ANNUAL REPORT

ANNUAL MEETING OF STOCKHOLDERS

Thursday, May 10, 2007

8:00 a.m. Local Time

ORTHOLOGIC®

Letter from the Executive Chairman

Dear Fellow Shareholders:

The year 2006 was marked by challenges and change for OrthoLogic. We made progress on each of our key objectives and we are poised to continue advancing both of our promising peptide platforms in 2007.

Chrysalin® (TP508)

During 1Q2006 we announced topline results of the Chrysalin Phase 3 clinical trial in distal radius fracture. Our stock price fell precipitously and Chrysalin was summarily classified as a "failed" drug. While the study showed that Chrysalin did not meet its primary endpoint in the overall evaluable patient population, it did demonstrate that Chrysalin has biologic activity, as evidenced by statistically significant results observed along key radiographic secondary endpoints. These findings led management to believe the product has potential value, and we developed a plan to optimize that value.

Among the actions taken were the following:

- We interrupted enrollment in the concurrent Chrysalin Phase 2b dose-ranging study in mid-March 2006 in order to perform an interim analysis of subjects enrolled to that date. Given the equivocal information obtained from the interim analysis, curtailing the study proved to be a prudent decision, saving the company $10MM - $12MM of additional clinical expense.
- We continued to focus on advancing the basic science supporting TP508. In December 2006 we announced presentations at the American Society for Cell Biology describing results of two sets of experiments supporting this goal. One study demonstrated binding and chemical cross-linking of TP508 to specific molecules on the surface of endothelial cells, which was the first identification of what may be a specific TP508 receptor. This may represent a significant step in understanding how TP508 activates cells. The second study showed that TP508 increases the ability of endothelial cells to produce nitric oxide and that TP508 prevents negative effects caused by oxygen deprivation, a condition found in myocardial ischemia and chronic wounds. These discoveries may provide a unifying hypothesis to explain how TP508 stimulates tissue repair, and raise the possibility that TP508 could be useful in treating a number of vascular diseases. Laboratory-based validation work continues in this area.
- In January 2007 we announced publication in the journal *Wound Repair and Regeneration* the results of a randomized, double-blind, placebo-controlled 60-subject Phase 1/2 study of Chrysalin in diabetic foot ulcers. The article described statistically and clinically significant results achieved with twice-weekly topical application of Chrysalin, combined with good wound care and standard off-loading, in subjects with chronic diabetic foot ulcers. The study was conducted by Chrysalis Biotechnology prior to its acquisition by OrthoLogic in 2004.
- We reached an important milestone with respect to our understanding of the data in the Chrysalin Phase 3 clinical trial in distal radius fractures. Results of this effort were announced on February 16, 2007 during the annual meeting of the American Academy of Orthopaedic Surgeons. Findings of a *post hoc* subgroup analysis of data from the Phase 3 clinical trial showed that within the subset of 157 female osteopenic subjects, treatment with 10 μg Chrysalin demonstrated a statistically significant benefit compared to placebo in the primary efficacy endpoint of time to removal of immobilization. Secondary endpoints including clinical assessment of fracture healing (pain or motion at the fracture site), time to radial cortical bridging and time to overall radiographic healing also showed a significant effect of Chrysalin treatment. These data are potentially compelling and have opened important new partnering possibilities for the Chrysalin commercialization program.

The cornerstones of our development program for Chrysalin include:

1. **Demonstration of statistically significant healing in the primary endpoint and multiple secondary endpoints within the osteopenic female cohort from the Phase 3 distal radius fracture study.** This is a patient population where bone tissue was physiologically compromised. The results may lead to one or more potential pathways to commercialization.
2. **Demonstration of statistically significant healing with respect to wound closure endpoints in the Phase 1/2 diabetic foot ulcer trial,** an example of Chrysalin's biologic activity in compromised dermal tissue.
3. **Laboratory experiments tying Chrysalin to potential modulation of the health of endothelial tissue in blood vessels,** where confirmatory work is ongoing.
4. **Mechanism of action studies are ongoing with Dr. Darrell Carney, inventor of TP508, at University of Texas Medical Branch.**

Armed with real evidence of biologic activity in three tissue groups with compromised physiology, and predicated upon gaining a clear understanding of the receptor-mediated mechanism of action for TP508, the OrthoLogic team is increasingly optimistic regarding the commercialization of TP508 in multiple potential indications.

AZX100

OrthoLogic strengthened and diversified its development pipeline during 1Q2006 with the acquisition of the peptide AZX100. OrthoLogic sees opportunities in multiple potential smooth-muscle relaxation and anti-fibrotic applications for AZX100, including vascular, pulmonary, scarring and other indications. We continue to make progress with respect to toxicology, pharmacology and GMP manufacturing efforts, and are encouraged by the preclinical results to date. We are executing an aggressive development plan for this peptide, with the goal of filing an IND by year-end 2007.

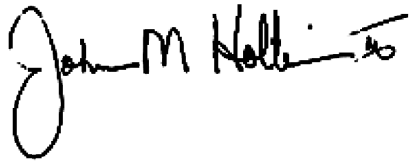
OrthoLogic

- At the request of the Board of Directors, I stepped in as Executive Chairman in April 2006, and my first action was to recruit Randy Steer, MD, Ph.D., as President. Dr. Steer's extensive background in pharmaceutical and biotechnology drug development, along with his many years of senior management experience, have made him an invaluable addition to OrthoLogic.
- Together with key members of the Management Team, we undertook a comprehensive review of our human resources and infrastructure, making difficult decisions with respect to the proper size and scope of the organization going forward. We trimmed staff from a planned staffing level of 52 to our current operating headcount of 28. The MD/Ph.D. inventors of both Chrysalin and AZX100 remain active contributors to our team.
- Through rigorous and disciplined cost containment we have successfully managed the burn rate. We began 2006 with $83.6 million in cash and investments and ended the fourth quarter of 2006 with $70.2 million in cash and investments, a net change of $13.4 million versus original guidance of $35 million.

The OrthoLogic Team has performed against every major objective of its value optimization plan for both the Chrysalin and AZX100 platforms.

Looking Ahead

We believe OrthoLogic is on the path to a brighter future as we advance our portfolio and make progress toward our value-creation goals. We look forward to providing updates throughout the year, and we thank you for your continued confidence and support.



JOHN M. HOLLIMAN, III
Executive Chairman

April 2007

ORTHOLOGIC®

1275 West Washington Street
Tempe, Arizona 85281

NOTICE OF ANNUAL MEETING OF STOCKHOLDERS
TO BE HELD THURSDAY, MAY 10, 2007

TO THE STOCKHOLDERS:

The Annual Meeting of Stockholders of OrthoLogic Corp., a Delaware corporation (the "Company"), will be held on Thursday, May 10, 2007 at 8:00 a.m., local time, at the offices of the Company at 1275 West Washington Street, Tempe, Arizona 85281, for the following purposes:

(1) To elect a director as a Class I director to serve until the Annual Meeting of Stockholders to be held in the year 2010 or until a successor is elected;

(2) To ratify the appointment of Ernst & Young LLP, as the Company's independent registered public accounting firm for the fiscal year ending December 31, 2007; and

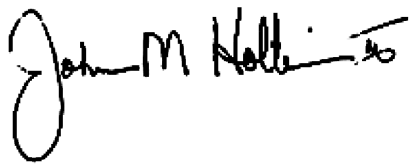
(3) To transact such other business as may properly come before the Annual Meeting or any adjournment thereof.

The foregoing items of business are more fully described in the Proxy Statement accompanying this Notice.

Stockholders of record at the close of business on Monday, March 26, 2007 are entitled to vote at the meeting and at any adjournment or postponement thereof. Shares can be voted at the meeting only if the holder is present or represented by proxy. A list of stockholders entitled to vote at the meeting will be open for inspection at the Company's corporate headquarters for any purpose germane to the meeting during ordinary business hours for 10 days prior to the meeting.

A copy of the Company's 2006 Annual Report to Stockholders, which includes certified financial statements, is enclosed. All stockholders are cordially invited to attend the Annual Meeting in person.

By order of the Board of Directors,



JOHN M. HOLLIMAN, III
Executive Chairman

Tempe, Arizona
April 13, 2007

IMPORTANT: It is important that your stockholdings be represented at this meeting. Whether or not you expect to attend the meeting, please complete, date and sign the enclosed Proxy and mail it promptly in the enclosed envelope to assure representation of your shares. No postage need be affixed if mailed in the United States.

ORTHOLOGIC CORP.

PROXY STATEMENT FOR THE ANNUAL MEETING OF STOCKHOLDERS TO BE HELD THURSDAY, MAY 10, 2007

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ORTHOLOGIC®
1275 West Washington Street
Tempe, Arizona 85281

PROXY STATEMENT
ANNUAL MEETING OF STOCKHOLDERS

TO BE HELD THURSDAY, MAY 10, 2007

SOLICITATION, EXECUTION AND REVOCATION OF PROXIES

Proxies in the accompanying form are solicited on behalf, and at the direction, of the Board of Directors of OrthoLogic Corp. (the "Company") for use at the Annual Meeting of Stockholders to be held on Thursday, May 10, 2007, at 8:00 a.m., local time, or any adjournment thereof (the "Annual Meeting") at the offices of the Company at 1275 West Washington Street, Tempe, Arizona 85281. All shares represented by properly executed proxies, unless such proxies have previously been revoked, will be voted in accordance with the direction on the proxies. If no direction is indicated, the shares will be voted in favor of the proposals to be acted upon at the Annual Meeting. The Board of Directors of the Company (the "Board") is not aware of any other matter which may come before the meeting. If any other matters are properly presented at the meeting for action, including a question of adjourning the meeting from time to time, the persons named in the proxies and acting thereunder will have discretion to vote on such matters in accordance with their best judgment.

When stock is in the name of more than one person, the proxy is valid if signed by any of such persons unless the Company receives written notice to the contrary. If the stockholder is a corporation, the proxy should be signed in the name of such corporation by an executive or other authorized officer. If signed as attorney, executor, administrator, trustee, guardian or in any other representative capacity, the signer's full title should be given and, if not previously furnished, a certificate or other evidence of appointment should be furnished.

This Proxy Statement and the form of proxy which is enclosed are being mailed to the Company's stockholders commencing on or about April 13, 2007.

A stockholder executing and returning a proxy has the power to revoke it at any time before it is voted. A stockholder who wishes to revoke a proxy can do so by executing a later-dated proxy relating to the same shares and delivering it to the Secretary of the Company prior to the vote at the Annual Meeting, by written notice of revocation received by the Secretary prior to the vote at the Annual Meeting or by appearing in person at the Annual Meeting, filing a written notice of revocation and voting in person the shares to which the proxy relates.

In addition to the use of the mails, proxies may be solicited by personal conversations or by telephone, telex, facsimile or telegram by the directors, officers and regular employees of the Company. Such persons will receive no additional compensation for such services. Arrangements will also be made with certain brokerage firms and certain other custodians, nominees and fiduciaries for the forwarding of solicitation materials to the beneficial owners of Common Stock held of record by such persons, and such brokers, custodians, nominees and fiduciaries will be reimbursed for their reasonable out-of-pocket expenses incurred in connection therewith. All expenses incurred in connection with this solicitation will be borne by the Company.

The mailing address of the principal executive offices of the Company is 1275 West Washington Street, Tempe, Arizona 85281.

VOTING SECURITIES AND PRINCIPAL HOLDERS THEREOF

Only stockholders of record at the close of business on March 26, 2007 (the "Record Date") will be entitled to vote at the Annual Meeting. On the Record Date, there were issued and outstanding 41,594,491 shares of the Company's Common Stock. Each holder of Common Stock is entitled to one vote, exercisable in person or by proxy, for each share of the Company's Common Stock held of record on the Record Date. The presence of a majority of the shares of Common Stock entitled to vote, in person or by proxy, is required to constitute a quorum for the conduct of business at the Annual Meeting. Abstentions and broker non-votes are each included in the determination of the number of shares present for quorum purposes. The Inspector of Election appointed by the Chairman of the Board of Directors shall determine the shares represented at the meeting and the validity of proxies and ballots and shall count all proxies and ballots. The nominee for director receiving the highest number of affirmative votes (whether or not a majority) cast by the shares represented at the Annual Meeting and entitled to vote thereon, a quorum being present, shall be elected as a director. Abstentions and broker non-votes will not be taken into account in determining the outcome of the election. The affirmative vote of a majority of the shares present in person or by proxy and entitled to vote is required with respect to the approval of the other proposals set forth herein. Abstentions have the effect of negative votes. Stockholders are not entitled to any dissenter's or appraisal rights under Delaware law or the Company's Restated Certificate of Incorporation for the proposals set forth in this Proxy Statement.

SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following table sets forth information regarding the beneficial ownership of the Company's Common Stock at March 9, 2007 with respect to (i) each person known to the Company to own beneficially more than five percent of the outstanding shares of the Company's Common Stock, (ii) each director of the Company, (iii) each of the named executive officers and (iv) all directors and executive officers of the Company as a group.

	Shares Beneficially Owned (1)	
Identity of Stockholder or Group	Number	Percent
Michael D. Casey (2)	106,612	*
Fredric J. Feldman (3)	308,462	*
John M. Holliman, III (4)	412,937	*
Elwood D. Howse (5)	260,256	*
William M. Wardell (6)	49,690	*
Augustus A. White III (7)	325,343	*
Randolph C. Steer (8)	121,965	*
Les M. Taeger (9)	125,625	*
Dana B. Shinbaum (10)	113,438	*
James T. Ryaby (11)	304,901	*
James M. Pusey (12)	170,469	*
Sherry A. Sturman	22,000	*
All directors and executive officers as a group (13)	2,321,698	5.3

* Less than one percent

(1) Beneficial ownership is determined in accordance with the rules of the Securities and Exchange Commission ("SEC") and generally includes voting or investment power with respect to securities. In accordance with SEC rules, shares, which may be acquired upon exercise of stock options which are currently exercisable or which become exercisable within 60 days of the date of the table, are deemed beneficially owned by the optionee. Except as indicated by footnote, and subject to community property laws where applicable, the persons or entities named in the table above have sole voting and investment power with respect to all shares of Common Stock shown as beneficially owned by them.

(2) Includes 95,000 shares Mr. Casey has a right to acquire upon exercise of stock options.

(3) Includes 210,000 shares Dr. Feldman has a right to acquire upon exercise of stock options. Voting and investment power shared with spouse.

(4) Includes 321,667 shares Mr. Holliman has a right to acquire upon exercise of stock options, 3,000 shares indirectly owned as trustee, 1,658 shares indirectly owned as trustee of Valley Ventures III, LP

(5) Includes 200,000 shares Mr. Howse has a right to acquire upon exercise of stock options.

(6) Includes 45,000 shares Dr. Wardell has a right to acquire upon exercise of stock options.

(7) Includes 210,000 shares Dr. White has a right to acquire upon exercise of stock options.

(8) Includes 96,667 shares Dr. Steer has a right to acquire upon exercise of stock options.

(9) Includes 115,625 shares Mr. Taeger has a right to acquire upon exercise of stock options.

(10) Includes 98,438 shares Mr. Shinbaum has a right to acquire upon exercise of stock options.

(11) Includes 282,001 shares Dr. Ryaby has a right to acquire upon exercise of stock options.

(12) Includes 170,469 shares Dr. Pusey has a right to acquire upon exercise of stock options.

(13) Includes 1,844,867 shares directors and executive officers have a right to acquire upon exercise of stock options.

PROPOSAL 1: ELECTION OF DIRECTOR

One director is to be elected at the Annual Meeting to serve as a Class I director until the Annual Meeting of Stockholders to be held in the year 2010 or until his respective successor is elected. Unless otherwise instructed, the proxy holders will vote the Proxies received by them FOR the Company's nominee Fredric J. Feldman, Ph.D. Dr. Feldman is currently a director of the Company. The nominee for director receiving the highest number of affirmative votes (whether or not a majority) cast by the shares represented at the Annual Meeting and entitled to vote thereon, a quorum being present, shall be elected as a director. Only affirmative votes are relevant in the election of directors.

Pursuant to the Company's Restated Certificate of Incorporation, the Board of Directors is classified into three classes, with each class holding office for a three-year period. The Restated Certificate of Incorporation restricts the removal of directors under certain circumstances. The number of directors may be increased to a maximum of nine. Directors are elected by a plurality of the votes present in person or represented by proxy and entitled to vote at the Annual Meeting. Stockholders do not have the right to cumulate their votes in the election of directors. If any nominee of the Company is unable or declines to serve as a director at the time of the Annual Meeting, the proxies will be voted for any nominee who shall be designated by the present Board of Directors to fill the vacancy. It is not expected that any nominee will be unable or will decline to serve as a director.

The name of the nominee for director and of the directors, whose terms continue beyond the Annual Meeting, and certain information about them, are set forth below.

The Board Recommends A Vote In Favor Of The Named Nominee

INFORMATION CONCERNING DIRECTORS AND EXECUTIVE OFFICERS

Nominee for Class I Director Whose Term Will Expire at the Annual Meeting Held in the Year 2010

Fredric J. Feldman, Ph.D. (1) (2) Director since 1991

Fredric J. Feldman, Ph.D., 66, has been the President of FJF Associates, a consultant to health care venture capital and emerging companies, since February 1992. From September 1995 to June 1996, he was the Chief Executive Officer of Biex, Inc., a women's healthcare company. He served as Chief Executive Officer of Oncogenetics, Inc., a cancer genetics reference laboratory from 1992 to 1995. Between 1988 and 1992, Dr. Feldman was the President and Chief Executive Officer of Microgenics Corporation, a medical diagnostics company. He has been a director of a number of public and private companies involved in the healthcare industry.

Class II Directors Whose Terms Will Expire at the 2008 Annual Meeting:

John M. Holliman, III (1) Director since 1987

John M. Holliman, III, 53, became Executive Chairman and Principal Executive Officer of the Company on April 5, 2006 and has served as a director of the Company since September 1987 and as Chairman of the Board of Directors since August 1997. Since February 1993 he has been a general partner of entities, which are the general partners of Valley Ventures, LP (formerly known as Arizona Growth Partners, LP), Valley Ventures II, LP and Valley Ventures III, LP, all of which are venture capital funds that invest principally in life science companies.

