRay Products LLC with the option of exchanging their notes for IsoRay Medical, Inc. Series A preferred shares, or receiving IsoRay Medical, Inc. notes payable with substantially the same terms and conditions as their IsoRay Products LLC notes. None of the IsoRay Products LLC note holders elected to receive IsoRay Medical, Inc. Series A preferred shares. Accordingly, all the note holders (i.e., investors) were issued convertible notes. Note holders can convert principal and accrued interest on their outstanding balances into Series B preferred shares by exercising the warrants that were issued to them in connection with the merger (see Note 1). The notes accrued interest at 10%, which was paid quarterly, and were scheduled to mature in 2006 and 2007. All of the notes were converted into preferred shares or repaid during 2006.

(e) In June 2006, the Company entered into a note payable with HAEIFC, which is collateralized by receivables, inventory, equipment, and certain life insurance policies. The total note payable facility is for $1.4 million and is to be used to purchase production equipment. In June 2006, the Company requested an initial disbursement of approximately $400,000. The note contains certain restrictive covenants relating to: financial ratios; payment of compensation to officers and directors; and payment of dividends. The note accrues interest at 9% and is payable in monthly installments with the final installment due in July 2016.

On October 14, 2005, the Company borrowed $250,000 under a short-term note payable from a shareholder who was later appointed to the Board of Directors in April 2006. The note, which bore interest at the rate of 10.0%, was paid in full on its due date of December 1, 2005. In connection with the loan, the Company granted a warrant to purchase 12,500 shares of common stock at an aggregate total exercise price of $10. The Company recorded financing expenses of $60,000 related to the issuance of these warrants.

Principal maturities on notes payable are due as follows:

Year ending June 30,		
2007	$	51,351
2008		49,072
2009		53,593
2010		179,068
2011		38,204
Thereafter		261,620
	$	632,908

10. Capital Lease Obligations

The Company leases certain equipment under long-term agreements that represent capital leases. Future minimum lease payments under capital lease obligations are as follows:

Year ending June 30,		
2007	$	232,336
2008		215,057
2009		27,627
2010		-
2011		-
Thereafter		-
Total future minimum lease payments		475,020
Less amounts representing interest		(71,051)
Present value of net minimum lease payments		403,969
Less amounts due in one year		(183,554)
Amounts due after one year	$	220,415

11. Convertible Debentures Payable

Through June 30, 2005, the Company had sold $3,587,875 of convertible debentures pursuant to the January 31, 2005 Offering (see Note 12). In July 2005, the Company sold an additional $550,000 of these convertible debentures. The debentures, which bear interest at 8% and mature two years from the date of issuance (through June 2007), can be converted into shares of the Company's common stock at a rate of $4.15 per share plus, at the discretion of the Company, either a cash payment for accrued interest, or that number of common shares equal to the amount of unpaid accrued interest at $4.15 per share.

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After the debentures had been outstanding for six months, the Company could, at its option, prepay them, in whole or in part, by paying the principal and interest accrued through the date of the prepayment. If only a portion of the debenture is prepaid, a new debenture with substantially the same terms and conditions will be issued to the debenture holder for the remaining principal balance.

On December 13, 2005, the Board of Directors announced a short-term conversion inducement to current holders of the convertible debentures, originally issued in conjunction with the January 31, 2005 Private Placement Offering. Holders were permitted two conversion options: 1) convert under the original terms of the debenture to the Company’s common stock at a $4.15 conversion price, and register the newly issued shares in the Form SB-2 Registration Statement filed with the SEC on November 10, 2005, or 2) convert under terms essentially identical to those offered to purchasers of Units in the Offering of October 17, 2005 - a $4.00 conversion price and one callable warrant to purchase one share of the Company's common stock at an exercise price of $6.00 per share for each share issued upon conversion (waiving registration rights for approximately one year). As of June 30, 2006, holders of $3,682,875 of debentures had converted to common stock of the Company, responding to the inducement of the second exercise method described above. As of June 30, 2006, the Company had issued 911,271 shares of common stock (including approximately 23,840 incremental shares not previously available to holders of debentures under the original conversion terms), and 659,469 warrants to purchase shares of common, exercisable at $6.00 per share. As of June 30, 2006, the Company recognized $385,511 in non-cash short-term inducement expense, in accordance with SFAS No. 84.