Augustus A. White III, MD, Ph.D. (2) (4) Director since 1993

Dr. White, 70, became a director of the Company in July 1993. He is the former Master of the Oliver Wendell Holmes Society and currently the Ellen and Melvin Gordon Professor of Medical Education and Professor of Orthopedic Surgery at the Harvard Medical School and the Harvard-MIT Division of Health Sciences and Technology since July 1978; and Orthopedic Surgeon-in-Chief, Emeritus, at the Beth Israel Deaconess Medical Center in Boston since 1990. From 1992 to 1994, he served as the Chief of Spine Surgery at Beth Israel and is Director of the Daniel E. Hogan Spine Fellowship Program. He is a graduate of Brown University, the Stanford University Medical School, holds a Ph.D. from the Karolinska Institute in Stockholm, and graduated from the Advanced Management Program at the Harvard Business School. Dr. White is a recipient of the Bronze Star, which he earned while stationed as a Captain in the U.S. Army Medical Corps in Vietnam. Dr. White is currently a director of Zimmer Holdings, Inc., a publicly held designer, marketer and manufacturer of orthopedic products.

Class III Directors Whose Terms Will Expire at the 2009 Annual Meeting:

Elwood D. Howse, Jr. (1)(2)(3) Director since 1987

Elwood D. Howse, Jr., 67, has served as a director of the Company since September 1987. In 1982, Mr. Howse founded Cable, Howse and Ragen, investment banking and stock brokerage firm, now owned by Wells Fargo and known as Ragen MacKenzie. In 1977, Mr. Howse co-founded Cable & Howse Ventures, an early stage venture capital firm focused on technology. In 1976, he served as Vice President, Corporate Finance, for Foster & Marshall, a northwest stock brokerage firm. In 1974 he was the Chief Financial Officer of Seattle Stevedore Company and the Miller Produce Company. Mr. Howse has served as a corporate director and advisor to various public, private and non-profit enterprises. He served on the board of the National Venture Capital Association and is past President of the Stanford Business School Alumni Association. He currently serves on the boards of directors of BSQUARE Corporation (BSQR), Formotus, Inc., Perlego Systems Inc., PowerTech Group, Inc., and not-for-profits, Junior Achievement Worldwide and Junior Achievement of Washington.

William M. Wardell, MD, Ph.D. (4) Director since February 2006

Dr. Wardell, 68, was appointed by the OrthoLogic Board of Directors on February 11, 2006, to fill a vacancy (Class III) on the Board. He owns and operates the consulting firm Wardell Associates International LLC in Princeton, NJ, where he specializes in drug development, regulatory approval, and safety for a range of pharmaceutical and biotechnology companies. Dr. Wardell has published over one hundred scientific papers and four books, and has testified as an expert in drug development during several Congressional hearings. Dr. Wardell has 22 years of experience in the healthcare industry, holding leadership positions as President, Protein Engineering Corporation (now DYAX); Senior Vice President of Drug Development, Parke-Davis; Vice President and Medical Director, Boehringer Ingelheim Pharmaceuticals; Senior Scientific Officer, Covance; and Executive Director of the Covance Institute for Drug Development Sciences. During his tenure at these companies, Dr. Wardell was responsible for 11 approved New Drug Applications. He previously served as an associate professor of Pharmacology, Toxicology and Medicine, attending on the Clinical Pharmacology consultation service of Strong Memorial Hospital at the University of Rochester Medical Center, where he co-founded and directed the University's Center for the Study of Drug Development. Dr. Wardell earned his MA, PhD in pharmacology, and MD at the University of Oxford (UK), and was a Merck International Fellow in Clinical Pharmacology and Medicine under Dr. Louis Lasagna at the University of Rochester / Strong Memorial Hospital. He currently serves on the Board of Directors of PhytoCeutica, Inc., the Scientific Advisory Board of Eleos, Inc., and the Board of the American Board of Clinical Pharmacology.

Class I Director Whose Term Will Expire at the Annual Meeting of Stockholders on May 10, 2007:

Michael D. Casey (3) Director since 2004

Michael D. Casey, 61, became a director of the Company in January 2004, filling a newly created vacancy on the Board of Directors. Mr. Casey informed the OrthoLogic Board of Directors on March 28, 2007, that he does not intend to seek re-election to the Board at the Annual Meeting of Stockholders on May 10, 2007 due to personal and family commitments, and, accordingly, his term will expire on that date.

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(1) Member of the Executive Committee.

(2) Member of the Audit Committee.

(3) Member of the Compensation Committee.

(4) Member of the Corporate Governance/Nominating Committee

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BOARD MEETINGS AND COMMITTEES

The Board of Directors was composed of six outside directors. On April 5, 2006, Mr. Holliman became Executive Chairman and Principal Executive Officer of the Company and is no longer an independent director under NASD Marketplace Rule 4200(a)(15). The Board has determined that each director other than Mr. Holliman is independent for purposes of Marketplace Rule 4200(a)(15) of the National Association of Securities Dealers, Inc. ("NASD"). The Board of Directors held a total of twelve meetings during the fiscal year ended December 31, 2006. No director attended fewer than 75% of the aggregate of all meetings of the Board of Directors and any committee on which such director served during the period of such service. Currently, the Board of Directors does not have a policy regarding director attendance at the Company's annual meeting of stockholders. All of the directors attended last year's annual meeting of stockholders in person.

Independent directors regularly meet in executive sessions without the Executive Chairman or other members of management to review the criteria upon which the performance of the Executive Chairman is based, the performance of the Executive Chairman against that criteria, to ratify the compensation of the Executive Chairman as approved by the Compensation Committee, and to discuss other relevant matters.

The Board presently has an Executive Committee, an Audit Committee, a Compensation Committee and a Corporate Governance/Nominating Committee. The Executive Committee, which acts on Board matters that arise between meetings of the full Board of Directors, consists of Dr. Feldman, Mr. Holliman and Mr. Howse. During 2006 the Executive Committee did not meet separately as all matters were discussed and acted on by the full Board.

Audit Committee

The Audit Committee, which is a separately-designated standing committee established in accordance with section 3(a)(58)(A) of the Exchange Act, consisted of Mr. Howse (Chairman), Dr. White and Dr. Feldman and met five times in 2006. The Audit Committee assists the Board of Directors in its oversight of financial reporting practices, including the independent auditors' qualifications and independence, and the performance of the Company's internal audit function. The Audit Committee appoints the Company's independent auditors. The Audit Committee meets independently with representatives of the Company's independent auditors and with representatives of senior management. The Committee reviews the general scope of the Company's annual audit, the fee charged by the independent auditors and other matters relating to internal control systems. In addition, the Audit Committee is responsible for approving, reviewing and monitoring the performance of non-audit services by the Company's auditors. The Audit Committee operates under a written charter that has been adopted by the Board of Directors.

The Board of Directors has determined that the composition of the Audit Committee, the attributes of its members and the responsibilities of the Audit Committee, as reflected in its charter, are in accordance with applicable NASD Marketplace Rules for audit committees. In particular, all audit Committee members possess the required

level of financial literacy, at least one member of the Audit Committee meets the current standard of requisite financial management expertise and the Board of Directors has determined that Elwood D. Howse, Jr., the Chairman of the Audit Committee, is an "audit committee financial expert" as defined in Item 401(h) of Regulation S-K of the Securities and Exchange Commission (the "SEC"). Additionally, Mr. Howse and each of the other members of the Audit Committee is an "independent director" as defined in NASD Marketplace Rule 4200(a)(15).

The Audit Committee Charter is available on the Company's website at *www.orthologic.com*.

Compensation Committee

The Compensation Committee, which consists of Mr. Casey and Mr. Howse, met three times during 2006. Each member of the Compensation Committee is an "independent" director as defined in NASD Marketplace Rule 4200(a)(15) and is an "outside director" as defined in Section 162(m) of the Internal Revenue Code. The Compensation Committee reviews salaries and benefit programs designed for senior management, officers and directors and administers certain grants under the Company's stock option plans with a view to ensure that the Company is attracting and retaining highly qualified managers through competitive salary and benefit programs and encouraging extraordinary effort through incentive rewards. The Compensation Committee does not have a written charter.

Corporate Governance/Nominating Committee

The Corporate Governance/Nominating Committee examines and recommends nominations for the Board of Directors and officers of the Company. The criteria prepared by the Corporate Governance/Nominating Committee are used to determine whether the selection of a particular nominee, either nominated by the Company or by a stockholder, would be appropriate. The Corporate Governance/Nominating Committee operates under a written charter, a copy of which is posted on our website. Although the Corporate Governance/Nominating Committee has not established minimum standards for Board nominees, the Corporate Governance/Nominating Committee generally seeks candidates with chief operating, executive or financial officer experience in complex organizations; a commitment to give the time and attention to the duties required of them; and evidence of an independent and inquiring mind willing to question management's assumptions. On an as needed basis, the Corporate Governance/ Nominating Committee uses the services of outside consultants to assist the Corporate Governance/Nominating Committee to identify capable director candidates.

The Corporate Governance/Nominating Committee consists of Dr. Wardell and Dr. White. Dr. Wardell and Dr. White are independent directors under NASD Marketplace Rule 4200(a)(15 The Corporate Governance/Nominating Committee met one time during 2006. The Corporate Governance/Nominating Committee nominated Mr. Casey and Dr. Feldman for election as Class I directors for this year's annual meeting of stockholders.

Stockholder Nomination of Director Candidates

The Corporate Governance/Nominating Committee will consider for nomination as a director of the Company any director candidate recommended or nominated by stockholders in accordance with the process outlined below.

Stockholders wishing to recommend candidates for consideration by the Corporate Governance/Nominating Committee may do so by providing the candidate's name, contact details, biographical data, and qualifications in writing to the Corporate Governance/Nominating Committee, c/o Secretary, 1275 West Washington Street, Tempe, Arizona 85281. The Board may change the process for the means by which stockholders may recommend director candidates to the Corporate Governance/Nominating Committee. Please refer to the Company's website at *www.orthologic.com* and the Company's SEC filings for any changes to this process. The Company has not received any stockholder recommendations of director candidates with regard to the election of directors covered by this Proxy Statement or otherwise.

Any stockholder entitled to vote for the election of directors at a meeting may nominate persons for election as directors only if written notice of such stockholder's intent to make such nomination is given, either by personal delivery at 1275 West Washington Street, Tempe, Arizona or by United States mail, postage prepaid to Secretary, OrthoLogic Corp., 1275 West Washington Street, Tempe, Arizona 85281, not later than: (i) with respect to the election to be held at an annual meeting of stockholders, 20 days in advance of such meeting; and (ii) with respect to

any election to be held at a special meeting of stockholders for the election of directors, the close of business on the fifteenth (15th) day following the date on which notice of such meeting is first given to stockholders. Each such notice must set forth: (a) the name and address of the stockholder who intends to make the nomination and of the person or persons to be nominated; (b) a representation that such stockholder is a holder of record of stock of the corporation entitled to vote at such meeting and intends to appear in person or by proxy at the meeting to nominate the person or persons specified in the notice; (c) a description of all arrangements or understandings between such stockholder and each nominee and any other person or persons (naming such person or persons) pursuant to which the nomination or nominations are to be made by such stockholder; (d) such other information regarding each nominee proposed by such stockholder as would have been required to be included in a proxy statement filed pursuant to the proxy rules of the SEC if such nominee had been nominated, or intended to be nominated, by the Board of Directors; and (e) the consent of each nominee to serve as a director of the Company if elected. The chairman of the stockholders' meeting may refuse to acknowledge the nomination of any person not made in compliance with the foregoing procedure.

Stockholder Communications with Board

Stockholders wishing to communicate with the Board of Directors or with a Board member should address communications to the Board or to the particular Board member, c/o Secretary, 1275 West Washington Street, Tempe, Arizona 85281. All communications sent in this manner to the Board members will be forwarded directly to the Board. From time to time, the Board may change the process for the means by which stockholders may communicate with the Board or its members. Please refer to the Company's website at *www.orthologic.com* for any changes to this process.

COMPENSATION OF DIRECTORS

Name (a)	Fees Earned or Paid in Cash ($) (b)	Stock Awards ($) (c)	Option Awards ($) (d)	Non-Equity Incentive Plan Compensation ($) (e)	Change in Pension Value and Nonqualified Deferred Compensation Earnings ($) (f)	All Other Compensation ($) (g)	Total ($) (h)
Michael D. Casey Director	28,000	20,000	46,000				94,000
Fredric J. Feldman, Ph.D. Director	28,000	20,000	46,000				94,000
John M. Holliman, III, Executive Chairman	28,000	20,000	174,000			133,000	355,000
Elwood D. Howse, Director	28,000	20,000	46,000				94,000
William M. Wardell, MD, Ph.D. Director	28,000	8,000	48,000			78,000	162,000
Augustus A. White, III, MD, Ph.D. Director	28,000	20,000	46,000				94,000

During the year ended December 31, 2006, the Company paid directors an annual retainer of $24,000 payable quarterly in advance and $1,000 for each board meeting attendance. All directors are eligible for the grant of nonqualified stock options pursuant to the Company's 1997 Stock Option Plan or 2005 Equity Incentive Plan. On June 10, 2005, the Board of Directors approved an annual award to each director of a non-qualified stock option to purchase 10,000 shares of the Company's common stock. The Company issued to each director non-qualified options to acquire 10,000 shares at a price of $4.90 per share on January 1, 2006 (fair value of $25,000), and 10,000 shares at a price of $1.43 per share on January 1, 2007 (fair value of $11,000). Annual option grants are granted on January 1 of each year at the closing market price on the last trading day of the prior year. On May 12, 2006 the Board of Directors issued each director non-qualified options to purchase 25,000 shares of the Company's Common Stock at $1.75 a share (fair value of $21,000). These options vested immediately and were granted at the market price on the date of grant. All options have been granted with ten-year terms.

On June 10, 2005 the Board of Directors also approved an annual award to each director of $25,000 of restricted stock. The shares granted vest one year from the date of issuance. The Board of Directors conditionally granted to each director 6,510 shares on June 10, 2005 and 5,102 shares on January 1, 2006, subject to shareholder approval of the 2005 Equity Incentive Plan. On May 12, 2006 the Company's shareholders approved the 2005 Equity Incentive Plan and the conditional grants became effective (fair value on May 12, 2006 of 11,612 shares was $20,000) and all shares were fully vested at December 31, 2006. On January 1, 2007 the Board awarded 17,483 shares of restricted stock to each director, which represents a fair value of $25,000, with the number of shares determined by the closing price of the Company's Common stock on the last trading day of 2006.

William M. Wardell, MD, Ph.D, performed various regulatory related consulting services for the Company during 2006 for which he was paid $78,000.

On April 4, 2006, John M. Holliman, III, became Executive Chairman of the Company and subsequently entered into an agreement that provides for annual compensation of $200,000 and eligibility for an additional payment (bonus) of up to 40% of the annual compensation, to be determined assuming a fiscal year ending March 31, 2007.

On May 12, 2006, John M. Holliman, III, Executive Chairman, was granted an option to purchase 200,000 shares of the Company's common stock at $1.75 per share, the closing market price on the date of grant. The options vest over a two-year period and have a fair value of $196,000 on the date of grant. (See the Executive Compensation Summary Compensation Table included in this proxy statement for additional information.)

Director Outstanding Equity Awards at Fiscal Year-End

	Option Awards				
Name (a)	Number of Securities Underlying Unexercised Options (#) Exercisable (b)	Number of Securities Underlying Unexercised Options (#) Unexercisable (c)	Equity Incentive Plan Awards: Number of Securities Underlying Unexercised Unearned Options (#) (d)	Options Exercise Price ($) (e)	Option Expiration Date (f)
Michael D. Casey	40,000			7.40	1/23/2014
John M. Holliman, III	20,000			3.58	8/24/2011
*	58,333	141,667		1.75	5/12/2016
William M. Wardell, MD, Ph.D.	10,000			5.33	2/11/2016
Augustus A. White, III, MD, Ph.D.	10,000			3.25	8/21/2008
Various directors:					
(2) (3) (4) (6)	12,000			5.25	5/16/2007
(2) (3) (4) (6)	13,000			5.38	10/17/2007
(2) (3) (4) (6)	5,000			5.53	1/1/2008
(2) (3) (4) (6)	5,000			3.34	12/31/2008
(2) (3) (4) (6)	5,000			2.53	12/29/2009
(2) (3) (4) (6)	5,000			2.44	12/15/2010
(2) (3) (4) (6)	30,000			3.19	1/19/2011
(2) (3) (4) (6)	25,000			3.93	10/26/2011
(2) (3) (4) (6)	5,000			4.89	12/31/2011
(2) (3) (4) (6)	10,000			3.61	12/31/2012
(2) (3) (4) (6)	10,000			6.13	12/31/2013
(2) (3) (4) (6)	30,000			7.40	1/23/2014
(2) (3) (4) (6)(1)	10,000			6.25	12/31/2014
(2) (3) (4) (6)(1)	10,000			4.90	1/2/2016
(2) (3) (4) (6)(1)(5)	25,000			1.75	5/12/2016

* Vest monthly over a two-year period ending 5/12/08

All other directors options were fully vested on 12/31/2006

(1) Casey, Michael

(2) Feldman, Fred

(3) Holliman, John

(4) Howse, Elwood

(5) Wardell, William

(6) White, Augustus

EXECUTIVE OFFICERS

The following table sets forth information regarding our executive officers:

Name	Age	Title
John M. Holliman, III	53	Executive Chairman and Principal Executive Officer
Randolph C. Steer, MD, Ph.D.	57	President
Les M. Taeger	56	Senior Vice President and Chief Financial Officer
Dana B. Shinbaum	44	Vice President, Business Development
James T. Ryaby, Ph.D.	48	Senior Vice President and Chief Scientific Officer (resigned effective November 17, 2006)
James M. Pusey, MD	48	President and Chief Executive Officer (resigned April 5, 2006)
Sherry A. Sturman	42	Senior Vice President and Chief Financial Officer (resigned January 16, 2006)

OrthoLogic announced the resignation of its Chief Financial Officer, Sherry A. Sturman, and the hiring of its new Chief Financial Officer, Les M. Taeger, effective January 16, 2006. Effective January 16, 2006 Ms. Sturman began a two-year transition period per the terms of her employment agreement leading to the termination of her employment with the Company. On April 5, 2006 the Company announced the resignation of its Chief Executive Officer, Dr. James M. Pusey. Effective April 5, 2006, John M. Holliman, III, Chairman of the Board, assumed certain duties of the Chief Executive Officer and Randolph C. Steer assumed the duties of the President. On November 22, 2006 the Company announced the resignation of its Senior Vice President and Chief Scientific Officer, James T. Ryaby, Ph.D.

John M. Holliman, III, became Executive Chairman and Principal Executive Officer of the Company on April 5, 2006 and has served as a director of the Company since September 1987 and as Chairman of the Board of Directors since August 1997. Since February 1993 he has been a general partner of entities, which are the general partners of Valley Ventures, LP (formerly known as Arizona Growth Partners, LP), Valley Ventures II, LP and Valley Ventures III, LP, all of which are venture capital funds that invest principally in life science companies.

Randolph C. Steer, MD, Ph.D., became President of the Company on April 5, 2006. Dr. Steer has been an independent pharmaceutical, biotechnology and medical devices consultant since 1989, and has provided consulting services to OrthoLogic since 2002. He has a broad scientific, medical and business background, including extensive experience in pre-clinical, clinical and regulatory affairs, having held key management positions in leading corporations and having served as an advisor to many companies in the United States and abroad. Dr. Steer has also advised numerous venture capital firms, investment banks and independent investors on the commercial development of drugs, biologics, diagnostics and medical devices. He has served as Associate Director of Medical Affairs at Marion Laboratories; Medical Director at Ciba Consumer Pharmaceuticals (Ciba-Geigy Corporation); Vice President, Senior Vice President and Member of the Executive Committee at Physicians World Communications Group; Chairman, President and Chief Executive Officer of Advanced Therapeutics Communications International, a global drug regulatory group, and Chairman and Chief Executive Officer of Vicus.com, Inc. He is a member of the Board of Directors of Techne Corporation and BioCryst Pharmaceuticals. Dr. Steer received his MD degree

from the Mayo Medical School and his Ph.D. from the University of Minnesota, where he also completed a residency and subspecialty fellowship in clinical and chemical pathology. He is a Fellow of the American College of Clinical Pharmacology.

Les M. Taeger joined OrthoLogic as Senior Vice President and Chief Financial Officer on January 16, 2006. Mr. Taeger most recently served as Chief Financial Officer of CardioTech International, Inc. ("CardioTech"). CardioTech is a publicly-traded, medical device company that develops, manufactures and sells advanced products for the treatment of cardiovascular disease. From September, 2000 to February, 2004, when Mr. Taeger became Chief Financial Officer of CardioTech, Mr. Taeger served as Chief Financial Officer of Gish Biomedical, Inc. ("Gish"). Gish, now a subsidiary of CardioTech pursuant to a merger transaction involving the companies in April, 2003, specializes in the manufacture and sale of products used in open-heart surgery, vascular access and orthopedic surgery. Prior to his employment with CardioTech and Gish, Mr. Taeger was employed for over five years as Chief Financial Officer of Cartwright Electronics, Inc., a division of Meggitt, PLC. Mr. Taeger is a Certified Public Accountant, with a Bachelor degree in accounting.

Dana B. Shinbaum joined OrthoLogic as Vice President of Business Development in October 2005. Previously he served as Vice President, Product Planning and Market Analytics at Savient Pharmaceuticals, Inc., and has over seventeen years of experience in the pharmaceutical/biotechnology industry. While at Savient his responsibilities included creating and developing new business opportunities, leading global project teams and managing product launches. He played key strategic planning roles in Savient's acquisition of Rosemont Pharmaceuticals Ltd. and the divestiture of Bio-Technology General Ltd., Savient's global biologics business. Prior to joining Savient, Mr. Shinbaum was at Wyeth-Ayerst Laboratories, where he served in a variety of market planning and marketing roles, including Product Manager for the PREMARIN® franchise. Mr. Shinbaum received a Master of Business Administration, *summa cum laude*, from Drexel University in Philadelphia and a Bachelor of Arts degree from Lafayette College in Easton, Pennsylvania.

James T. Ryaby, Ph.D., (departed Executive) joined OrthoLogic as Director of Research in 1991, became Vice President of Research in 1997 and was promoted to Senior Vice President and Chief Technology Officer in early 2003.

James M. Pusey, MD (departed Executive), joined OrthoLogic as President and Chief Executive Officer on March 15, 2005.

Sherry A. Sturman (departed Executive) joined OrthoLogic as Director of Finance in October 1997 and began serving as the Vice President of Administration and Chief Financial Officer in June 2000, and was promoted to Senior Vice President in early 2003.

EXECUTIVE COMPENSATION

COMPENSATION DISCUSSION AND ANALYSIS

Compensation Philosophy

The objectives of the Company's executive compensation policies are to attract, retain and reward executive officers who contribute to the Company's success, to align the financial interests of executive officers with the performance of the Company, to strengthen the relationship between executive pay and shareholder value, to motivate executive officers to achieve the Company's business objectives and to reward individual performance. The Company used base salary, cash bonuses, restricted stock and stock options to achieve these objectives.

Review of Current Compensation Components of Executive Chairman and other Executive Officers

The Compensation Committee reviews all components of the Executive Chairman's and other executive officers' compensation, including salary, bonus, restricted stock, accumulated vested and unvested stock options, the dollar value to the executive and cost to the company of all perquisites and other personal benefits, as well as the actual projected payout obligations under several potential severance and change-in-control scenarios and any limitations on the deductibility for federal income tax purposes of all compensation. Documentation is provided to the Compensation Committee consisting of the following:

1) *Each Executive has individual performance goals for the fiscal year.* The Compensation Committee reviews the performance goals and expectations for individual executive positions. Based on recommendations from the Executive Chairman and the Compensation Committee's evaluation of the performance achievement of these goals, the Compensation Committee determines the resulting bonus and/or changes to salary components for the executive officers. The Executive Chairman also recommends individual performance objectives for himself for each fiscal year. The Compensation Committee approves the performance objectives of the Executive Chairman and evaluates the Executive Chairman's performance measured against these objectives and evaluates and formulates any potential changes in compensation accordingly.

2) *The Company's performance is compared against the goals for the fiscal year.* Strategic, high level performance expectations are identified each fiscal year for the Company. The Executive Chairman provides documentation to the Compensation Committee regarding the expectations and corresponding results of operations.

3) *The level of compensation for executives in similar positions for companies of similar size and development structure is used as a benchmark.* To enable the Company to continue to attract and retain executives in the competitive marketplace, executive compensation for similar companies is reviewed annually. The Company typically obtains this data through a review of publicly available executive compensation information for comparable public companies listed on the Nasdaq Global Market and through purchased survey data tailored to the industry and size of the Company.

The Compensation Committee's Conclusion

Based on the review detailed above, the Compensation Committee, at its meeting held at the beginning of the fiscal year, formulates its recommendations regarding what areas of the compensation components will be adjusted for the upcoming year and what the performance bonus for the prior year will be.

Board Approval

At the first Compensation Committee meeting of the year, the Compensation Committee reviews the Executive Chairman and other executive officers' compensation and bonuses and presents its recommendations to the Board of Directors. The final total compensation package decision regarding the Executive Chairman is made by the Independent Directors in an Executive Session without the Executive Chairman or other members of management present, and the final decisions on other executives' total compensation packages are made by the full Board of Directors.

The following discussion is provided to facilitate stockholder understanding of the Named Executive Officer compensation information included with this proxy statement. Overall our compensation decisions are framed by the nature of our business as a development stage pharmaceutical company with the need for highly specialized and talented individuals. Our compensation policies are designed to take into account the fact that the competition for executives is with all sizes of pharmaceutical firms and must factor in not just comparable compensation, including health care, retirement or other traditional executive benefits, but issues such as location and position stability. We operate in Tempe, Arizona, a relatively small market for biotechnology, and in a field with substantial product development risks, with no current revenue and limited funds.

ANNUAL BASE COMPENSATION AND CASH BONUS

As previously mentioned, each executive officer receives a base salary and a cash bonus which is based on performance against both Company and individual performance goals. We have established base salaries which we feel are comparable to other biotechnology firms and with the potential cash bonus, provide for a reasonable level of cash-based compensation to the executives. Base compensation in 2006 ranged from $368,000 for Dr. Pusey (resigned April 5, 2006) to $227,000 for Mr. Taeger. In 2006 the bonus potential ranged from 50% of base salary for Dr. Pusey to 40% for Mr. Shinbaum. The bonus plan placed 25-30% of the executive's cash compensation at risk, which we believe is a reasonable level of risk for cash-based compensation. In 2006, performance for the bonus plan was weighted 70% towards Company goals and 30% towards individual goals. Company and individual goals included a combination of operating, such as timely completion of clinical or pre-clinical tasks and performance

against our strategic plan, financial, such as performance to budget or generation of unbudgeted cost savings, and administrative, such as maintaining compliance with Securities and Exchange Commission rules, regulations and reporting requirements. We believe that the cash compensation at risk and the performance goals of the 2006 bonus plan serve to align our executive's interests with our interests and focus their efforts where we believe they have the potential to achieve performance we have identified as important to accomplishing objectives necessary to advance our development efforts.

The disclosed bonus compensation for 2006 for Dr. Pusey and Mr. Shinbaum include negotiated amounts which were part of our employment offer to them in 2005. Such amounts were determined based on the position and competitive factors at the time of the offers.

Equity Based Compensation

As previously discussed, we provide a certain level of cash compensation to each executive as both a short-term reward and to focus executive performance on short-term goals that are part of our long-term strategies. Additionally, we use a combination of stock option grants and stock awards, both during the employment offer process and annually, to generate a commitment to and a long-term investment in our company. Grants and awards connected with employment offers were determined based on the position and competitive factors at the time of the offers.

Stock Option Grants

As part of our long-term incentives we grant options to purchase shares of our common stock to our executives. Grants to our executives under our compensation plan ranged from options to purchase 50,000 shares for Dr. Pusey to options to purchase 35,000 shares for Mr. Shinbaum. Grants are targeted such that an annual $1 increase in market price, currently an annual $42,000,000 increase in shareholder value, would provide approximately 10% of the executive's compensation. We believe grants at these levels serve to gradually increase our executive's commitment to our company and align their interests with other stockholders of the company.

Stock option compensation in 2006 for Mr. Holliman and Dr. Steer relate to grants negotiated as part of our offers to them to assume the duties of Executive Chairman and President, respectively, in April 2006, upon the resignation of our CEO Dr. Pusey.

On March 15, 2006, the Company reported results of an analysis of data from its Phase 3 clinical trial of the novel synthetic peptide Chrysalin® (TP508) in unstable, displaced distal radius (wrist) fractures. Subsequent to the release of the results we experienced a significant decline in our stock price which greatly diminished the value of the past long-term incentive grants and awards. In order to strengthen the alignment of our executives interests with our shareholders interests during what we believe is a critical period in our development efforts, in June 2006, we granted our executives non-qualified stock options to purchase, from 200,000 (Dr. Pusey) to 150,000 (other executives), shares of our common stock, with the options vesting monthly over two years. These grants were not part of our annual compensation plan and were separately determined to be an important step in reestablishing a competitive long-term compensation component to our executive compensation plan.

Stock Awards

In 2006 there were no stock awards for executive performance. The disclosed compensation relates to awards made in 2005 to Dr. Ryaby and Ms. Sturman and to Dr. Pusey and Mr. Shinbaum for awards negotiated as part of our employment offers to them in 2005, on which the performance conditions were achieved in 2006.

We believe stock awards are an important element in our compensation plan, however in 2006 we made no stock awards due to the previously discussed additional stock option grant to executives in June 2006. Future awards may be made and are targeted to comprise approximately 10% of total executive compensation and will be a fixed dollar amount award with the number of shares determined by the closing market price on the date prior to the date of grant. Given the compensation levels of our executives we believe awards at these levels serve to gradually increase our executive's commitment to our company and align their interests with other stockholders of the company.

Fringe Benefits, Perquisites and Retirement Benefits

Our executives participate in group health, dental, life, and disability programs and participate in our 401K plan on the same basis as other employees. No perquisites are provided to executives that are not provided to other employees or that in aggregate exceed $10,000 per year.

As part of our employment offer to Dr. Pusey in 2005, we agreed to annually reimburse Dr. Pusey for up to $30,000 in personal travel expenses. In 2006 Dr. Pusey was reimbursed $14,000 for personal travel expenses.

REPORT OF THE COMPENSATION COMMITTEE OF THE BOARD OF DIRECTORS

The Compensation Committee of the Company's Board of Directors (the "Compensation Committee") recommends the compensation of the Executive Chairman and President to the Board and reviews and approves the design, administration and effectiveness of compensation programs for other key executive officers, including salary, cash bonus levels, other perquisites and stock awards or option grants under the Company's stock option plans. The Compensation Committee has reviewed and discussed the Compensation Discussion and Analysis with management, and based on this review and discussion, the Compensation Committee recommended to the Board of Directors that the Compensation Discussion and Analysis be included in this proxy statement.

Compensation Committee during 2006:

Michael D. Casey
Elwood D. Howse, Jr.
Fredric J. Feldman, Ph.D. (replaced by Mr. Casey on August 24, 2006)

COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION

During 2006, Fredric J. Feldman, Ph.D., Michael D. Casey and Elwood D. Howse, Jr., each an independent director, served on the Compensation Committee of the Board of Directors. Dr. Feldman was replaced on the Compensation Committee by Mr. Casey on August 24, 2006.

SUMMARY COMPENSATION TABLE

The following table sets forth, with respect to the year ended December 31, 2006 compensation awarded to, earned by or paid to the Company's named executive officers.

Name (a)	Year (b)	Salary ($) (c)	Bonus ($) (d)	Stock Awards ($) (e)	Option Awards ($) (f)	Non-Equity Incentive Plan Compensation ($) (g)	Change in Pension Value and Nonqualified Deferred Compensation Earnings ($) (h)	All Other Compensation ($) (i)	Total ($) (j)
John M. Holliman, III Executive Chairman	2006	133,000		20,000	174,000			28,000(1)	355,000
Randolph C. Steer, MD, Ph.D. President	2006	200,000			174,000			66,000(2)	440,000
Les M. Taeger Chief Financial Officer	2006	198,000	86,000		351,000				635,000
Dana B. Shinbaum VP Business Development	2006	227,000	107,000	26,000	187,000				547,000
James M. Pusey, MD	2006	197,000	188,000	426,000	487,000			14,000(3)	1,312,000
Sherry A. Sturman	2006	173,000		35,000					208,000
James T. Ryaby, Ph.D.	2006	196,000		35,000	151,000			70,000(4)	452,000

(1) Mr. Holliman is a member of the Board of Directors and received $28,000 in Board fees in 2006.

(2) Prior to becoming an employee, Dr. Steer performed consulting services for the Company for which he was paid $66,000 in 2006.

(3) Dr. Pusey's employment agreement provided for reimbursement of personal travel expenses up to $30,000 per year. Prior to his resignation on April 5, 2006, Dr. Pusey had been reimbursed $14,000 for personal travel expenses.

(4) On November 12, 2006, Dr. Ryaby resigned his position as Senior Vice President and Chief Scientific Officer and entered into a consulting agreement with the Company that provided for an initial payment of $40,000 and monthly consulting fees of $21,000.

OPTION GRANTS / STOCK AWARDS

The following table sets forth information about stock option grants and stock awards during the last fiscal year to the executive officers named in the Summary Compensation Table.

Grants of Plan-based Awards

Name (a)	Grant Date (b)	All Other Stock Awards: Number of Shares of Stock or Units (#) (i)	All Other Option Awards: Number of Securities Underlying Options (#) (j)	Exercise or Base Price of Option Awards ($/Share) (k)	Grant Date Fair Value of Stock and Option Awards (1) ($) (l)
John M. Holliman, III.	1/1/06		10,000	4.90	25,000
Executive Chairman	5/12/06		25,000	1.75	21,000
	5/12/06		200,000	1.75	196,000
	5/12/06	11,612			20,000
Randolph C. Steer, MD, Ph.D.	5/12/06		200,000	1.75	196,000
President					
Les M. Taeger	1/16/06		150,000	5.15	482,000
Chief Financial Officer	6/2/06		150,000	1.70	143,000
Dana B. Shinbaum	1/30/06		35,000	5.39	119,000
VP Business Development	6/2/06		150,000	1.70	143,000
	5/12/06	15,000			26,000
James M. Pusey, MD	2/11/06		50,000	5.33	168,000
Sherry A. Sturman	5/12/06	20,000			35,000
James T. Ryaby, Ph.D.	1/30/06		35,000	5.39	119,000
	6/2/06		150,000	1.70	143,000
	5/12/06	20,000			35,000

(1) Fair value of the grants at the date of the grants was determined using the Black-Scholes model as described in Note 8 to our Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 14, 2007.

OUTSTANDING EQUITY AWARDS AT FISCAL YEAR-END

		Option Awards				
Name (a)		Number of Securities Underlying Unexercised Options (#) Exercisable (b)	Number of Securities Underlying Unexercised Options (#) Unexercisable (c)	Equity Incentive Plan Awards: Number of Securities Underlying Unexercised Unearned Options (#) (d)	Option Exercise Price ($) (e)	Option Expiration Date (f)
John M. Holliman, III						
		12,000			5.25	5/16/2007
		13,000			5.38	10/17/2007
		5,000			5.53	1/1/2008
		5,000			3.34	12/31/2008
		5,000			2.53	12/29/2009
		5,000			2.44	12/15/2010
		30,000			3.19	1/19/2011
		20,000			3.58	8/24/2011
		25,000			3.93	10/26/2011
		5,000			4.89	12/31/2011
		10,000			3.61	12/31/2012
		10,000			6.13	12/31/2013
		30,000			7.40	1/23/2014
		10,000			6.25	12/31/2014
		10,000			4.90	1/2/2016
		25,000			1.75	5/12/2016
**		58,333	141,667		1.75	5/12/2016
Randolph C. Steer, MD, Ph.D. . . .		5,000			5.94	1/30/2008
**		58,333	141,667		1.75	5/12/2016
Les M. Taeger	***	34,375	115,625		5.15	1/16/2016
**		37,500	112,500		1.70	6/2/2016
Dana B. Shinbaum		14,583	35,417		3.27	10/29/2015
*		0	35,000		5.39	1/30/2016
**		37,500	112,500		1.70	6/2/2016
James M. Pusey, MD		24,375			5.31	4/5/2008
		103,125			5.88	4/5/2008
		42,969			5.88	4/5/2008
James T. Ryaby, Ph.D.		15,000			6.00	2/21/2007
		100			4.94	8/15/2007
		2,000			5.38	10/17/2007
		35,000			5.00	7/1/2008
		3,750			3.63	1/22/ 2009
		100			3.53	1/21/2010
		3,750			3.53	1/21/2010
		85,000			4.56	5/19/2010
		300			3.93	10/26/2011
		30,000			3.50	11/11/2012
		42,000			3.28	3/5/2013
		271	229		5.90	10/22/2014
*		0	35,000		5.39	1/30/2016
**		37,500	112,500		1.70	6/2/2016

* Vesting four years - 25% year one and monthly thereafter

** Vesting two years - monthly

*** Vesting four years - monthly

OPTION EXERCISES AND STOCK VESTED

	Option Awards		Stock Awards	
Name (a)	Number of Shares Acquired on Exercise (#) (b)	Value Realized on Exercise ($) (c)	Number of Shares Acquired On Vesting (#) (d)	Value Realized on Vesting ($) (e)
Dana B. Shinbaum			15,000	26,000
James M. Pusey, MD			100,000	230,000
James T. Ryaby, Ph.D.			20,000	35,000
Sherry A. Sturman			20,000	35,000

EMPLOYMENT CONTRACTS, TERMINATION OF EMPLOYMENT, AND CHANGE-IN-CONTROL ARRANGEMENTS

The Company hired Dr. James M. Pusey as Chief Executive Officer and Dr. Pusey signed an employment agreement with OrthoLogic on March 3, 2005, which provides for a minimum base salary of $350,000, which could be increased subject to annual reviews, and allowed for Dr. Pusey's participation in a discretionary bonus program, which provided for a bonus of up to 50% of his base salary. Dr. Pusey received a signing bonus of $125,000 and an additional bonus of $125,000 paid at the one year anniversary of the commencement of his employment. In addition, Dr. Pusey's employment agreement provided for the reimbursement of certain business, relocation and travel expenses as well as the medical, dental and other fringe benefits generally granted to the Company's senior management. Under Dr. Pusey's employment agreement, Dr. Pusey could be terminated at any time, with or without cause, at the option of either the Company or Dr. Pusey. In the event that Dr. Pusey was terminated without cause, he would have been entitled to receive 12 months' salary, payable at the rate in effect at the time of termination in the ordinary course of business as if Dr. Pusey was continuing as an employee of the Company.