12. Shareholders’ Equity (Deficit)

The authorized capital structure of the Company consists of $.001 par value preferred stock and $.001 par value common stock.

Preferred Stock

The Company's Certificate of Incorporation authorizes 6,000,000 shares of $0.001 par value preferred stock available for issuance with such rights and preferences, including liquidation, dividend, conversion and voting rights, as described below.

Series A

Series A preferred shares are entitled to a 10% dividend annually on the stated par value per share. These shares are convertible into shares of common stock at the rate of one share of common stock for each share of Series A preferred stock, and are subject to automatic conversion into common stock upon the closing of an underwritten public offering pursuant to an effective registration statement under the Securities Act of 1933 covering the offer and sale of common stock in which the gross proceeds to the Company are at least $4 million. Series A preferred shareholders have voting rights equal to the voting rights of common stock, except that the vote or written consent of a majority of the outstanding preferred shares is required for any changes to the Company’s Certificate of Incorporation, Bylaws or Certificate of Designation, or for any bankruptcy, insolvency, dissolution or liquidation of the Company. Upon liquidation of the Company, the Company’s assets are first distributed ratably to the Series A preferred shareholders. At June 30, 2006, there were no Series A preferred shares outstanding.

Series B

Series B preferred shares are entitled to a cumulative 15% dividend annually on the stated par value per share. These shares are convertible into shares of common stock at the rate of one share of common stock for each share of Series B preferred stock, and are subject to automatic conversion into common stock upon the closing of an underwritten public offering pursuant to an effective registration statement under the Securities Act of 1933 covering the offer and sale of common stock in which the gross proceeds to the Company are at least $4 million. Series B preferred shareholders have voting rights equal to the voting rights of common stock, except that the vote or written consent of a majority of the outstanding preferred shares is required for any changes to the Company's Certificate of Incorporation, Bylaws or Certificate of Designation, or for any bankruptcy, insolvency, dissolution or liquidation of the Company. Upon liquidation of the Company, the Company's assets are first distributed ratably to the Series A preferred shareholders, then to the Series B preferred shareholders. At June 30, 2006, there were 144,759 Series B preferred shares outstanding and cumulative dividends in arrears were $39,356.

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In addition to the shares of common stock and Series B preferred stock issued pursuant to the merger transaction (see Note 1), the Company had the following transactions that affected shareholders' equity (deficit) during the years ended June 30, 2006 and 2005.

IsoRay, Inc. June 2006 Warrant Exercise Solicitation

In June 2006, the Board of Directors approved a limited one-time discount of the exercise price of outstanding warrants (with exercise prices over $3.00) to $3.00 per share of common stock if the warrants were exercised on or before June 30, 2006. The warrants were primarily held by investors who purchased them as part of the Company's October 2005 and February 2006 private placement offerings. The Company issued 427,764 common shares and raised $1,223,602, net of offering costs, through this warrant exercise solicitation.

IsoRay, Inc. February 2006 Private Placement

On February 1, 2006 the Company commenced an offering of Investment Units ("Units") for sale, pursuant to a Private Placement Offering (the "February 2006 Offering"), which management believes was exempt from registration under the Securities Act of 1933 ("the Act") pursuant to Section 4(2) of the Act and Rule 506 of Regulation D. The February 2006 Offering consisted of a maximum of 89 Units, each Unit consisting of 5,000 shares of common stock and a warrant to purchase 5,000 shares of common stock at an exercise price of $6.50 per share. The Units were sold for $22,500 per Unit. The Company closed this offering on February 24, 2006. Approximately $1.1 million, net of offering costs, was raised under the February 2006 Offering.

IsoRay, Inc. Subscriptions Receivable

On December 7, 2005, the Company entered into a SICAV ONE Securities Purchase Agreement and a SICAV TWO Securities Purchase Agreement (collectively, the "Purchase Agreements") with Mercatus & Partners, Limited, a United Kingdom private limited company ("Mercatus"). The Purchase Agreements permitted Mercatus to purchase 1,748,146 shares of the Company's common stock at a purchase price of $3.502 per share subject to receipt of funding. As no funding had been received, on May 18, 2006, the Company requested immediate return of the certificates representing all shares of common stock to which Mercatus had previously subscribed in accordance with the terms of the Purchase Agreements. The Purchase Agreements call for return of certificates within ten days if funding is not received within two days of receipt of the notice. After significant delay and the Company's attainment of a court order, the share certificates were returned. On August 8, 2006, the share certificates were cancelled and the Purchase Agreements were terminated (see Note 17).

IsoRay, Inc. October 2005 Private Placement

On January 30, 2006 the Company closed an offering of Units for sale, pursuant to a Private Placement Offering ("the October 2005 Offering") of October 17, 2005, which management believes was exempt from registration under the Securities Act of 1933 ("the Act") pursuant to Section 4(2) of the Act and Rule 506 of Regulation D. The October 2005 Offering consisted of a maximum of 200 Units, each Unit consisting of 5,000 shares of common stock and a warrant to purchase 5,000 shares of common stock at an exercise price of $6.00 per share. This maximum was increased, pursuant to the terms of the October 2005 Offering, at the sole discretion of the Company, to a maximum of 300 Units. The Units were sold for $20,000 per Unit. Approximately $5.4 million, net of offering costs, was raised under the October 2005 Offering.

IsoRay Medical, Inc. January 2005 Private Placement

In January 2005, Medical commenced an offering (“the January 2005 Offering”) of up to $2,000,000 of 8% convertible debentures (see Note 11) to accredited investors in a private placement, which management believes was exempt from registration under the Securities Act of 1933 ("the Act") pursuant to Section 4(2) of the Act and Rule 506 of Regulation D. On May 27, 2005, Medical amended and restated the January 2005 Offering to increase the maximum amount of the offering to $4,150,000.

Through June 30, 2005, Medical sold debentures totaling $3,587,875. In connection with the sales of these debentures, Medical paid commissions totaling $216,783 and legal expenses totaling $56,470, which amounts have been recorded as deferred financing costs.

In July 2005, Medical sold an additional $550,000 of debentures pursuant to this offering. The sale of these additional debentures was not subject to payment of commissions.

In 2006, $3,682,875 of the debentures were converted to common stock pursuant to a short-term conversion inducement (see Note 11).

IsoRay Medical, Inc. October 2004 Private Placement

In October 2004, Medical commenced an offering (“the October 2004 Offering”) of up to $2,000,000 of securities to accredited investors in a private placement, which management believes was exempt from registration under the Securities Act of 1933 ("the Act") pursuant to Section 4(2) of the Act and Rule 506 of Regulation D. The October 2004 Offering consisted of up to 100 Investment Units, each unit consisting of 10,000 shares of Medical’s common stock and a callable warrant to purchase 3,000 shares of common stock at an exercise price of $.50 per share, for $20,000 per Investment Unit. Simultaneous with the October 2004 Offering, the officers and directors of Medical had the right to independently sell similar Investment Units pursuant to a separate private placement memorandum on substantially the same terms and conditions as the October 2004 Offering.

During the year ended June 30, 2005, Medical sold 76.55 Investment Units, representing 765,500 common shares and callable warrants for the purchase of 229,650 common shares, for cash totaling $1,531,000. In connection with the sales of the Investment Units, Medical paid commissions and expense allowances totaling $119,980 to broker-dealers, and legal expenses totaling $54,442 to attorneys, which amounts have been recorded as reductions of additional paid-in capital.

In connection with the October 2004 Offering, Medical granted the selling broker-dealers warrants to purchase 4.23 Investment Units at $20,000 per Investment Unit. These Investment Units, which expire on March 25, 2007, represent 42,300 IsoRay Medical, Inc. common shares and 12,690 warrants to purchase common shares at $.50 per share.