On March 3, 2005, the Company granted to Dr. Pusey options to purchase 425,000 shares of the Company's common stock at an exercise price equal to the closing price of the Company's common stock on March 3, 2005, as reported by the Nasdaq Global Market, and granted to Dr. Pusey, effective as of the date he commenced his employment, March 15, 2005, an option to purchase an additional 75,000 shares of the Company's common stock at an exercise price equal to the closing price of the Company's common stock on that date, as reported by the Nasdaq Global Market (the grant of the options to purchase 425,000 shares and 75,000 shares are collectively, the "Initial Option Grant"). The grants are evidenced by a Letter of Stock Option Grant for 200,000 shares and a Letter of Stock Option Grant for 300,000 shares, each of which provide for immediate vesting upon effectiveness of the grants as to 10% of the shares covered thereby and monthly vesting of the remainder in equal amounts over a period of 48 months, subject to continued employment by Dr. Pusey.

On March 3, 2005, the Company also granted to Dr. Pusey 200,000 shares of restricted stock of the Company (the "Restricted Shares"). The Letter of Restricted Stock Grant provides that the Restricted Shares shall be subject to restrictions on transferability and forfeiture, with such restrictions to lapse as to 50% of such stock upon the acceptance by the United States Food and Drug Administration for filing of a New Drug Application for Chrysalin for fresh fracture indications, and with the restrictions to lapse as to the remaining 50% upon the attainment of certain milestones to be mutually agreed upon by Dr. Pusey and the Compensation Committee of the Company's Board of Directors. On March 18, 2006, 100,000 shares of Dr. Pusey's restricted stock became fully vested.

In the event that the Company underwent a change of control or a sale of substantially all of its assets, Dr. Pusey's employment agreement provided that Dr. Pusey would have been entitled to receive a special bonus of up to $2.0 million, and at least 90% of the shares included in the Initial Option Grant would have fully vested and the restrictions on at least 90% of the Restricted Shares would have fully lapsed upon such a change of control or sale of assets.

On April 5, 2006, Dr. Pusey resigned his position as Chief Executive Officer and President of the Company. Under Dr. Pusey's separation agreement, Dr. Pusey received severance benefits of $100,000, paid in six equal installments and the Company's normal executive health benefits for the six month period following his resignation. In accordance with Company policy, all of Dr. Pusey's unvested stock options and restricted stock were cancelled upon Dr. Pusey's resignation.

Effective April 5, 2006, Mr. John M. Holliman, III, became Executive Chairman and Principal Executive Officer. On May 12, 2006, the Company entered into an agreement with VV III Management, LLC and John M. Holliman, III, to compensate Mr. Holliman for his services as the Company's Executive Chairman and principal executive officer (the "Holliman Agreement").

Under the Holliman Agreement, Mr. Holliman's services to the Company may be terminated by the Company at any time, with or without cause. In the event of termination without cause in connection with or following a Change in Control, payments under the Holliman Agreement will continue for six months after the date of termination. It provides for annual base cash compensation of $200,000, payable in accordance with the Company's standard payroll practices and a target bonus of 40% of base compensation upon the achievement of individual and corporate performance objectives. In addition, the Holliman Agreement includes other terms and conditions consistent with agreements entered into with other Company executives.

In connection with Mr. Holliman's services to the Company as its Executive Chairman and principal executive officer, on May 12, 2006 the Company also granted him options to purchase 200,000 shares of the Company's common stock at an exercise price equal to $1.75, the closing price of the Company's common stock on the date of grant as reported by the Nasdaq Global Stock Market. These options will vest in equal amounts over a twenty-four month period and are exercisable, subject to the vesting schedule, for ten years from the date of grant. In the event of a change of control or liquidation of the Company, the vesting of the options will be accelerated so that the options will become fully exercisable.

Effective April 5, 2006, Randolph C. Steer, MD, Ph.D., became President of the Company. Dr. Steer has performed consulting services for the Company since 2002. On May 12, 2006, the Company also entered into an agreement with Randolph C. Steer, MD, Ph.D., to compensate Dr. Steer for his services as the Company's President and Chief Operating Officer (the "Steer Agreement"). In connection with Dr. Steer's services to the Company, Dr. Steer also executed an Intellectual Property, Confidentiality and Non-Competition Agreement, which sets forth restrictions on the disclosure of Company proprietary information and protects the Company's interest in its intellectual property, and an Indemnification Agreement, which provides for indemnification by the Company for certain Company-related claims against the directors or officers to the fullest extent permitted by law, as well as the advancement of expenses relating to such claims.

Under the Steer Agreement, Dr. Steer's services to the Company may be terminated by the Company at any time, with or without cause. If the event of termination is without cause, payments under the Steer Agreement will continue for three months after the date of termination. The Steer Agreement provides for annual base cash compensation of $300,000, payable in accordance with the Company's standard payroll practices and a target bonus of 40% of base compensation upon the achievement of individual and corporate performance objectives. In addition, the Steer Agreement includes other terms and conditions consistent with agreements entered into with other Company executives.

In connection with Dr. Steer's services to the Company, on May 12, 2006 the Company also granted him options to purchase 200,000 shares of the Company's common stock at an exercise price equal to $1.75, the closing price of the Company's common stock on the date of grant as reported by the Nasdaq Stock Market. These options will vest in equal amounts over a twenty-four month period and are exercisable, subject to the vesting schedule, for ten years from the date of grant. In the event of a change of control or liquidation of the Company, the vesting of the options will be accelerated so that the options will become fully exercisable.

On October 17, 2005, the Company entered into an employment agreement with Dana Shinbaum (the "Shinbaum Employment Agreement"), pursuant to which Mr. Shinbaum serves as the Company's Vice President of Business Development and Strategic Marketing. Under the Shinbaum Employment Agreement, Mr. Shinbaum may be terminated at any time, with or without cause, at the option of either the Company or Mr. Shinbaum. If the Company terminates Mr. Shinbaum without cause, provided Mr. Shinbaum first executes a Severance Agreement in

the form then used by the Company, the Company shall continue to pay to Mr. Shinbaum his minimum base salary in effect at the time of termination for a period of one year following the date of termination, at the time and in the manner dictated by the Company's standard payroll policies. Should such termination occur as a result of a Change in Control, the Company shall also pay Mr. Shinbaum a pro-rata share of his bonus at the time of termination. Effective January 29, 2007, Mr. Shinbaum's annual base salary was increased to $235,000. Under the initial terms of Mr. Shinbaum's employment with the Company, the Company granted him 15,000 shares of restricted stock, subject to performance vesting requirements, which fully vested in 2006, and options to purchase 50,000 shares of the Company's common stock at an exercise price equal to the closing price of the Company's common stock on the business day immediately preceding the date of such grant, as reported by the Nasdaq Global Market. In addition, Mr. Shinbaum is eligible to participate in the Company's discretionary bonus program, which provides for a bonus of up to 40% of his base salary, and Mr. Shinbaum will receive medical, dental and other fringe benefits generally granted to the Company's senior management. Under the employment agreement, Mr. Shinbaum was granted a signing bonus of $50,000, paid $35,000 on the date of the agreement and $15,000 upon completion of one year of service. Mr. Shinbaum also received relocation assistance of $34,735.

On January 10, 2006, the Company entered into an employment agreement with Les M. Taeger, dated as of January 10, 2006, effective as of January 16, 2006 (the "Taeger Employment Agreement"), pursuant to which Mr. Taeger serves as the Company's Senior Vice President / Chief Financial Officer. Under the Taeger Employment Agreement, Mr. Taeger may be terminated at any time, with or without cause, at the option of either the Company or Mr. Taeger. If the Company terminates Mr. Taeger without cause, provided Mr. Taeger first executes a Severance Agreement in the form then used by the Company, the Company shall continue to pay to Mr. Taeger his minimum base salary in effect at the time of termination for a period of one year following the date of termination, at the time and in the manner dictated by the Company's standard payroll policies. Should such termination occur as a result of a Change in Control, the Company shall also pay Mr. Taeger a pro-rata share of his bonus at the time of termination. Effective January 29, 2007, Mr. Taeger's annual base salary was increased to $235,000. Under the initial terms of Mr. Taeger's employment with the Company, the Company granted him options to purchase 150,000 shares of the Company's common stock at an exercise price equal to the closing price of the Company's common stock on the business day immediately preceding the date of such grant, as reported by the Nasdaq Global Market. In addition, Mr. Taeger is eligible to participate in the Company's discretionary bonus program, which provides for a bonus of up to 45% of his base salary, and Mr. Taeger will receive medical, dental and other fringe benefits generally granted to the Company's senior management.

On November 8, 2004, the Company entered into a Third Amended and Restated Employment Agreement with Sherry A. Sturman (the "Sturman Agreement"), which provides for a minimum base salary, currently $225,000 per year. Ms. Sturman was also eligible for annual and long-term incentives, including performance-based bonuses. Under the terms of the Sturman Agreement, on January 16, 2006, Ms. Sturman elected a two-year transition leading to the termination of Ms. Sturman's employment with the Company. Under the terms of the Sturman Agreement, Ms. Sturman was eligible to continue receiving salary, at declining base salary rates, and benefits from February 16, 2006 to February 15, 2008.

The Company entered into an employment agreement with James T. Ryaby, Ph.D. This annual contract provided for a one-year employment term that was automatically renewed. Effective as of November 17, 2006, the Company entered into a Separation Agreement and Release (the "Separation Agreement") and a Consulting Agreement (the "Consulting Agreement") with James T. Ryaby, Ph.D., the Company's Senior Vice President and Chief Scientific Officer in connection with Dr. Ryaby's resignation. Under the terms of the Separation Agreement, the Company's Employment Agreement with Dr. Ryaby dated June 1, 2001, as amended, was terminated effective November 17, 2006. The Separation Agreement provides that Dr. Ryaby's outstanding stock options will continue to vest and vested options will continue to be exercisable during the term of the Consulting Agreement.

Under the Consulting Agreement, Dr. Ryaby will provide exclusive consulting services for the Company through March 20, 2007, and substantially exclusive consulting services thereafter. The Consulting Agreement terminates on December 31, 2007, but may be terminated by either party upon sixty (60) days notice given on or after March 20, 2007. The Consulting Agreement provides for payment for services at an annual rate of $250,000, payable monthly, and a one-time payment of $40,000 to cover Dr. Ryaby's consulting start-up expenses.

Under the Company's stock option plans, upon the occurrence of a merger in which the Company is not the surviving entity, a sale of substantially all of the assets of the Company, an acquisition by a third party of 100% of the Company's outstanding equity securities or a similar reorganization of the Company, 75% of all unvested options will vest, with the balance vesting equally over 12 months or according to the individual's vesting schedule, whichever is earlier. If the option holder loses his position with the Company as a result of the merger or sale, 100% of his options will immediately vest. Additionally, the Company's 1997 Stock Option Plan and 2005 Equity Incentive Plan provide that, upon a merger, consolidation or reorganization with another corporation in which the Company is not the surviving corporation, outstanding options shall be substituted on an equitable basis for options for appropriate shares of the surviving corporation, or optionees shall receive cash in exchange for cancellation of outstanding options.

REPORT OF THE AUDIT COMMITTEE OF THE BOARD OF DIRECTORS

The role of the Audit Committee (the "Audit Committee") is to assist the Board of Directors in its oversight of the Company's financial reporting process. Management of the Company is responsible for the preparation, presentation and integrity of the Company's financial statements, the Company's accounting and financial reporting principles and internal controls and procedures designed to assure compliance with accounting standards and applicable laws and regulations. The independent registered public accountant is responsible for auditing the Company's financial statements and expressing an opinion as to their conformity with generally accepted accounting principles.

Among other matters, the Audit Committee monitors and oversees the activities and performance of the external independent registered public accountant, including the audit scope, external audit fees, and auditor independence matters. The Audit Committee also is responsible for approving non-audit services proposed to be performed by the independent auditor. The Audit Committee has responsibility to appoint and dismiss the Company's independent auditor. Management and independent auditor presentations to and discussions with the Audit Committee also cover various topics and events that may have significant financial impact or are the subject of discussions between management and the independent auditor.

In the performance of its oversight function, the Audit Committee reviewed and discussed the audited financial statements with management and the independent registsered public accountant. The Audit Committee has also discussed with the independent registered public accountant the matters required to be discussed by Statement on Auditing Standards No. 61, as amended, *Communication with Audit Committees*, and Rule 2-07 of Regulation S-X. Finally, the Audit Committee has received the written disclosures and the letter from the independent registered public accountant required by Independence Standards Board Standard No. 1, *Independence Discussions with Audit Committees*, as currently in effect, and written confirmations from management with respect to services provided by the independent registered public accountant, has considered whether the provision of non-audit services by the independent registered public accountant to the Company is compatible with maintaining the auditor's independence and has discussed with the independent registered public accountant the independent registered public accountant's independence. The Audit Committee met four times in 2006, each time meeting separately with the independent registered public accountant without the presence of management.

Based upon the reports and discussions described in this report, the Audit Committee recommended to the Board that the audited financial statements be included in the Company's Annual Report on Form 10-K for the year ended December 31, 2006 for filing with the Securities and Exchange Commission.

Audit Committee during 2006:

Elwood D. Howse, Jr.
Augustus A. White, III, MD, Ph.D.
Fredric J. Feldman, Ph.D.

The foregoing report of the Audit Committee of the Company's Board of Directors shall not be deemed soliciting material or otherwise deemed filed and shall not be subject to the liabilities of Section 18 of the Securities Exchange Act of 1934, or deemed to be incorporated by reference by any general statement incorporating by reference this proxy statement into any other filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, except to the extent that we specifically incorporate the Report by reference therein.

CODE OF CONDUCT AND CORPORATE GOVERNANCE

In March 2004, the Company adopted a code of conduct that applies to all of its employees and has particular sections that apply only to its principal executive officer and senior financial officers. The Company has posted the text of its code of conduct on its website under the "Investors" section under the link for the "Code of Conduct." In addition, the Company will promptly disclose on its website (1) the nature of any amendment to its code of conduct that applies to its principal executive officer and senior financial officers, and (2) the nature of any waiver, including an implicit waiver, from a provision of its code of conduct that is granted to one of these specified officers, the name of such officer who is granted the waiver and the date of the waiver.

The full Board of Directors addresses all matters regarding corporate governance (that is, the relationships of the Board, the stockholders and management in determining the direction and performance of the Company) and the procedural rules regarding the operation of the Board itself. As such, the Board reviews all proposals submitted by stockholders for action at the annual stockholders' meeting with regards to each such proposal.

CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The Company has entered into indemnity agreements with all of its directors and officers for the indemnification of and advancing of expenses to such persons to the fullest extent permitted by law.

On February 23, 2006, the Company entered into an Asset Purchase Agreement and Plan of Reorganization (the "Definitive Agreement") to acquire certain assets and certain liabilities of AzERx, Inc. ("AzERx") for $390,000 in cash and the issuance of 1,325,000 shares of the Company's common stock, with a market value of $7.5 million based on the closing share price on the date the Definitive Agreement was entered into. Pursuant to the terms of the Definitive Agreement, the Company acquired an exclusive license for the core intellectual property relating to AZX100, a 24-amino acid peptide. In addition, the Company agreed to issue 30,000 shares of its common stock to Arizona Science and Technology Enterprises, LLC, the licensor of AzERx's core technology patents, in connection with certain modifications of the license effective upon consummation of the transactions contemplated in the Definitive Agreement. The transaction closed February 27, 2006.

The Chairman of the Company's Board of Directors, John M. Holliman, III, is a member of the AzERx board of directors and is affiliated with Valley Ventures III, L.P., an investment fund that owned approximately 30% of AzERx's fully diluted equity at the time of the transaction. Mr. Holliman recused himself from all Board matters involving AzERx. This included the Board's analysis of AzERx as a potential target of acquisition for expanding the Company's drug development portfolio, and subsequent negotiations between the Company and AzERx, which were led by the Company's Chief Executive Officer. In addition, Mr. Holliman was not present during the deliberations and vote of the Board approving the Definitive Agreement and the transactions contemplated thereby. The Board has evaluated NASDAQ Listing Standards and Security and Exchange Regulations regarding director independence and believes Mr. Holliman continued to meet the requirements to be considered an independent director until April 5, 2006, at which time Mr. Holliman became Executive Chairman and Principal Executive Officer of the Company and no longer met the requirements to be considered an independent director.

SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Under the securities laws of the United States, the Company's directors, its executive officers and any persons holding more than 10% of the Company's Common Stock are required to report their initial ownership of the Company's Common Stock and any subsequent changes in that ownership to the SEC. Specific due dates for these reports have been established, and the Company is required to disclose any failure to file by these dates. The company believes that all of these filing requirements were satisfied during the year ended December 31, 2006 except as follows:

1) The Board of Directors receive an annual grant on January 1 of each year of fully vested options to purchase 10,000 shares of the Company's common stock. The grants on January 1, 2006 were required to be reported by January 3, 2006, but were actually reported on Form 4's filed with the SEC on January 13, 2006; and

2) As reported on Form 5 filed with the SEC on February 14, 2007, John M. Holliman, III, did not file by the appropriate due date a change in ownership of the Company's common stock caused by the acquisition of a beneficial interest of 1,658 shares of the Company's common stock, in connection with the AzERx, Inc. transaction on February 27, 2006, through Mr. Holliman's interest in a partnership that holds a general partnership interest in Valley Ventures III, LP.

In making these disclosures, the Company has relied solely on written representations of those persons it knows to be subject to the reporting requirements and copies of the reports that they have filed with the SEC.

EQUITY COMPENSATION PLANS

The following provides tabular disclosure of the number of securities to be issued upon the exercise of outstanding options, the weighted average exercise price of outstanding options, and the number of securities remaining available for future issuance under equity compensation plans as of December 31, 2006, aggregated into two categories – plans that have been approved by stockholders and plans that have not.

Plan Category:	Number of Securities to be issued upon exercise of outstanding options, warrants and rights	Weighted Average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuances under equity compensation plans (excluding securities reflected in column a)
Equity Compensation Plans Approved by Secutity Holders	3,438,126	$3.69	1,030,894
Equity Compensation Plans Not Approved by Security Holders (1) . .	103,125	$5.88	—
	3,541,251	$3.75	1,030,894

(1) Includes options outstanding and exercisable by James M. Pusey, MD, former CEO, to purchase 103,125 shares of the Company's common stock at a weighted average exercise price of $5.88 with no additional options available for future issuance.

PROPOSAL 2: RATIFICATION OF INDEPENDENT REGISTERED PUBLIC ACCOUNTANT

On June 14, 2006 the Company dismissed Deloitte & Touche, LLP, ("Deloitte") as its independent registered public accounting firm. The decision to dismiss Deloitte was initiated and approved by the Audit Committee of the Company's Board of Directors. On June 19, 2006, the Audit Committee of the Board of Directors appointed Ernst & Young LLP ("E&Y) as our independent registered public accounting firm.

The Board of Directors is submitting the selection of the independent registered public accountant firm for shareholder ratification at the 2006 Annual Meeting and recommends that stockholders vote FOR ratification of such appointment.

In the event the shareholders fail to ratify the appointment, the Audit Committee will consider it a direction to consider other accounting firms for the subsequent year. E&Y representatives are expected to be present at the Annual Meeting with the opportunity to make a statement if they desire to do so and are expected to be available to respond to appropriate questions.

Deloitte's reports on the Company's financial statements for the fiscal years ended December 31, 2005 and 2004, respectively, did not contain an adverse opinion or a disclaimer of opinion, and were not qualified or modified as to uncertainty, audit scope, or accounting principles. Deloitte's audit reports on the Company's financial statements for the fiscal years ended December 31, 2005 and 2004 did contain an explanatory paragraph regarding the fact that the Company was in the Development Stage. The audit reports of Deloitte on management's assessment of the effectiveness of internal control over financial reporting and the effectiveness of internal control over financial reporting as of December 31, 2005 and 2004 did not contain an adverse opinion or disclaimer of opinion and were not qualified or modified as to uncertainty, audit scope or accounting principles. In connection with the audits of the financial statements of the Company for the years ended December 31, 2005 and 2004 and through the interim period of January 1, 2006 through June 14, 2006, there were no disagreements between us and Deloitte on any

matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure, which disagreements, if not resolved to Deloitte's satisfaction, would have caused Deloitte to make a reference to the subject matter of the disagreements in connection with its reports. During the years ended December 31, 2005 and 2004, and during the subsequent interim period of January 1, 2006 through June 14, 2006, there were no reportable events, as defined in Item 304(a)(1)(v) of Regulation S-K. During the Company's fiscal years ended December 31, 2005 and 2004 and through the interim period of January 1, 2006 through June 14, 2006, we did not consult with E&Y regarding any of the matters or events set forth in Item 304(a)(2)(i) and (ii) of Regulations S-K.

The Company provided Deloitte with a copy of this disclosure and requested that Deloitte furnish it with a letter addressed to the Securities and Exchange Commission stating whether or not Deloitte agrees with the above statements. A copy of such letter dated June 19, 2006 from Deloitte is filed as Exhibit 16.1 to our Form 8-K filed with the Securities and Exchange Commission on June 20, 2006.

THE BOARD OF DIRECTORS RECOMMENDS THAT THE STOCKHOLDERS VOTE FOR RATIFICATION OF THE APPOINTMENT OF ERNST & YOUNG LLP AS THE COMPANY'S INDEPENDENT REGISTERED PUBLIC ACCOUNTANT FOR THE 2007 FISCAL YEAR.

PRINCIPAL ACCOUNTING FIRM FEES

The following table sets forth the aggregate fees billed to the Company for the years ended December 31, 2006 and December 31, 2005 by our principal accounting firms Ernst & Young, LLP and Deloitte & Touche LLP.

	Amount	
Type of Fee	2006	2005
Audit-Fees (1)	$ 332,000	$ 540,000
Audit-Related Fees (2)	59,000	22,000
Total Audit and Audit-Related Fees	391,000	562,000
Tax Fees (3)	28,000	35,000
All Other Fees (4)	—	—
Total Fees	$ 419,000	$ 597,000

(1) Audit fees include fees for services rendered in connection with the audits of the Company's financial statements for the fiscal years ended December 31, 2006 and 2005, audit of management's assessment including Management's Annual Report on Internal Control over Financial Reporting as of December 31, 2006 and 2005, and reviews of the financial statements included in the Company's quarterly reports on Form 10-Q during the applicable fiscal year.

(2) Audit-related fees include fees for services rendered for matters such as the purchase of substantially all of the assets of AzERx, Inc., sales of shares of the Company's common stock to PharmaBio Development, Inc., audits of employee benefit plans and responses to accounting and reporting-related matters.

(3) Tax fees include fees for services rendered for tax compliance, preparation of original and amended tax returns, claims for refunds and other tax services.

(4) Our principal accounting firms did not perform nor bill the Company for any other services during the fiscal years ended December 31, 2006 and 2005 that are appropriately classified as "All Other Fees."

The Audit Committee has concluded that the services provided by the principal accounting firms that were not related to the audit of the Company's financial statements were at all times compatible with maintaining that firm's independence.

Consistent with the rules of the Securities and Exchange Commission regarding auditor independence, the Audit Committee has responsibility for appointing, setting compensation for, and overseeing the work of, the independent auditor. In recognition of this responsibility, the Audit Committee has included in its charter the responsibility to pre-approve "all auditing services and permitted non-auditing services proposed to be performed by the independent auditor, subject to the de minimis exceptions for non-audit services that were not recognized as non-audit services at the time of engagement and which are subsequently approved by the committee prior to completion of the audit." No fees were paid to the independent auditor pursuant to the "de minimis" exception to the foregoing pre-approval policy in 2006.

OTHER MATTERS

The Company knows of no other matters to be submitted at the Annual Meeting. If any other matter properly comes before the Annual Meeting, it is the intention of the persons named in the enclosed proxy card to vote the shares they represent as the Board of Directors may recommend.

STOCKHOLDER PROPOSALS

Proposals of stockholders of the Company which are intended to be presented by such stockholders at the Company's Annual Meeting for the fiscal year ending December 31, 2007 must be received by the Company no later than December 14, 2007 in order that they may be considered for inclusion in the proxy statement and form of proxy relating to that meeting. Additionally, if a stockholder wishes to present to the Company an item for consideration as an agenda item for a meeting without inclusion in the proxy statement, he, she or it must timely give notice to the Secretary and give a brief description of the business desired to be discussed. To be timely for next year's Annual Meeting, our bylaws require that such notice must have been delivered to or mailed to and received by the Company between 60 and 90 days prior to that Annual Meeting. If we do not publicly announce our meeting date or give notice of our meeting date at least 70 days before next year's Annual Meeting, stockholders may submit items for consideration as agenda items until 5:00 pm on the 15th day after the public disclosure or notice.

ANNUAL REPORT

A copy of the Company's 2006 Annual Report to Stockholders is enclosed. The Annual Report to Stockholders is not a part of the proxy soliciting material enclosed herewith. Upon the written request of any stockholder entitled to vote at the Annual Meeting, the Company will furnish, without charge, a copy of the Company's annual report on Form 10-K for the year ended December 31, 2006, as filed with the Securities and Exchange Commission. Copies of exhibits to the annual report on Form 10-K are also available upon specific request and payment of 25 cents per page for reproduction plus $3.00 for postage and handling. All requests should be directed to the Secretary of the Company at 1275 West Washington Street, Tempe, Arizona 85281.

HOUSEHOLDING

We have adopted the "householding" procedure approved by the Securities and Exchange Commission that allows the Company to deliver one proxy statement and annual report to a household of stockholders instead of delivering a set of documents to each stockholder in the household. This procedure is more cost effective because it reduces the number of materials to be printed and mailed. If they have elected, stockholders who share the same last name and address will receive one proxy statement and annual report per address unless the Company receives, or has previously received, contrary instructions. Stockholders will continue to receive separate proxy cards/voting instruction forms to vote their shares.

If you would like to receive a separate copy of the proxy statement and annual report for this year, please write or call the Company at the following address or telephone number: OrthoLogic Corp., Corporate Secretary, 1275 West Washington Street, Tempe, Arizona 85281; (800) 937-5520. Upon receipt of your request, the Company will promptly deliver the requested materials to you.

If you and other OrthoLogic stockholders of record with whom you share and address currently receive multiple sets of the proxy statement and annual report, and you would like to receive only a single copy of each in the future, please contact our distribution agent, ADP, by calling (800) 542-1061. If you hold your shares in street name (that is, through a bank, brokerage account or other record holder), please contact your bank, broker or the other record holder to request information about householding. You may also revoke your consent to householding by contacting ADP, Attention Householding Department, 51 Mercedes Way, Edgewood, NY 11717, telephone (800) 542-1061.

April 13, 2007 THE BOARD OF DIRECTORS

U.S. SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-K

☒ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2006

☐ **TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from _____ to _____

Commission file number: 0-21214

ORTHOLOGIC CORP.

(Exact name of registrant as specified in its charter)

Delaware	**86-0585310**
(State or other jurisdiction of incorporation or organization)	*(IRS Employer Identification No.)*

1275 West Washington Street, Tempe, Arizona 85281
(Address of principal executive offices)

Registrant's telephone number: (602) 286-5520

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	**Name of each exchange on which registered**
Common Stock, par value $.0005 per share	*NASDAQ Global Market*

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☐ No ☒.

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes ☐ No ☒.

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☐

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

Large accelerated filer ☐ Accelerated filer ☒ Non-accelerated filer ☐

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant, based upon the closing sale price of the registrant's common stock as reported on the NASDAQ National Market on June 30, 2006 was approximately $65,189,000. Shares of common stock held by each officer and director and by each person who owns 10% or more of the outstanding common stock have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily conclusive.

Documents incorporated by reference: Portions of the registrant's proxy statement related to its 2006 annual meeting of stockholders to be held on May 10, 2007 are incorporated by reference into Part III of this Form 10-K.

The number of outstanding shares of the registrant's common stock on February 28, 2007 was 41,594,491.

ORTHOLOGIC CORP.

FORM 10-K ANNUAL REPORT
YEAR ENDED DECEMBER 31, 2006

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PART I

ITEM 1. BUSINESS

OVERVIEW OF THE BUSINESS IN 2006

Prior to November 26, 2003, we developed, manufactured and marketed proprietary, technologically advanced orthopedic products designed to promote the healing of musculoskeletal bone and tissue, with particular emphasis on fracture healing and spine repair. Our product lines included bone growth stimulation and fracture fixation devices including the OL1000 product line, SpinaLogic® and OrthoFrame/Mayo, which we sometimes refer to as our "Bone Device Business."

On November 26, 2003, we sold our Bone Device Business. Our principal business remains focused on tissue repair, although through biopharmaceutical approaches rather than through the use of medical devices.

On August 5, 2004, we purchased substantially all of the assets and intellectual property of Chrysalis Biotechnology, Inc. ("CBI"), including its exclusive worldwide license for Chrysalin for all medical indications, for $2.5 million in cash and $25.0 million in OrthoLogic common stock plus an additional $7.0 million in OrthoLogic common stock upon the occurrence of certain triggering events. We became a development stage entity commensurate with the acquisition. Subsequently, all of our collective efforts were focused on research and development of our Chrysalin Product Platform, with the goal of commercializing our products.

On February 27, 2006 we purchased certain assets and assumed certain liabilities of AzERx, Inc. Under the terms of the transaction, we acquired an exclusive license for the core intellectual property relating to AZX100, a 24-amino acid synthetic peptide, and will continue to develop the new class of compounds in the field of smooth muscle relaxation called Intracellular Actin Relaxing Molecules, or ICARMs™, based on the unique technology developed by AzERx. The acquisition provides us with a new technology platform that diversifies the portfolio, and may provide more than one potential product. AZX100 is currently being investigated for medically important and commercially significant applications such as the treatment of vasospasm associated with subarachnoid hemorrhage, prevention of keloid scarring, and the treatment of asthma. Preclinical and human in vitro studies have shown that this novel compound has the ability to relax smooth muscle in multiple tissue types.

Chrysalin and OrthoLogic are registered United States domestic trademarks of OrthoLogic Corp.

Description of the Business

OrthoLogic is currently a development stage biotechnology company focused on the development and commercialization of the novel synthetic peptides Chrysalin® (TP508) and AZX100. However, we continue to evaluate other biopharmaceutical compounds that can complement our research activity internally and broaden our potential pipeline for successful products.

CHRYSALIN PRODUCT PLATFORM

Chrysalin, or TP508, is a 23-amino acid synthetic peptide representing a receptor-binding domain of the human thrombin molecule, a naturally occurring molecule in the body responsible for both blood clotting and initiating many of the cellular events responsible for tissue repair. Chrysalin mimics specific attributes of the thrombin molecule, stimulating the body's natural healing processes. Drugs based on the Chrysalin peptide can be used to mimic part of the thrombin response without stimulating the events associated with blood clotting and therefore has the potential to accelerate the natural cascade of healing events. The Chrysalin molecule serves as the basis for a group of potential therapeutic products we refer to collectively as the "Chrysalin Product Platform." We have conducted clinical trials for two potential Chrysalin products, acceleration of fracture repair, and diabetic foot ulcer. We previously conducted a pilot study for spine fusion. We have conducted pre-clinical testing for cartilage defect repair, cardiovascular repair, dental bone repair, and tendon repair. We recently commenced pre-clinical testing of the effects of Chrysalin on vascular endothelial dysfunction.

The development of each of our potential product candidates in the Chrysalin Product Platform is based on our collective knowledge and understanding of how the human thrombin molecule contributes to the repair of bone and soft tissue. While there are important differences in each of the product candidates in terms of purpose (fracture

repair, diabetic foot ulcer healing, etc.) each product candidate is focused on accelerating and enhancing tissue repair and is based on the ability of Chrysalin to mimic specific attributes of the human thrombin molecule to stimulate the body's natural healing process.

Through December 31, 2006, we have focused most of our efforts on the development and commercialization of fracture repair and diabetic foot ulcer healing indications.

Acceleration of Fracture Repair

Every broken bone is called a fracture and approximately 30 million fractures are treated every year throughout the developed world, as reported by medical reimbursement records in countries with national healthcare systems. The treatment of a fracture depends on the severity of the break. Simple fractures often heal themselves, with more complex closed fractures potentially amenable to treatment by manipulation (also called "reduction") without requiring surgery. Fractures that break the skin (or "open fractures") or where the fragments cannot be lined up correctly usually require surgery. Sometimes plates, screws or pins are used for mechanical stabilization, occasionally with the use of bone grafts, all of which are invasive, expensive and time consuming procedures.

Chrysalin is a substance that, when injected through the skin into the fracture site at the time of fracture reduction, was shown in a clinical trial to accelerate the healing of the fracture. Chrysalin does this by mimicking certain stimulatory aspects of the thrombin molecule. Fractures that heal faster lead to earlier return of function for the patient and potentially improved clinical outcomes.

In pre-clinical animal studies, a single injection of Chrysalin into the fracture gap accelerated fracture healing by up to 50% as measured by mechanical testing. In late 1999, we initiated a combined Phase 1/2 human clinical trial to evaluate the safety of Chrysalin and its effect on the rate of healing in adult subjects with unstable distal radius fractures (fractures around and in the wrist joint). We presented the results of this Phase 1/2 human clinical trial for fracture repair at the 57th Annual Meeting of the American Society for Surgery of the Hand in October 2002. The data from x-ray evaluations revealed that a single injection of Chrysalin into the fracture gap resulted in a trend toward accelerated fracture healing compared with the saline placebo control. There were no reportable adverse events attributable to Chrysalin in the study. A summary of these results was published November 2006 in *The Journal of Bone and Joint Surgery.*

We completed subject enrollment in our pivotal Phase 3 human clinical trial evaluating the efficacy of Chrysalin in subjects with unstable and/or displaced distal radius (wrist) fractures in May 2005. We enrolled a total of 503 study subjects in 27 health centers throughout the United States. The primary efficacy endpoint in the trial was to measure how quickly wrist fractures in subjects injected with Chrysalin heal, as measured by the removal of immobilization. Accelerated removal of immobilization allows patients to initiate hand therapy and regain full function of their wrists and hands sooner. The clinical trial's secondary efficacy endpoints include radiographic analysis of healing, as well as clinical, functional, and subject outcome parameters. On March 15, 2006, the Company reported results of an analysis of data from its Phase 3 clinical trial of the novel synthetic peptide Chrysalin® (TP508) in unstable, displaced distal radius (wrist) fractures. Treatment with 10μg Chrysalin did not demonstrate a statistically significant benefit compared to placebo in the primary efficacy endpoint of time to removal of immobilization in the overall evaluable subject population. Within the secondary endpoints, radiographic evidence of time to radial cortical bridging, showed a statistically significant benefit for Chrysalin–treated subjects ($p = 0.046$). This benefit mirrored findings from the Phase 1/2 clinical trial that provided part of the foundation for the Phase 3 study. A statistically significant difference between Chrysalin treatment and placebo in the functional secondary endpoints was not observed. From a safety perspective, there were no adverse events related to Chrysalin reported in this Phase 3 trial, nor were there any differences in adverse event rates observed between the Chrysalin and placebo treated subjects.

The Company announced on February 16, 2007 findings of a *post-hoc* subgroup analysis of data from the Phase 3 clinical trial, which were presented at the American Academy of Orthopedic Surgeons Annual Meeting. This subgroup analysis was based on bone mineral density, a pre-specified stratification. Within the subset of female osteopenic subjects, treatment with 10 μg Chrysalin demonstrated a statistically significant benefit compared to placebo in the primary efficacy endpoint of time to removal of immobilization. Secondary endpoints including time to clinical evaluation of healing, time to radial cortical bridging and time to overall radiographic healing also showed a significant effect of Chrysalin treatment.

The Company was assessing Chrysalin in a Phase 2b human clinical trial in distal radius fractures, which was a double-blind, randomized placebo controlled trial that explored a wider dose range of Chrysalin, including 1µg, 3 µg, 10 µg, or 30 µg doses. Our enrollment goal was 500 evaluable subjects in approximately 60 sites. On March 15, 2006, the Company temporarily interrupted enrollment in its Phase 2b fracture repair dosing human clinical trial to perform an interim analysis of the subjects enrolled up to that date.