Issuance of Common Stock for Guarantee of Debt

During fiscal year 2005, Medical issued 211,140 shares of its common stock to certain shareholders as an inducement for their guarantee of the Columbia River Bank line of credit (see Note 8) and the note payable to Benton-Franklin Economic Development District (see Note 9). The transactions were recorded at the fair value of the shares, estimated to be $348,381, since management considered this amount to be more readily determinable than the value of the guarantees. The guarantees were recorded as deferred financing costs (see Note 2).

Issuance of Common Stock in Payment of Consulting Services

During 2006, the Company issued 173,472 shares of its common stock in full satisfaction of consulting services including 168,472 shares that were issued as payment for merger consulting services (see Note 1). The shares were valued using the market price of the stock on the date of issue.

Issuance of Common Stock in Partial Payment of Equipment Purchase

During 2006, the Company issued 10,000 shares of its common stock and paid $962 of cash in full satisfaction for the purchase of production equipment and repairs and maintenance invoices totaling $40,962. The shares were valued using the market price of the stock on the date of issue.

During 2005, Medical issued 30,303 shares of its common stock and paid $40,000 of cash in full satisfaction of the $90,000 purchase price of three laser welding stations. The transaction was recorded at the purchase price of the laser welding stations, since management considered this amount to be more readily determinable than the fair value of the shares.

Cash Payments for Fractional Shares

During 2006, the Company paid a combined total of $734 to the former common and preferred shareholders of Medical and Century for fractional shares that resulted from the merger that was effective July 28, 2005 (see Note 1).

During 2005, Medical paid a combined total of $100 to the former common shareholders of IsoRay, Inc. (WA) and the former Class A, B and C members of IsoRay Products LLC for fractional shares that resulted from the merger that was effective October 1, 2004 (see Note 1).

Warrants to Purchase Series B Preferred Stock

Pursuant to a private placement of debt units during 2003 and 2004, IsoRay Products LLC issued $365,000 of notes payable to investors (see Note 9) and granted warrants for the purchase of 227,750 of its Class A member shares. In connection with the merger transaction of IsoRay (WA) and IsoRay Products LLC into IsoRay Medical, Inc. (see Note 1), Medical exchanged the IsoRay Products LLC warrants for warrants to purchase 384,440 IsoRay Medical, Inc. Series B preferred shares. The warrants activity is summarized as follows:

	2006 (a)			2005 (a)		
	Warrants		Price (b)	Warrants		Price (b)
Beginning balance outstanding	233,008	$	0.84	323,830	$	0.91
Exercised	(53,496)		1.03	(90,822)		1.07
Ending balance outstanding	179,512	$	0.79	233,008	$	0.84

(a) 2005 share and price data and 2006 beginning balances have been adjusted to reflect the 0.842362 conversion ratio (see Note 1).

(b) Weighted average price per share.

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The following table summarizes additional information about the Company's preferred warrants outstanding as of June 30, 2006:

Number of Warrants		Price	Expiration Date
56,876	$	0.70	October 30, 2006
28,438		0.70	January 31, 2007
31,102		1.06	February 28, 2007
6,220		1.40	February 28, 2007
56,876		0.70	March 30, 2007
179,512			

Warrants to Purchase Common Stock

In connection with the February 2006 Offering, the October 2005 Offering, the October 2004 Offering, and at other times the Company has issued warrants for the purchase of common stock. The warrants activity is summarized as follows:

	2006 (a)			2005 (a)		
	Warrants		Price (b)	Warrants		Price (b)
Beginning balance outstanding	136,158	$	1.20	-	$	-
Warrants issued	2,878,522		5.85	245,454		0.93
Exercised	(511,911)		2.49	(109,296)		0.59
Ending balance outstanding	2,502,769	$	5.73	136,158	$	1.20

(a) 2005 share and price data and 2006 beginning balances have been adjusted to reflect the 0.842362 conversion ratio (see Note 1).

(b) Weighted average price per share.