On August 29, 2006, the Company reported the results of interim analysis of data from our Phase 2b dose ranging clinical trial of the novel synthetic peptide Chrysalin (TP508) in unstable, displaced distal radius (wrist) fractures and termination of the Phase 2b study. In the dataset of 240 subjects as a group that were evaluable in the Phase 2b interim analysis, treatment with Chrysalin did not demonstrate benefit compared to placebo in the primary efficacy endpoint of time to removal of immobilization. Individual findings of efficacy in secondary endpoints, including radiographic healing, were not seen in this interim analysis and no dose response relationship was observed. The Company stated at the time that the trial was not powered at the interim analysis stage to detect statistically significant differences among dose cohorts regarding the efficacy of Chrysalin. The trial met the pre-specified safety endpoint by demonstrating no significant difference in the incidence of adverse events between the Chrysalin and placebo groups.

Dermal Wound Healing

Our dermal wound healing studies are focused on healing diabetic foot ulcers, a common problem for diabetic patients. The World Health Organization (WHO) estimates that at least 171 million people worldwide have diabetes and that number is expected to double by 2030. Diabetic patients suffer from open wound foot ulcers because diabetes related nerve damage causes the patient to lose sensation. Patients thus may not notice an injury to the foot and neglect the injury. This fact and the diminished blood flow to extremities caused by diabetes cause a diabetic patient's wounds to heal more slowly or not at all.

Standard therapy for diabetic foot ulcer wounds includes sharp debridement, infection control, moisture/exudate management and non-use of the foot (off loading) to allow for the body's natural healing processes to occur. These treatments require high patient compliance and effectively heal only approximately 33% of these ulcers. Wounds that do not respond to treatment can sometimes result in amputation of the affected limb.

We believe topical treatment of the wound with Chrysalin will promote new tissue growth necessary for healing of a diabetic foot ulcer. CBI conducted a multicenter Phase 1/2 double blind human trial with 60 subjects, the results of which were presented at the Wound Healing Society in May 2002. We found no drug related adverse events due to Chrysalin in this trial and complete wound closure occurred in 70% of Chrysalin-treated ulcers versus 33% in placebo controls, a statistically significant difference. Results of this trial were published January 2007 in *Wound Repair and Regeneration*.

Vascular Endothelial Dysfunction

Impaired nitric oxide (NO) production reduces the responsiveness of endothelial cells to angiogenic factors and causes loss of endothelial function in ischemic and inflamed blood vessels contributing to a number of chronic diseases. We hypothesize that TP508 may produce angiogenic and other tissue repair effects by activating or upregulating nitric oxide synthetase (NOS) in endothelial cells, and if so, that it may have potential therapeutic value in tissues and diseases exhibiting endothelial dysfunction. In 2007, we plan to continue pre-clinical testing on the effect of TP508 on vascular endothelial dysfunction.

On November 2, 2006, we announced that we have no immediate plans to re-enter clinical trials for Chrysalin-based product candidates and a strategic shift in its development approach to our Chrysalin Product Platform. We currently intend to pursue development partnering or licensing opportunities for our Chrysalin-based product candidates, a change from our previous development history of independently conducting human clinical trials necessary to advance our Chrysalin-based product candidates to market, and to continue to explore the science behind and potential of Chrysalin.

AZX100

On February 27, 2006, we purchased certain assets and assumed certain liabilities of AzERx, Inc. Under the terms of the transaction, we acquired an exclusive license for the core intellectual property relating to AZX100, and will continue to develop the new class of compounds in the field of smooth muscle relaxation called Intracellular Actin Relaxing Molecules, based on the unique technology developed by AzERx. The acquisition provides us with a new technology platform that diversifies the portfolio, and may provide more than one potential product. AzERx's lead compound is AZX100, a 24-amino acid synthetic peptide.

AZX100 relaxes smooth muscle, which modulates blood pressure and the function of blood vessels, airways, sphincters, the gastrointestinal tract and the genitourinary tract. Sustained abnormal contraction of any of these muscles is called spasm. Any disorders known to be associated with excessive constriction or inadequate dilation of smooth muscle represent potential applications for AZX100.

AZX100 may also inhibit the fibrotic phenotype of fibroblasts and smooth muscle cells in a mechanism similar to that which causes vasorelaxation. Through phenotypic modulation of fibroblasts and smooth muscle cells, AZX100 may inhibit the scarring that results from wound healing and disease states in the dermis, blood vessels, lungs, liver and other organs.

We are currently evaluating AZX100 for applications such as the treatment of vasospasm associated with subarachnoid hemorrhage, prevention of keloid scarring, pulmonary fibrosis, the treatment of asthma and intimal hyperplasia. Preclinical and human *in vitro* studies have shown that this novel compound has the ability to relax smooth muscle in multiple tissue types and prevent dermal scarring. We will continue pre-clinical development activities on AZX100 in 2007, and intend to also explore development partnering or licensing opportunities for certain AZX100 potential applications.

Our development activities for the Chrysalin Product Platform and AZX100 represent a single operating segment as they share the same product development path and utilize the same Company resources. As a result, we have determined that it is appropriate to reflect our operations as one reportable segment. Through December 31, 2006, we have incurred $91 million in net losses as a development stage company.

ADDITIONAL INFORMATION ABOUT ORTHOLOGIC

OrthoLogic Corp. was incorporated as a Delaware corporation in July 1987 as IatroMed, Inc. We changed our name to OrthoLogic Corp. in July 1991. Our executive offices are located at 1275 West Washington Street, Tempe, Arizona 85281, and our telephone number is (602) 286-5520.

Our website address is *www.orthologic.com*. Our annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K, as well as any amendments to those reports, are available free of charge through our website as soon as reasonably practical after we file or furnish them to the U.S. Securities and Exchange Commission. Once at our website, go to the "Investors" section to locate these filings.

In March 2004, we adopted a code of conduct that applies to all of our employees and has particular sections that apply only to our principal executive officer and senior financial officers. We posted the text of our code of conduct on our website in the "Investors" section of our website under "Code of Conduct." In addition, we will promptly disclose on our website (1) the nature of any amendment to our code of conduct that applies to our principal executive officer and senior financial officers, and (2) the nature of any waiver, including an implicit waiver, from a provision of our code of ethics that is granted to one of these specified officers, the name of such officer who is granted the waiver and the date of the waiver.

In this document references to "we", "our" and the "Company" refer to OrthoLogic Corp. References to our "Bone Device Business" refer to our former business line of bone growth stimulation and fracture fixation devices, including the OL1000 product line, SpinaLogic®, OrthoFrame® and OrthoFrame/Mayo.

COMPETITION

The biopharmaceutical industry is characterized by intense competition and confidentiality. We may not be aware of the other biotechnology, pharmaceutical companies or public institutions that are developing pharmaceuticals that compete with our potential products. We also may not be aware of all the other competing products our known competitors are pursuing. In addition, these biotechnology companies and public institutions compete with us in recruiting for research personnel and subjects, which may affect our ability to complete our research studies.

Chrysalin Product Platform

We believe that current competing technologies in tissue regeneration have focused on three primary areas:

- Single recombinant growth factor proteins. These proteins are naturally produced by the body to repair and regenerate injured or damaged tissue. The proteins are grown in laboratories and then extracted from host cells and processed for distribution to the patient. Examples of these include platelet derived growth factor and bone morphogenetic growth factor proteins. Bone morphogenetic proteins induce bone formation.
- Osteoconductive matrices. Osteoconductive matrices are a variety of substances that function as a replacement for the damaged tissue, serving as a scaffold that allows the cells to fill the gaps in the damaged tissue. Because these matrices do not stimulate growth of new tissue, they rely on the body's natural healing process to graft the matrices to the damaged tissue area.
- Cell-based therapeutics. Cell-based therapeutics involves the extraction of cells from a patient, growing the cells in a lab and then reintroducing the resultant cells back into the patient. Research in this area is particularly intensive in the search for universal donor materials, which would eliminate the need to customize the therapy to each patient. Scientists have been exploring stem cells as possible sources of universal donor sources.

We believe that Chrysalin may have a competitive advantage over these therapies in safety and cost. Chrysalin's mode of operation resembles that of growth factors. Instead of impacting a single cell pathway, Chrysalin stimulates a cascade of growth factors to be released by the body in the proper combination, amounts and timing.

Fracture Repair

As the concept of treatment of fracture repair through biotechnology and biopharmaceuticals gains momentum, we anticipate seeing more companies develop new potentially competitive products in all of these areas. For example, Pfizer received IND authorization to begin a Phase 1/2 human clinical trial for a potential product to accelerate fracture healing in 2004. While this potential product is being evaluated in a different fracture site than the distal radius fracture, it has been targeted to try to achieve a similar outcome. However, we are not aware of any other competitor that has a drug candidate and has received authorization in the United States to begin a human clinical trial for this indication.

Dermal Wound Healing

Standard therapy for diabetic foot ulcers includes sharp debridement, infection control, moisture / exudate management, and non-use of the foot. There is only one drug product on the market today for the healing of diabetic ulcers and we believe it is currently a secondary treatment choice. Regranex, marketed by Johnson & Johnson, is a gel containing platelet derived growth factor. Unlike Regranex, we believe Chrysalin may not require daily rinsing by the patient to remove residual gel. This may ease patient use of the product. In addition, CBI's proof of concept Phase 1/2 clinical trial showed equivalent or better wound healing rates than Regranex. Currently, several other companies are conducting human clinical trials for this indication.

Vascular Endothelial Dysfunction (VED)

Impaired nitric oxide (NO) production reduces the responsiveness of endothelial cells to angiogenic factors and causes loss of endothelial function in ischemic and inflamed blood vessels contributing to a number of chronic diseases. We hypothesize that TP508 may produce angiogenic and other tissue repair effects by activating or

upregulating nitric oxide synthetase (NOS) in endothelial cells, and if so, that it may have potential therapeutic value in tissues and diseases exhibiting endothelial dysfunction. Currently, we have not identified specific VED indications to pursue. While the potential product markets are significant in size, the markets are characterized by intense competition by both large and small companies with a variety of competing technologies.

AZX100

Subarachnoid Hemorrhage (SAH)

Approved

The only current pharmacological treatment for SAH is the calcium channel antagonist Nimotop (nimodipine). Although Nimotop significantly improves the outcome of surviving patients through a neuroprotective effect, it has not been shown to alter the incidence or magnitude of vasospasm or to decrease mortality. Nimotop carries in the label a "black box" warning regarding i.v. or other parenteral administration.

In Development

The other potential competing products currently under development for SAH are endothelin antagonists (endothelin has been implicated in SAH-induced vasospasm). Elevated plasma levels of endothelin-1 (ET-1) have been shown to occur in patients with SAH-induced vasospasm, although the timing of endothelin elevation has varied from as early as three days after SAH to 8 – 14 days after SAH. Such differences indicate endothelin may not induce vasospasm, but rather may play a role in vasospasm progression. Conflicting results have also been reported regarding the cerebrospinal fluid levels of ET-1. Taken together, these studies indicate that endothelin may contribute to SAH-induced vasospasm. Thus, clinical trials have been conducted for Acetelion's endothelial antagonists, clazosentan (specific ETA receptor antagonist) and bosentan (Tracleer®, dual ETA and ETB receptor antagonist). Recently announced results from a Phase 2 clinical trial indicate that although clazosentan reduced vasospasm in SAH patients, there was no impact on clinical outcome and there were significant side effects (hypotension and fluid retention). Although bosentan appears effective for pulmonary arterial hypertension, the trial for SAH was discontinued due to lack of efficacy.

Roche is reportedly developing a follow-up compound from bosentan, Ro 61-1790, to improve water solubility and ETA potency and has demonstrated in vivo efficacy with a canine double hemorrhage model. In the double hemorrhage model two blood clots must be placed to cause vasospasm. While vasospasm can be demonstrated angiographically, it does not typically result in cerebral infarction. Thus, Ro 61-1790 must be tested in humans to determine whether its improvements will increase efficacy.

The primary disadvantage of endothelin antagonists is that they act on a single vasoconstrictor, although additional mediators have been implicated in SAH. Therefore, targeting downstream vasorelaxing pathways with administration of AZX100 may be more effective. In addition, the ET receptor is internalized once it interacts with the ET peptide. Thus, this drug may only be effective as a prevention measure, not treatment.

In addition, the recombinant haemostatic agent NovoSeven (activated factor VIIa) is currently registered for treatment of bleeding of hemophilia patients, but has also been shown to be effective against the intracerebral hemorrhage (ICH) in phase 2b clinical trials. NovoSeven accelerates the coagulation process at the site of ICH limiting hematoma.

Keloid Scarring

Approved

There is no approved pharmacologic treatment for scarless healing. In the setting of keloid formation, the scars are often excised and treated with steroids with variable results.

In Development

Among potential competing products are recombinant transforming growth factor beta 3 (TGF ß3) and antiTGFß1 antibodies. Renovo is conducting Phase 3 clinical trials in Europe and the U.S. with recombinant TGFß3 (Juvista) for various scar prevention indications, including a recently approved IND for keloid revisions. While preliminary efficacy has been shown in healing in healthy individuals, like other therapeutics, TGFß3 addresses upstream signaling and only one fibrotic pathway and may have limited effectiveness in scar inhibition. AZX100 inhibits fibrotic responses induced by multiple mediators, suggesting it may be more effective than TGFß3 at scarless healing. Renovo has also begun clinical trials using a TGFß1 antibody, which, like TGFß3, also blocks part of the signaling cascade resulting in scar formation. AZX100 may be more effective than TGFß1 antibodies through more comprehensive inhibition of multiple scarring cascades.

While many other companies are investigating therapeutics for wound healing we believe that these therapeutics may be synergistic and not competitive with AZX100 as they are targeting more rapid healing and not scar inhibition.

Asthma

Asthma ranks as the third highest reason for preventable hospitalizations in the U.S. with 470,000 hospitalizations and more than 5,000 deaths each year (American Academy of Allergy Asthma and Immunology Report). Acute asthma accounts for an estimated two-million emergency department visits annually. There are many competitors with asthma products approved or in development. AZX100 has been shown to relax ex vivo airway smooth muscle and may be developed for the treatment of asthmatic attacks. Specific markets include severe acute asthma and asthma that is refractory to current therapies. Severe asthma has been defined as asthma that is refractory to current therapeutic approaches in clinical use (anti-inflammatory agents and bronchodilators). The current approach is to use adrenergic agonists, which activate the cAMP/PKA pathway. AZX100 is a mimetic of the molecule downstream of this pathway and hence may be more sensitive and specific for the treatment of severe asthma. In addition, patients with severe asthma present to the emergency room for treatment, hence efficacy can be closely monitored and outcomes will be apparent in a short time frame after treatment. Recent data has demonstrated that one out of every six asthmatics has a mutation in the adrenergic receptor. These patients do not respond to adrenergic agonists and in fact do worse when treated with adrenergic agonists. This patient population would be potentially effectively treated with the AZX100 compound in that it acts downstream of the receptors.

MARKETING AND SALES

Upon the acquisition of CBI in August 2004, we are focused on the research and development of Chrysalin. As previously discussed, on February 27, 2006, we acquired an exclusive license to AZX100 and commenced pre-clinical activities. Neither Chrysalin nor AZX100 are currently available for sale and we do not expect them to be available for sale for some time into the future. Thus, we currently have no marketing or sales staff. External consultants and members of our staff provide some technical marketing support relating to the development of, and market need for, new potential products and additional therapeutic applications of products already under research.

RESEARCH AND DEVELOPMENT

Our Pre-clinical, Clinical, Chemical Materials and Controls, Regulatory and Quality Assurance departments (research and development) consist of approximately 17 employees who are assisted by consultants from the academic and medical practitioner fields. Our employees have extensive experience in the areas of biomaterials, bioengineering, animal modeling, cellular and molecular biology, clinical trial design and data management. Our clinical affairs department designs, initiates investigative sites for, monitors and manages the data on clinical trials. Currently, our staff is focused on pre-clinical studies to advance AZX100 to IND status and the completion of regulatory requirements for our Phase 2b clinical trial for Chrysalin for fracture repair which we halted enrollment in on March 15, 2006 and subsequently terminated on August 29, 2006. On November 2, 2006, we announced that we have no immediate plans to re-enter clinical trials for Chrysalin-based product candidates and a strategic shift in our development approach to the Chrysalin Product Platform. We currently intend to pursue development partnering or licensing opportunities for our Chrysalin-based product candidates, a change from our previous development history of independently conducting human clinical trials necessary to advance our Chrysalin-based product candidates to

market, and to continue to explore the science behind and potential of Chrysalin. In 2006 we incurred $19.7 million on research efforts on Chrysalin and AZX100. Given the overlapping nature of our research efforts it is not possible to clearly separate research expenditures between Chrysalin and AZX100; however, in 2006 the substantial majority of expenditures were Chrysalin-related. We incurred $25.4 million and $17.1 million on Chrysalin research efforts during fiscal years 2005 and 2004, respectively.

MANUFACTURING

Currently third parties certified under Good Manufacturing Practices manufacture Chrysalin and AZX100 for us in limited amounts for our clinical and pre-clinical studies. We use a primary manufacturer for the Chrysalin peptide used in our human clinical trials, but have secondary manufacturers available as needed. Our current Chrysalin formulation and manufacturing work has been focused on injectable and gel formulations. Our current AZX100 formulation and manufacturing work is focused on an injectable formulation.

PATENTS, LICENSES AND PROPRIETARY RIGHTS

As part of our purchase of CBI on August 5, 2004, the license agreements between CBI and OrthoLogic for the development, use, and marketing of the therapeutic products within the Chrysalin Product Platform were replaced by a direct license agreement between OrthoLogic and the University of Texas. Under this direct license, OrthoLogic expanded its current license for Chrysalin from a license for only orthopedic indications to a license for any and all indications. On July 1, 2005 the Company entered into an agreement whereby the University of Texas assigned to the Company certain patents previously exclusively licensed to the Company, for a $400,000 fee. OrthoLogic must pay the University of Texas continuing royalties, sublicense fees and various other fees in connection with filing and maintaining Chrysalin-related patents. This obligation will expire upon the expiration of the subject patents. Chrysalin has been patented in the United States and in some other countries for a number of methods of use, including cardiovascular and chronic wounds in addition to orthopedic indications. The patents for hard and soft tissue repair expire between 2007 and 2026.

As part of the February 27, 2006 AzERx transaction we acquired a license from AzTE, an affiliate of Arizona State University, for worldwide rights to AZX100 for all indications. Under the license agreement with AzTE, we are required to pay patent filing, maintenance and other related patent fees as well as royalties on future sales of products that contain AZX100. These obligations will end on the expiration of the last patent. The license is supported by patents that expire from 2021 to 2024.

As part of the February 27, 2006 AzERx transaction we also acquired a non-exclusive license from Washington University for a transduction domain carrier patent which forms part of AZX100. Under the license we are required to pay license maintenance payments and royalties on future sales of products that contain the licensed technology. These obligations will end on the expiration of the last patent.

Chrysalin and OrthoLogic are registered United States domestic trademarks of OrthoLogic Corp.

INSURANCE

Our business entails the risk of product liability claims. We maintain a product liability and general liability insurance policy and an umbrella excess liability policy. There can be no assurance that liability claims will not exceed the coverage limit of such policies or that such insurance will continue to be available on commercially reasonable terms or at all. Consequently, product liability claims or claims arising from our clinical trials could have a material adverse effect on our business, financial condition and results of operations. We have not experienced any material liability claims to date resulting from our clinical trials.

EMPLOYEES

As of December 31, 2006, we had thirty employees in our operations, including seventeen employees in research and development, nine in administration and four in facilities and maintenance for our building. As a pure research and development business, we believe that the success of our business will depend, in part, on our ability to identify,

attract and retain qualified research personnel, both as employees and as consultants. We face competition from private companies and public institutions for qualified research personnel. None of our employees are represented by a union and we consider our relationship with our employees to be good.

ITEM 1A RISK FACTORS

RISKS

OrthoLogic may from time to time make written or oral forward-looking statements, including statements contained in our filings with the Securities and Exchange Commission and our reports to stockholders. The safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995 protects companies from liability for their forward looking statements if they comply with the requirements of that Act. This Annual Report on Form 10-K contains forward-looking statements made pursuant to that safe harbor. These forward-looking statements relate to future events or to our future financial performance, and involve known and unknown risks, uncertainties and other factors that may cause our actual results, levels of activity, performance, or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by these forward-looking statements. In some cases, you can identify forward-looking statements by the use of words such as "may," "could," "expect," "intend," "plan," "seek," "anticipate," "believe," "estimate," "predict," "potential," "continue," or the negative of these terms or other comparable terminology. You should not place undue reliance on forward-looking statements since they involve known and unknown risks, uncertainties and other factors which are, in some cases, beyond our control and which could materially affect actual results, levels of activity, performance or achievements. Factors that may cause actual results to differ materially from current expectations, which we describe in more detail in this section titled "Risks," include, but are not limited to:

- unfavorable results of our product candidate development efforts;
- unfavorable results of our pre-clinical or clinical testing;
- delays in obtaining, or failure to obtain FDA approvals;
- increased regulation by the FDA and other agencies;
- the introduction of competitive products;
- impairment of license, patent or other proprietary rights;
- failure to achieve market acceptance of our products;
- the impact of present and future collaborative agreements; and
- failure to successfully implement our drug development strategy.

If one or more of these or other risks or uncertainties materialize, or if our underlying assumptions prove to be incorrect, actual results may vary significantly from what we projected. Any forward-looking statement you read in this Annual Report on Form 10-K reflects our current views with respect to future events and is subject to these and other risks, uncertainties and assumptions relating to our operations, results of operations, business strategy and liquidity. We assume no obligation to publicly update or revise these forward-looking statements for any reason, or to update the reasons actual results could differ materially from those anticipated in these forward-looking statements, even if new information becomes available in the future.

Risks Related to Our Business

We are a biopharmaceutical company with no revenue generating operations and high investment costs.

We expect to incur losses for a number of years as we expand our research and development projects. There is no assurance that our current level of funds will be sufficient to support all research expenses to achieve commercialization of any of our product candidates. On November 26, 2003, we sold all of our revenue generating operations. We are now focused on developing and testing the product candidates in our Chrysalin Product Platform and have allocated most of our resources to bringing these product candidates to the market. However, on February 27, 2006 we acquired the rights to AZX100, and we also intend to continue preclinical activities on AZX100 in

2007. We may invest in other peptide or small molecule-based therapeutics in the future, but there can be no assurance that opportunities of this nature will occur at acceptable terms, conditions or timing. We currently have no pharmaceutical products being sold or ready for sale and do not expect to be able to introduce any pharmaceutical products for at least several years. As a result of our significant research and development, clinical development, regulatory compliance and general and administrative expenses and the lack of any products to generate revenue, we expect to incur losses for at least the next several years and expect that our losses will increase if we expand our research and development activities and incur significant expenses for clinical trials. Our cash reserves are the primary source of our working capital. There can be no assurance that our cash resources will be sufficient to cover our future operating requirements, or should there be a need, other sources of cash will be available, or if available, at acceptable terms.

We may not receive any revenue from our product candidates until we receive regulatory approval and begin commercialization of our product candidates. We cannot predict when that will occur or if it will occur.

We caution that our future cash expenditure levels are difficult to forecast because the forecast is based on assumptions about the number of research projects we pursue, the pace at which we pursue them, the quality of the data collected and the requests of the FDA to expand, narrow or conduct additional clinical trials and analyze data. Changes in any of these assumptions can change significantly our estimated cash expenditure levels.

Our product candidates are in various stages of development and may not be successfully developed or commercialized.

If we fail to commercialize our product candidates, we will not be able to generate revenue. We currently do not sell any products. Our product candidates are at the following stages of development:

- Acceleration of Fracture Repair — Phase 3 / Phase 2b human clinical trials
- Diabetic Foot Ulcer Healing — Phase 1/2 human clinical trials
- Spine Fusion — Phase 1/2 human clinical trials
- Cartilage Defect Repair — Late stage pre-clinical trials
- Tendon Repair — Early stage pre-clinical trials
- Cardiovascular Repair — Pre-clinical trials
- Dental Bone Repair — Pre-clinical trials
- AZX100 — Pre-clinical testing

We are subject to the risk that:

- the FDA finds some or all of our product candidates ineffective or unsafe;
- we do not receive necessary regulatory approvals;
- we are unable to get some or all of our product candidates to market in a timely manner;
- we are not able to produce our product candidates in commercial quantities at reasonable costs;
- our products undergo post-market evaluations resulting in marketing restrictions or withdrawal of our products; or
- the patients, insurance and/or physician community does not accept our products.

In addition, our product development programs may be curtailed, redirected or eliminated at any time for many reasons, including:

- adverse or ambiguous results;
- undesirable side effects which delay or extend the trials;
- inability to locate, recruit, qualify and retain a sufficient number of patients for our trials;

- regulatory delays or other regulatory actions;
- difficulties in obtaining sufficient quantities of the particular product candidate or any other components needed for our pre-clinical testing or clinical trials;
- change in the focus of our development efforts; and
- re-evaluation of our clinical development strategy.

We cannot predict whether we will successfully develop and commercialize any of our product candidates. If we fail to do so, we will not be able to generate revenue.

Certain results from our Phase 3 and Phase 2b clinical trials showed that the differences in the primary endpoint analyses between our lead compound, Chrysalin, and the placebo were not statistically significant, which will make it more difficult to obtain FDA approval and result in a substantial delay in our ability to generate revenue.

On March 15, 2006, we reported results of our Phase 3 fracture repair human clinical trial. For the primary endpoint, time to removal of immobilization, no statistically significant difference was observed between placebo and a single injection of Chrysalin. Consistent with the Phase 1/2 human clinical trial results, a statistically significant difference for a secondary endpoint, radiographic evidence of radial cortical bridging, was achieved. However, no statistically significant difference was noted in the study's other secondary endpoints. On March 15, 2006, we temporarily halted our Phase 2b fracture repair dosing clinical trial to perform an interim analysis of the data of the subjects enrolled to that date.

The Company announced on February 16, 2007 findings of a *post-hoc* subgroup analysis of data from the Phase 3 clinical trial, which were presented at the American Academy of Orthopedic Surgeons Annual Meeting. This subgroup analysis was based on bone mineral density, a pre-specified stratification. Within the subset of female osteopenic subjects, treatment with 10 μg Chrysalin demonstrated a statistically significant benefit compared to placebo in the primary efficacy endpoint of time to removal of immobilization. Secondary endpoints including time to clinical evaluation of healing, time to radial cortical bridging and time to overall radiographic healing also showed a significant effect of Chrysalin treatment.

On August 29, 2006, we reported the results of interim analysis of data from our Phase 2b dose-ranging clinical trial of the novel synthetic peptide Chrysalin® (TP508) in unstable, displaced distal radius (wrist) fractures and termination of the Phase 2b study. In the dataset of 240 subjects as a group that were evaluable in the Phase 2b interim analysis, treatment with Chrysalin did not demonstrate benefit compared to placebo in the primary efficacy endpoint of time to removal of immobilization. Individual findings of efficacy in secondary endpoints, including radiographic healing, were not seen in this interim analysis and no dose response relationship was observed. The trial met the pre-specified safety endpoint by demonstrating no significant difference in the incidence of adverse events between the Chrysalin and placebo groups.

We have implemented a strategic shift in our development approach to our Chrysalin Product Platform. We currently intend to pursue development partnering or licensing opportunities for our Chrysalin-based product candidates, a change from our previous development history of independently conducting human clinical trials necessary to advance our Chrysalin-based product candidates to market.

The results of our Phase 3 and 2b clinical trials increases the risk that we will not be successful and there will be a substantial delay in obtaining FDA approval and may lead to the termination of development efforts for the Chrysalin fracture repair or other Chrysalin-based product candidates, will result in a delay in our ability to generate revenue, will change the amount of revenue we may generate and could have a material adverse effect on our business going forward.

Our late-stage product candidates are all based on the same chemical peptide, Chrysalin. If one of our Chrysalin product candidates reveals safety or fundamental efficacy issues in clinical trials, it could impact the development path for all our other current Chrysalin product candidates.

The development of each of our product candidates in the Chrysalin Product Platform is based on our knowledge and understanding of how the human thrombin molecule contributes to the repair of soft tissue and bone. While there are important differences in each of the product candidates in terms of their purpose (fracture repair, diabetic foot ulcer, etc.), each product candidate is focused on accelerating the repair of soft tissue and bone and is based on the ability of Chrysalin to mimic specific attributes of the human thrombin molecule to stimulate the body's natural healing processes.

Since we are developing the product candidates in the Chrysalin Product Platform in parallel, we expect to learn from the results of each trial and apply some of our findings to the development of the other product candidates in the platform. The fact that the results from the Phase 3 and Phase 2b fracture repair human clinical trials showed no statistical significance between Chrysalin and the placebo for the primary endpoint in the study will likely impact the development path or future development of the other product candidates in the platform. In addition, if we find that one of our biopharmaceutical product candidates is unsafe in the future, it could impact the development of our other product candidates in clinical trials.

If we cannot protect the Chrysalin patents, the AZX100 patents, or our intellectual property generally, our ability to develop and commercialize our products will be severely limited.

Our success will depend in part on our ability to maintain and enforce patent protection for Chrysalin and AZX100 and each product resulting from Chrysalin or AZX100. Without patent protection, other companies could offer substantially identical products for sale without incurring the sizable discovery, development and licensing costs that we have incurred. Our ability to recover these expenditures and realize profits upon the sale of products would then be diminished.

Chrysalin and AZX100 are patented and there have been no successful challenges to the patents. However, if there were to be a challenge to these patents or any of the patents for product candidates, a court may determine that the patents are invalid or unenforceable. Even if the validity or enforceability of a patent is upheld by a court, a court may not prevent alleged infringement on the grounds that such activity is not covered by the patent claims. Any litigation, whether to enforce our rights to use our or our licensors' patents or to defend against allegations that we infringe third party rights, will be costly, time consuming, and may distract management from other important tasks.

As is commonplace in the biotechnology and pharmaceutical industry, we employ individuals who were previously employed at other biotechnology or pharmaceutical companies, including our competitors or potential competitors. To the extent our employees are involved in research areas which are similar to those areas in which they were involved at their former employers, we may be subject to claims that such employees and/or we have inadvertently or otherwise used or disclosed the alleged trade secrets or other proprietary information of the former employers. Litigation may be necessary to defend against such claims, which could result in substantial costs and be a distraction to management and which may have a material adverse effect on us, even if we are successful in defending such claims.

We also rely in our business on trade secrets, know-how and other proprietary information. We seek to protect this information, in part, through the use of confidentiality agreements with employees, consultants, advisors and others. Nonetheless, we cannot assure that those agreements will provide adequate protection for our trade secrets, know-how or other proprietary information and prevent their unauthorized use or disclosure. The risk that other parties may breach confidentiality agreements or that our trade secrets become known or independently discovered by competitors, could adversely affect us by enabling our competitors, who may have greater experience and financial resources, to copy or use our trade secrets and other proprietary information in the advancement of their products, methods or technologies.

Our success also depends on our ability to operate and commercialize products without infringing on the patents or proprietary rights of others.

Third parties may claim that we or our licensors or suppliers are infringing their patents or are misappropriating their proprietary information. In the event of a successful claim against us or our licensors or suppliers for infringement of the patents or proprietary rights of others, we may be required to, among other things:

- pay substantial damages;
- stop using our technologies;
- stop certain research and development efforts;
- develop non-infringing products or methods; and
- obtain one or more licenses from third parties.

A license required under any such patents or proprietary rights may not be available to us, or may not be available on acceptable terms. If we or our licensors or suppliers are sued for infringement, we could encounter substantial delays in, or be prohibited from, developing, manufacturing and commercializing our product candidates.

If we do not successfully develop AZX100 we may not recover the value of our investment.

On February 27, 2006, we purchased certain assets and assumed certain liabilities of AzERx, Inc. for $390,000 in cash and the issuance of 1,355,000 shares of our common stock, with a market value of $7.7 million determined by the closing share price on the date the agreement was entered into. The transaction was completed (closed) on February 27, 2006. Under the terms of the transaction, we acquired an exclusive license for the core intellectual property relating to AZX100, a 24-amino acid synthetic peptide, and will continue to develop the new class of compounds in the field of smooth muscle relaxation called Intracellular Actin Relaxing Molecules, or ICARMs™, based on the unique technology developed by AzERx. The acquisition provides us with a new technology platform that diversifies the portfolio, and may provide more than one potential product. AZX100 is currently being investigated for medically important and commercially significant applications such as the treatment of vasospasm associated with subarachnoid hemorrhage, prevention of keloid scarring, and the treatment of asthma. Preclinical and human *in vitro* studies have shown that this novel compound has the ability to relax smooth muscle in multiple tissue types. While we performed a reasonable level of due diligence on AZX100 and the rights acquired, there can be no assurances that we will recover the costs of our investment from the future development of AZX100 or that commercially significant applications will be developed.

The loss of our key management and scientific personnel may hinder our ability to execute our business plan.

As a small company our success depends on the continuing contributions of our management team and scientific personnel, and maintaining relationships with the network of medical and academic centers in the United States that conduct our clinical trials. The resignation or retirement of members of senior management or scientific personnel could materially adversely affect our business prospects.

Reliance on Outside Suppliers and Consultants

We rely on outside suppliers and consultants for the manufacture of Chrysalin and AZX100 and technical assistance in our research and development efforts. The inability of our suppliers to meet our production quality requirements in a timely manner, or the lack of availability of experienced consultants to assist in our research and development efforts, could have a material effect on our ability to perform research or clinical trials.

We face an inherent risk of liability in the event that the use or misuse of our products results in personal injury or death.

The use of our product candidates in clinical trials may expose us to product liability claims, which could result in financial losses. Our clinical liability insurance coverage may not be sufficient to cover claims that may be made against us. In addition, we may not be able to maintain insurance coverage at a reasonable cost or in sufficient

amounts or scope to protect us against losses. Any claims against us, regardless of their merit, could severely harm our financial condition, strain our management and other resources and adversely impact or eliminate the prospects for commercialization of the product which is the subject of any such claim.

Risks of our Industry

We are in a highly regulated field with high investment costs and high risks.

Our Chrysalin Product Platform is currently in the human testing phase for three potential products and earlier pre-clinical testing phases for two other potential products. AZX100 is currently in pre-clinical testing. The FDA and comparable agencies in many foreign countries impose substantial limitations on the introduction of new pharmaceuticals through costly and time-consuming laboratory and clinical testing and other procedures. The process of obtaining FDA and other required regulatory approvals is lengthy, expensive and uncertain. Chrysalin and AZX100 are new drugs and are subject to the most stringent level of FDA review.

Even after we have invested substantial funds in the development of our Chrysalin products and AZX100 and even if the results of our future clinical trials are favorable, there can be no guarantee that the FDA will grant approval of Chrysalin and/or AZX100 for the indicated uses or that it will do so in a timely manner.

If we successfully bring one or more products to market, there is no assurance that we will be able to successfully manufacture or market the products or that potential customers will buy them if, for example, a competitive product has greater efficacy or is deemed more cost effective. In addition, the market in which we will sell any such products is dominated by a number of large corporations that have vastly greater resources than we have, which may impact our ability to successfully market our products or maintain any technological advantage we might develop. We also would be subject to changes in regulations governing the manufacture and marketing of our products, which could increase our costs, reduce any competitive advantage we may have and/or adversely affect our marketing effectiveness.

The pharmaceutical industry is subject to stringent regulation, and failure to obtain regulatory approval will prevent commercialization of our products.

Our research, development, pre-clinical and clinical trial activities and the manufacture and marketing of any products that we may successfully develop are subject to an extensive regulatory approval process by the FDA and other regulatory agencies in the United States and abroad. The process of obtaining required regulatory approvals for drugs is lengthy, expensive and uncertain, and any such regulatory approvals may entail limitations on the indicated usage of a drug, which may reduce the drug's market potential.

In order to obtain FDA approval to commercialize any product candidate, an NDA must be submitted to the FDA demonstrating, among other things, that the product candidate is safe and effective for use in humans for each target indication. Our regulatory submissions may be delayed, or we may cancel plans to make submissions for product candidates for a number of reasons, including:

- negative or ambiguous pre-clinical or clinical trial results;
- changes in regulations or the adoption of new regulations;
- unexpected technological developments; and
- developments by our competitors that are more effective than our product candidates.

Consequently, we cannot assure that we will make our submissions to the FDA in the timeframe that we have planned, or at all, or that our submissions will be approved by the FDA. Even if regulatory clearance is obtained, post-market evaluation of our products, if required, could result in restrictions on a product's marketing or withdrawal of a product from the market as well as possible civil and criminal sanctions.

Clinical trials are subject to oversight by institutional review boards and the FDA to ensure compliance with the FDA's good clinical practice regulations, as well as other requirements for good clinical practices. We depend, in part, on third-party laboratories and medical institutions to conduct pre-clinical studies and clinical trials for our products and other third-party organizations, usually universities, to perform data collection and analysis, all of

which must maintain both good laboratory and good clinical practices. If any such standards are not complied with in our clinical trials, the FDA may suspend or terminate such trial, which would severely delay our development and possibly end the development of a product candidate.