The following table summarizes additional information about the Company's common warrants outstanding as of June 30, 2006:

Number of Warrants		Range of Exercise Prices	Expiration Date
19,500	$	6.00	January 2007
2,488	$	1.06	February 2007
46,419	$	0.59 to $2.37	March 2007
277,616	$	4.15	July 2007
12,500	$	0.0008	October 2007
53,000	$	6.00	October 2007
162,500	$	6.00	November 2007
935,382	$	5.75 to $6.00	December 2007
680,750	$	6.00	January 2008
281,923	$	6,00 to $6,50	February 2008
5,691	$	4.15	March 2008
25,000	$	2.00	July 2015
2,502,769			

Common Stock Option Plans

On July 28, 2005, the Company adopted the Amended and Restated 2005 Stock Option Plan (the "Option Plan") and the Amended and Restated 2005 Employee Stock Option Plan (the "Employee Plan"), pursuant to which it may grant equity awards to eligible persons. The Option Plan allows the Board of Directors to grant options to purchase up to 1,800,000 shares of common stock to directors, officers, key employees and service providers of the Company, and the Employee Plan allows the Board of Directors to grant options to purchase up to 2,000,000 shares of common stock to officers and key employees of the Company. These options can be granted with various vesting schedules and have a maximum term of 10 years.

These plans replaced the IsoRay Medical, Inc. 2004 Stock Option Plan (“the 2004 Plan”) and the IsoRay Medical, Inc. 2004 Employee Stock Option Plan (“the 2004 Employee Plan”). The stated purpose of the plans was to provide an incentive-based form of compensation to directors, officers, key employees and service providers of Medical and encourage such persons to invest in shares of Medical’s common stock, thereby acquiring a proprietary interest in the success of Medical.

Replacement options were issued from the Option Plan and the Employee Plan to replace those options previously granted under the 2004 Plan and the 2004 Employee Plan. The replacement options are included in the totals show below for options granted and outstanding pursuant to the Option Plan and the Employee Plan.

Stock-Based Compensation

As described in Note 2, the Company currently accounts for stock-based compensation in accordance with SFAS No. 123. As permitted by SFAS No. 123, management currently accounts for share-based payments to employees using APB 25's intrinsic value method, and provides expanded footnote disclosure when necessary.

In December 2004, the Financial Accounting Standards Board issued SFAS No. 123 (revised 2004), *Share-Based Payment* ("SFAS No. 123(R)"), which is a revision of SFAS No. 123. SFAS No. 123(R) also supersedes APB 25, and amends SFAS No. 95, *Statement of Cash Flows*. Generally, the approach in SFAS No. 123(R) is similar to the approach prescribed by SFAS No. 123. SFAS No. 123(R) requires that all share-based payments to employees, including grants of employee stock options, be recognized in the income statement based on their fair values. Pro forma disclosure will no longer be permitted. SFAS No. 123(R) is effective at the beginning of the first fiscal year beginning after December 15, 2005. The Company plans to adopt SFAS 123(R) on July 1, 2006 on a prospective basis. Upon adoption, all future employee stock option grants plus the balance of the non-vested grants awarded prior to July 1, 2006, will be expensed over the stock option vesting period based on the fair value at the date the options are granted. The Company estimates that the impact of adoption will be an additional expense of $189,430 for employee stock options granted prior to June 30, 2006.

A summary of the Company’s stock option activity and related information for the years ended June 30, 2006 and 2005 is as follows:

	2006 (a)			2005 (a)		
	Shares		Price (b)	Shares		Price (b)
Beginning balance outstanding	2,237,802	$	1.31	383,430	$	1.19
Granted (c)	1,189,722		3.23	1,962,703		1.33
Cancelled	(196,548)		1.19	-		-
Exercised	(101,284)		1.18	(108,331)		1.19
Ending balance outstanding	3,129,692	$	2.05	2,237,802	$	1.31
Exercisable at end of year	2,649,576	$	1.79			

(a) 2005 share and price data and 2006 beginning balances have been adjusted to reflect the 0.842362 conversion ratio (see Note 1).

(b) Weighted average price per share.

(c) All options granted had exercise prices equal to the ending market price of the Company’s common stock on the grant date.

The following table summarizes additional information about the Company's stock options outstanding as of June 30, 2006:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Shares	Price (a)	Life (b)	Shares	Price (a)
$1.00 to $1.19	1,886,179	$ 1.16	8.97 yrs	1,717,707	$ 1.16
$1.96 to $2.00	653,791	1.98	9.09 yrs	653,791	1.98
$3.80 to $4.15	318,472	3.99	9.49 yrs	128,078	3.88
$5.50 to $6.55	271,250	6.15	9.64 yrs	150,000	6.38
Total options	3,129,692			2,649,576	

(a) Weighted average exercise price.
(b) Weighted average remaining contractual life.

The pro forma net loss presented below for the years ended June 30, 2006 and 2005 was determined as if the Company had accounted for these options under the fair value method of SFAS No. 123. The fair value of these options was estimated at the date of grant using the Black-Scholes method set forth in SFAS No. 123(R).

	2006	2005
Net loss as reported	$ 8,218,130	$ 4,269,188
SFAS No. 123 stock option expense	1,167,086	771,365
Pro forma net loss	$ 9,385,216	$ 5,040,553
Net loss per share:		
Basic, as reported	$ 0.68	$ 0.78
Basic, pro forma	0.77	0.92
Diluted, as reported	0.68	0.78
Diluted, pro forma	0.77	0.92

The following assumptions were used in calculating the fair value of the options:

	2006	2005
Weighted average risk-free interest rate	4.67%	3.50%
Expected life of the option (in years)	7.31	10.00
Expected price volatility	31.24%	30.00%
Expected dividend yield	0.00%	0.00%

If the Company had fully accounted for its employee stock options in accordance with the provisions of SFAS No. 123, compensation expense would have been $1,167,086 and $771,365 greater than the amounts recorded for the years ended June 30, 2006 and 2005, respectively.

13. Income Taxes

The Company recorded no income tax provision or benefit for the years ended June 30, 2006 and 2005.

At June 30, 2006, the Company had a net deferred tax asset of approximately $3,820,000, arising principally from net operating loss carryforwards. The deferred tax asset was calculated based on the currently enacted 34% statutory income tax rate. Since management of the Company cannot determine if it is more likely than not that the Company will realize the benefit of its net deferred tax asset, a valuation allowance equal to the full amount of the net deferred tax asset at June 30, 2006 has been established.

At June 30, 2006, the Company had tax basis net operating loss carryforwards of approximately $11,000,000 available to offset future regular taxable income. These net operating loss carryforwards expire through 2026.

IsoRay Products LLC was a limited liability company prior to the merger with Medical. In lieu of current federal income taxes arising at the company level, the individual members were taxed on their proportionate share of the company's taxable income. Accordingly, there are no net operating loss carryforwards related to this entity.

14. Related Party Transactions

In addition to transactions described in Note 12, the Company had the following transactions with related parties:

The Company received various legal services from two law firms in which one of the firm's partners is a member of the Company's Board of Directors. The total amounts paid in 2006 and 2005 to the law firms were $390,000 and $285,000, respectively. The 2006 expenses include approximately $77,000 accrued in accounts payable as of June 30, 2006.

During fiscal year 2006, the Company paid $60,000 to a shareholder for strategic business and financial consulting.

During 2005, Medical paid or accrued $5,600 for accounting services performed by a company owned by a member of Medical's Board of Directors.

15. Commitments and Contingencies

Royalty Agreement for Invention and Patent Application

A shareholder of the Company previously assigned his rights, title and interest in an invention to IsoRay Products LLC in exchange for a royalty equal to 1% of the Gross Profit, as defined, from the sale of "seeds" incorporating the technology. The patent and associated royalty obligations were transferred to the Company in connection with the merger transactions (see Note 1).

The Company must also pay a royalty of 2% of Gross Sales, as defined, for any sub-assignments of the aforesaid patented process to any third parties. The royalty agreement will remain in force until the expiration of the patents on the assigned technology, unless earlier terminated in accordance with the terms of the underlying agreement. To date, there have been no product sales incorporating the technology and there is no royalty due pursuant to the terms of the agreement.

Patent and Know-How Royalty License Agreement

IsoRay Products LLC was the holder of an exclusive license to use certain "know-how." This license was transferred to Medical and subsequently to the Company in connection with the merger transactions (see Note 1). The terms of the original license agreement required the payment of a royalty based on the Net Factory Sales Price, as defined in the agreement, of licensed product sales. Because the licensor's patent application was ultimately abandoned, only a 1% "know-how" royalty based on Net Factory Sales Price, as defined, remains applicable. To date, there have been no product sales incorporating the licensed technology and there is no royalty due pursuant to the terms of the agreement. Management does not believe that it will ever incorporate this technology in its products and therefore that no royalty payment will be due.

Battelle Memorial Institute Production Agreement

In April 2004, IsoRay Products LLC entered into an agreement with Battelle Memorial Institute, Pacific Northwest Division (Battelle), the operator of the Pacific Northwest National Laboratory, for certain production-related services and facilities. This agreement was assumed by Medical and subsequently by the Company following the merger transactions (see Note 1). In accordance with the terms of the agreement, the Company is required to make advance payments, which are then applied against billings by Battelle as services are provided. During the years ended June 30, 2006 and 2005, the Company incurred $868,650 and $574,225, respectively, of costs for production-related services and facilities provided by Battelle. At June 30, 2006, prepaid expenses include $7,913 related to this agreement. The agreement, which expires December 31, 2007, may be terminated at any time by either party, upon giving a 60-day written notice to the other party.

Operating Lease Agreements

The Company leases office and laboratory space and production and office equipment under noncancelable operating leases. The lease agreements require monthly lease payments and expire on various dates through June 2011. Future minimum lease payments under operating leases are as follows:

Year ending June 30,		
2007	$	45,443
2008		13,369
2009		9,747
2010		9,604
2011		9,175
Thereafter		-
	$	87,338

In February 2005, the Company entered into a lease agreement for a portion of a building in which it established production facilities. The lease term commenced on regulatory licensing approval, which was obtained in October 2005, and terminates one year from the commencement date of the lease. The annual rental was paid using 24,007 shares of the Company's common stock. Rent expense of $90,026 has been recognized in the year ended June 30, 2006 relating to this facility.

Rental expense (including rent paid with common stock) amounted to $155,838 and $28,641 for the years ended June 30, 2006 and 2005, respectively.

License Agreement with IBt

In February 2006, the Company signed a license agreement with International Brachytherapy s.a. ("IBt") covering North America and providing the Company with access to IBt's Ink Jet production process and its proprietary polymer seed technology for use in brachytherapy procedures using Cesium-131. The Company paid license fees of $275,000 during 2006 and another payment of $225,000 was to be made in August 2006 pursuant to the license agreement. Royalty payments based on net sales revenue incorporating the technology are also required, with minimum quarterly royalties ranging from $100,000 to $200,000 and minimum annual royalties ranging from $400,000 to $800,000 over the term of the agreement.

As of the date of this report, the August 2006 payment has not been made as the Company has been in continued negotiations with IBt concerning the amount and timing of future royalty payments due to the low market acceptance of the polymer seed technology.

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16. Concentrations of Credit and Other Risks

Financial Instruments

The Company's financial instruments that are exposed to concentrations of credit risk consist primarily of cash and cash equivalents and accounts receivable.

The Company's cash and cash equivalents are maintained with high-quality financial institutions. The accounts are guaranteed by the Federal Deposit Insurance Corporation (FDIC) up to $100,000. At June 30, 2006, uninsured cash balances totaled $1,726,445.

The Company's accounts receivable result from credit sales to customers. The Company had three customers whose sales were greater than 10% for each of the years ended June 30, 2006 and 2005. These customers represented 49.15% and 70.93% of the Company's total revenues for the years ended June 30, 2006 and 2005, respectively. Those same customers accounted for 47.9% and 77.5% of the Company's net accounts receivable balance at June 30, 2006 and 2005, respectively.

Sales to the Company's largest customer totaled 20.6% and 30.6% of total revenues in 2006 and 2005, respectively.

The loss of any of these significant customers would have a temporary adverse effect on the Company's revenues, which would continue until the Company located new customers to replace them.

The Company routinely assesses the financial strength of its customers and provides an allowance for doubtful accounts as necessary.

Inventories

Most components used in the Company's product are purchased from outside sources. Certain components are purchased from single suppliers. The failure of any such supplier to meet its commitment on schedule could have a material adverse effect on the Company's business, operating results and financial condition. If a sole-source supplier were to go out of business or otherwise become unable to meet its supply commitments, the process of locating and qualifying alternate sources could require up to several months, during which time the Company's production could be delayed. Such delays could have a material adverse effect on the Company's business, operating results and financial condition.

17. Subsequent Events

The following events and transactions have occurred subsequent to June 30, 2006:

Return of Subscription Receivable Shares

The Company had previously entered into Purchase Agreements with Mercatus in December 2005 that permitted Mercatus to purchase 1,748,146 shares of common stock subject to the receipt of funding (see Note 12). As no funding had been received, on May 18, 2006, the Company requested the return of the share certificates. After significant delay and the Company's attainment of a court order, the share certificates were returned. On August 8, 2006, the share certificates were cancelled and the Purchase Agreements were terminated.

August 2006 Stock Purchase Agreement

On August 17, 2006, the Company sold certain shares of its common stock and warrants to purchase common stock pursuant to a Common Stock and Warrant Purchase Agreement (the "Purchase Agreement") dated August 9, 2006. The securities were issued to 25 accredited investors pursuant to the exemption from registration provided by Section 4(2) of the Securities Act of 1933, as amended. MicroCapital, LLC acted as the lead investor for the transaction. A total of $5,158,000 in cash proceeds (less 6% commissions to registered broker-dealers and other legal costs) was received by the Company in exchange for the issuance of 2,063,200 shares of common stock and warrants to purchase 2,063,200 shares of common stock. In addition, brokers assisting the Company with the capital raise were issued warrants to purchase 206,300 shares of common stock on identical terms as the warrants issued to investors. If all warrants were exercised, the Company would receive $6,808,500.

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Pursuant to the Purchase Agreement, the purchase price per share of the Company's common stock was $2.50, and the accompanying warrants were issued with an exercise price of $3.00 per share. The warrants and the Purchase Agreement contain anti-dilution provisions, including one providing that, if the Company issues stock or rights to acquire stock at a price less than $2.00 (excluding certain issuances such as options to employees, directors and certain consultants and shares issued in connection with licensing or leasing transactions), the Company is required to issue to each investor additional shares equal to 25% of what such investor purchased in the original transaction. The warrants are exercisable by the holder (subject to anti-dilution and adjustment provisions) for a period of five years from the date of issuance. The warrants are callable by the Company for 45 days after a period of 60 trading days in which the price of the underlying stock exceeds $4.50 per share for 30 of the 60 days, and only if a registration statement covering the underlying shares is effective.

In connection with the Purchase Agreement, the Company also entered into a Registration Rights Agreement whereby the Company has agreed to file a registration statement to cover the re-sale of the shares of common stock sold and issuable upon exercise of the warrants. Under the Registration Rights Agreement, the Company has agreed to file the registration statement within 60 days of the closing, cure any defect causing the registration statement to fail to be effective within 10 business days, and cause suspension periods for the registration statement to not exceed 60 days in any 360 day period. If the Company fails to comply with these provisions, the Company will be required to pay as liquidated damages an amount equal to 2% of the aggregate purchase price paid by the investors for each 30 day period during which the failure continues, not to exceed 10% of the aggregate purchase price.

Settlement Agreements with Former Executives

In September 2006, the Company entered into a settlement agreement with a former executive. As part of the settlement the Company agreed to pay the former executive $100,000 in September 2006 and $215,000 in January 2007. As the former executive's employment with the Company ended in March 2006, the full amount of both payments was accrued as of June 30, 2006 in accrued payroll.

Also in September 2006, the Company reached a preliminary settlement agreement with its former Chief Financial Officer. The preliminary settlement calls for payments totaling $288,000 through September 2007. As the former Chief Financial Officer's employment ended in September 2006, no accrual was made as of June 30, 2006.

SIGNATURES

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

Dated: September 28, 2006

ISORAY, INC., a Minnesota corporation

By /s/ Roger E. Girard

Roger E. Girard, Chief Executive Officer

By /s/ Jonathan R. Hunt

Jonathan R. Hunt, Chief Financial Officer