We also currently and in the future will depend upon third party manufacturers of our products, which are and will be required to comply with the applicable FDA Good Manufacturing Practice regulations. We cannot be certain that our present or future manufacturers and suppliers will comply with these regulations. The failure to comply with these regulations may result in restrictions in the sale of, or withdrawal of the products from the market. Compliance by third parties with these standards and practices are outside of our direct control.

In addition, we are subject to regulation under state and federal laws, including requirements regarding occupational safety, laboratory practices, environmental protection and hazardous substance control, and may be subject to other local, state, federal and foreign regulation. We cannot predict the impact of such regulations on us, although they could impose significant restrictions on our business and require us to incur additional expenses to comply.

If our competitors develop and market products that are more effective than ours, or obtain marketing approval before we do, our commercial opportunities will be reduced or eliminated.

Competition in the pharmaceutical and biotechnology industries is intense and is expected to increase. Several biotechnology and pharmaceutical companies, as well as academic laboratories, universities and other research institutions, are involved in research and/or product development for various treatments for or involving fracture repair and diabetic ulcer healing or smooth muscle relaxation. Many of our competitors have significantly greater research and development capabilities, experience in obtaining regulatory approvals and manufacturing, marketing, financial and managerial resources than we have.

Our competitors may succeed in developing products that are more effective than the ones we have under development or that render our proposed products or technologies noncompetitive or obsolete. In addition, certain of such competitors may achieve product commercialization before we do. If any of our competitors develops a product that is more effective than one we are developing or plan to develop, or is able to obtain FDA approval for commercialization before we do, we may not be able to achieve significant market acceptance for certain products of ours, which would have a material adverse effect on our business.

For a summary of the competitive conditions relating to indications which we are currently considering for Chrysalin and AZX100, see Part I, Item 1 in this Report titled “Competition”.

Our product candidates may not gain market acceptance among physicians, patients and the medical community, including insurance companies and other third party payors. If our product candidates fail to achieve market acceptance, our ability to generate revenue will be limited.

Even if we obtain regulatory approval for our products, market acceptance will depend on our ability to demonstrate to physicians and patients the benefits of our products in terms of safety, efficacy, and convenience, ease of administration and cost effectiveness. In addition, we believe market acceptance depends on the effectiveness of our marketing strategy, the pricing of our products and the reimbursement policies of government and third-party payors. Physicians may not prescribe our products, and patients may determine, for any reason, that our product is not useful to them. Insurance companies and other third party payors may determine not to reimburse for the cost of the therapy. If any of our product candidates fails to achieve market acceptance, our ability to generate revenue will be limited.

Healthcare reform and restrictions on reimbursements may limit our financial returns.

Our ability to successfully commercialize our products may depend in part on the extent to which government health administration authorities, private health insurers and other third party payors will reimburse consumers for the cost of these products. Third party payors are increasingly challenging both the need for, and the price of, novel therapeutic drugs and uncertainty exists as to the reimbursement status of newly approved therapeutics. Adequate

third party reimbursement may not be available for our drug products to enable us to maintain price levels sufficient to realize an appropriate return on our investments in research and product development, which could restrict our ability to commercialize a particular drug candidate.

Risks Related to Our Common Stock and Warrants

Our stock price is volatile and fluctuates due to a variety of factors.

Our stock price has varied significantly in the past (from a high of $8.96 to a low of $1.25 from January 1, 2004 to December 31, 2006) and may vary in the future due to a number of factors, including:

- announcement of the results of, or delays in, preclinical and clinical studies;
- fluctuations in our operating results;
- developments in litigation to which we or a competitor is subject;
- announcements and timing of potential acquisitions, divestitures, capital raising activities and conversions of preferred stock;
- announcements of technological innovations or new products by us or our competitors;
- FDA and other regulatory actions;
- developments with respect to our or our competitors' patents or proprietary rights;
- public concern as to the safety of products developed by us or others; and
- changes in stock market analyst recommendations regarding us, other drug development companies or the pharmaceutical industry generally.

In addition, the stock market has from time to time experienced significant price and volume fluctuations that are unrelated to the operating performance of particular companies. These broad market fluctuations may adversely affect the market price of our stock.

Additional authorized shares of our common stock available for issuance may have dilutive and other material effects on our stockholders.

We are authorized to issue 100,000,000 shares of common stock. As of December 31, 2006, there were 41,564,291 shares of common stock issued and outstanding. However, the total number of shares of our common stock issued and outstanding does not include shares reserved in anticipation of the exercise of options, warrants or additional investment rights. As of December 31, 2006 we had stock options outstanding to purchase approximately 3,438,126 shares of our common stock, the exercise price of which range between $1.70 per share to $8.00 per share, warrants outstanding to purchase 46,706 shares of our common stock with an exercise price of $6.39, warrants outstanding to purchase 357,423 shares of our common stock with an exercise price of $1.91, and we have reserved shares of our common stock for issuance in connection with the potential exercise thereof. Additionally, at our Annual Stockholder Meeting on May 12, 2006, our stockholders approved the OrthoLogic 2005 Equity Incentive Plan, which provides an additional 2,000,000 shares of our common stock for incentive awards. To the extent additional options are granted and exercised or additional stock is issued, the holders of our common stock will experience further dilution. In addition, in the event that any future financing or consideration for a future acquisition should be in the form of, be convertible into or exchangeable for, equity securities, investors will experience additional dilution.

Certain provisions of our amended and restated certificate of incorporation and bylaws will make it difficult for stockholders to change the composition of our board of directors and may discourage takeover attempts that some of our stockholders may consider beneficial.

Certain provisions of our amended and restated certificate of incorporation and bylaws may have the effect of delaying or preventing changes in control if our board of directors determines that such changes in control are not in the best interests of OrthoLogic Corp. and our stockholders. These provisions include, among other things, the following:

- a classified board of directors with three-year staggered terms;
- advance notice procedures for stockholder proposals to be considered at stockholders' meetings;
- the ability of our board of directors to fill vacancies on the board;
- a prohibition against stockholders taking action by written consent; and
- super majority voting requirements for the stockholders to modify or amend our bylaws and specified provisions of our amended and restated certificate of incorporation.

These provisions are not intended to prevent a takeover, but are intended to protect and maximize the value of our stockholders' interests. While these provisions have the effect of encouraging persons seeking to acquire control of our company to negotiate with our board of directors, they could enable our board of directors to prevent a transaction that some, or a majority, of our stockholders might believe to be in their best interests and, in that case, may prevent or discourage attempts to remove and replace incumbent directors. In addition, we are subject to the provisions of Section 203 of the Delaware General Corporation Law, which prohibits business combinations with interested stockholders. Interested stockholders do not include stockholders whose acquisition of our securities is pre-approved by our board of directors under Section 203.

We may issue additional shares of preferred stock that have greater rights than our common stock and also have dilutive and anti-takeover effects.

We are permitted by our amended and restated certificate of incorporation to issue up to 2,000,000 shares of preferred stock. We can issue shares of our preferred stock in one or more series and can set the terms of the preferred stock without seeking any further approval from our common stockholders or other security holders. Any preferred stock that we issue may rank ahead of our common stock in terms of dividend priority or liquidation rights and may have greater voting rights than our common stock.

We have not previously paid dividends on our common stock and we do not anticipate doing so in the foreseeable future.

We have not in the past paid any dividends on our common stock and do not anticipate that we will pay any dividends on our common stock in the foreseeable future. Any future decision to pay a dividend on our common stock and the amount of any dividend paid, if permitted, will be made at the discretion of our board of directors.

Developments in any of these areas, which are more fully described elsewhere in "Item 1 - Business," and "Item 7 - Management's Discussion and Analysis of Financial Condition and Results of Operations" could cause our results to differ materially from results that have been or may be projected by us.

ITEM 1B UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

We lease a facility in Tempe, Arizona, which is an approximately 100,000 square foot facility designed and constructed for industrial purposes and is located in an industrial district. It is the same facility we leased prior to our November 2003 divestiture of our bone growth stimulation device business. Following the divestiture, we occupy approximately 20% of the building capacity. We currently have subleased some portions of the building to other companies. We believe the facility is well-maintained and adequate for use through the end of our lease term. The table below sets forth certain information about our lease of our Tempe facility.

Location	Approx. Square Feet	Lease Expires	Description	Principal Activity
Tempe AZ	100,000 (1)	1/08	2-story, in an industrial park	Administration and lab space

(1) Approximately 45% of the facility is subleased to third parties through 2007.

In March 2007, we entered into an agreement to purchase a 34,440 square foot single story office building in Phoenix, Arizona. The purchase is subject to standard due diligence and closing conditions and the transaction is expected to close in the second quarter of 2007. We currently expect to vacate the Tempe facility in the fourth quarter of 2007 and relocate to this smaller facility, which is in close proximity to the current Tempe facility. We do not expect the relocation to have a significant effect on our operations.

ITEM 3. LEGAL PROCEEDINGS

None.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

PART II

ITEM 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

MARKET INFORMATION

Our common stock commenced trading on the NASDAQ Global Market on January 28, 1993 under the symbol "OLGC." The following table sets forth, for the fiscal periods indicated, the range of high and low sales prices of our common stock.

	2006		2005	
	High	Low	High	Low
First Quarter	$6.20	$2.08	$6.15	$5.00
Second Quarter	$2.18	$1.54	$5.31	$3.75
Third Quarter	$1.80	$1.25	$4.46	$3.83
Fourth Quarter	$1.46	$1.26	$5.00	$3.11

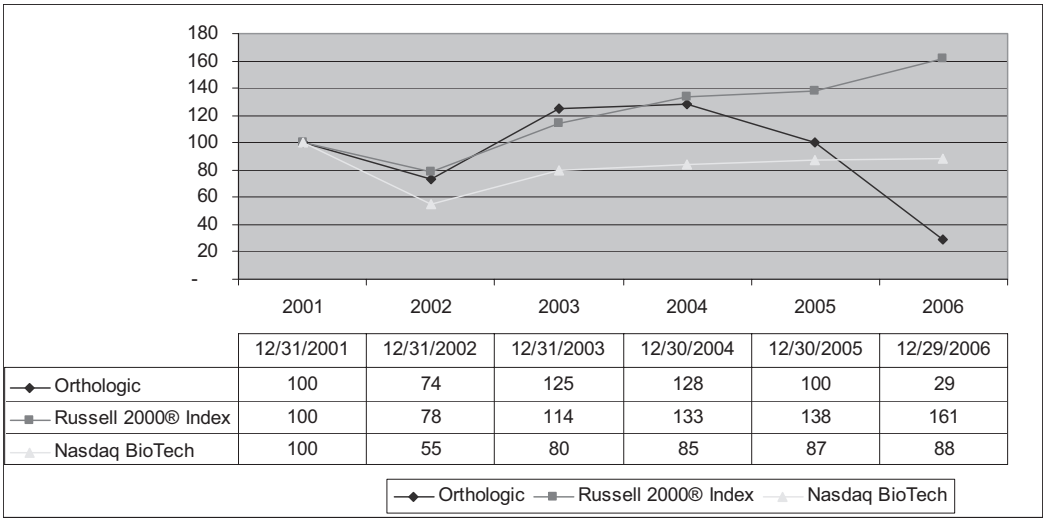
As of February 28, 2007, 41,594,491 shares of our common stock were outstanding and held by approximately 1,032 stockholders of record.

PERFORMANCE GRAPH

STOCK PERFORMANCE GRAPH

This performance graph shall not be deemed "filed" with the SEC or subject to Section 18 of the Exchange Act, nor shall it be deemed incorporated by reference in any of our filings under the Securities Act of 1933, as amended.

Set forth below is a graph comparing the cumulative total shareholder return on the Company's Common Stock to the cumulative total return of (i) the NASDAQ Biotechnology Index, and (ii) the Russell 2000 Index. The Company believes that the NASDAQ Biotechnology Index, which is composed of companies that are classified as either biotechnology or pharmaceutical, is an appropriate index for comparison. While many of the companies listed on that index may be larger in size based on market capitalization, the type of research and development work is comparable to the Company's activities. The graph is generated by assuming that $100 was invested on the last trading day in the fiscal year ended December 31, 2001 in each of the Company's Common Stock, the NASDAQ Biotechnology Index, and the Russell 2000 Index (all assume no dividends).



	12/31/2001	12/31/2002	12/31/2003	12/30/2004	12/30/2005	12/29/2006
Orthologic	100	74	125	128	100	29
Russell 2000® Index	100	78	114	133	138	161
Nasdaq BioTech	100	55	80	85	87	88

DIVIDENDS.

We have never paid a cash dividend on our common stock. Our Board of Directors currently does not intend to pay any cash dividends on our common stock in the foreseeable future.

RECENT SALES OF UNREGISTERED SECURITIES.

None, except for those sales otherwise reported in our Current Reports on Form 8-K and our Quarterly Reports on Form 10-Q.

ISSUER PURCHASES OF EQUITY SECURITIES.

None.

ITEM 6. SELECTED FINANCIAL DATA

SELECTED FINANCIAL DATA

The selected financial data for each of the five years in the period ended December 31, 2006, is derived from our audited financial statements. The selected financial data should be read in conjunction with the financial statements, related notes to the financial statements and other financial information appearing elsewhere in this annual report on Form 10-K and particularly the discussion in "Management's Discussion and Analysis of Financial Condition and Results of Operations." We sold our CPM business unit on July 11, 2001, and our bone growth stimulation device business ("Bone Device Business") on November 26, 2003. On August 5, 2004, we purchased substantially all the assets and the intellectual property of CBI. We became a development stage company commensurate with the CBI acquisition. On February 27, 2006, we purchased certain assets and assumed certain liabilities of AzERx. The financial data as presented below reflects the gain on the sale of the bone growth stimulation device business and its results of operations prior to the sale as discontinued operations.

STATEMENTS OF OPERATIONS DATA
(A Development Stage Company)
(in thousands, except per share amounts)

	Years Ended December 31,				
	2006(1)	2005(2)	2004(3)	2003(4)	2002(5)
Total net revenues	$ —	$ —	$ —	$ —	$ 2,230
Total cost of revenues	—	—	—	—	—
Operating expenses					
Selling, general and administrative	(6,558)	(4,910)	(3,306)	(4,331)	(4,576)
Research and development	(19,661)	(25,444)	(17,116)	(9,008)	(3,488)
Other divestiture and related gains	—	250	347	743	1,047
Purchased in-process research and development	(8,471)	—	(25,840)	—	—
Total operating expenses	(34,690)	(30,104)	(45,915)	(12,596)	(7,017)
Interest and other income, net	3,883	2,640	1,464	568	706
Loss from continuing operations before taxes	(30,807)	(27,464)	(44,451)	(12,028)	(4,081)
Income taxes benefit (expense)	(1,106)	108	642	4,414	1,571
Loss from continuing operations	(31,913)	(27,356)	(43,809)	(7,614)	(2,510)
Discontinued operations					
Net gain on the sale of the bone device business net of taxes $0, $96,($363), $5,205, $0, respectively	—	154	2,048	72,692	—
Income from the operations of the bone device business net of taxes $0, $0, $0, $4,414, $1,577, respectively	—	—	—	7,358	8,119
Net income from discontinued operations	—	154	2,048	80,050	8,119
NET INCOME (LOSS)	$ (31,913)	$(27,202)	$(41,761)	$ 72,436	$ 5,609
Per Share Information:					
Net loss from continuing operations					
Basic	$ (0.78)	$ (0.72)	$ (1.22)	$ (0.23)	$ (0.08)
Diluted	$ (0.78)	$ (0.72)	$ (1.22)	$ (0.23)	$ (0.08)
Net income (loss) from discontinued operations					
Basic	$ —	$ —	$ 0.06	$ 2.43	$ 0.25
Diluted	$ —	$ —	$ 0.06	$ 2.38	$ 0.24
Net income (loss)					
Basic	$ (0.78)	$ (0.72)	$ (1.16)	$ 2.20	$ 0.17
Diluted	$ (0.78)	$ (0.72)	$ (1.16)	$ 2.16	$ 0.17
Basic shares outstanding	40,764	38,032	35,899	32,970	32,642
Equivalent shares	—	—	—	613	731
Diluted shares outstanding	40,764	38,032	35,899	33,583	33,373

1. Research and development expenses in 2006 include recognition of a $2,100,000 patent cost impairment loss. Operating expenses in 2006 included $8,471,000 of purchased in-process research and development costs associated with the AzERx acquisition in February 2006. Income tax expenses in 2006 included the recording of a $1,106,000 valuation allowance for a deferred tax asset related to a Alternative Minimum Tax credit carryover.

2. Total operating expenses in 2005 were reduced by $250,000 as a result of a final settlement payment received from the buyer of the CPM business. A net gain of $154,000 was recognized on the sale of the Bone Device Business (defined below) due to receipt of the entire escrow deposit outstanding.

3. On August 5, 2004, we completed the acquisition of CBI. OrthoLogic expensed in-process research and development and acquisition costs of $25.8 million.

   Total operating expenses in 2004 were reduced by $347,000 as a result of settlement payments received against the contingent payment due from the buyer of the CPM business.

   A net gain of $2,048,000 was recognized on the sale of the Bone Device Business primarily due to a decrease in the risk related to the potential exposure of the representations and warranties provided in the governing asset purchase agreement.

4. On November 26, 2003, we completed the sale of all the assets and related liabilities of our Bone Device Business. The Bone Device Business comprised all our revenue generating operations. Our financial statements for the year ended December 31, 2003 include the results of operations prior to the divestiture and the related gain on the sale as discontinued operations.

   Total operating expenses in 2003 were reduced by $743,000 as a result of settlement payments received against the contingent payment due from the buyer of the CPM business and additional collections of the accounts receivable balances which are fully reserved.

5. Total operating expenses in 2002 were reduced by $1.0 million as a result of better than anticipated collection of CPM accounts receivable than had been originally estimated when the CPM business was sold in July 2001. Also, during 2002, we paid a $500,000 milestone payment to Chrysalis that was recorded as a research and development expense.

Balance Sheet Data
(in thousands)

	December 31,				
	2006	2005	2004	2003	2002
Working capital	$52,533	$78,423	$ 88,955	$112,775	$ 39,585
Total assets	$72,589	$88,343	$115,184	$130,106	$ 53,420
Long term liabilities, less current maturities	$ —	$ 183	$ 137	$ 280	$ 352
Stockholders' equity	$69,148	$84,178	$110,930	$123,975	$ 48,233

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITIONS AND RESULTS OF OPERATIONS

OVERVIEW OF BUSINESS

Description of the business

OrthoLogic is a biotechnology company committed to developing a pipeline of novel peptides and other molecules aimed at helping patients with under-served conditions. We are focused on the development and commercialization of two product platforms: Chrysalin® (TP508) and AZX100.

Chrysalin, the Company's first novel synthetic peptide, is being studied in two lead indications, both of which represent areas of significant unmet medical need – fracture repair and diabetic foot ulcer healing. Based on the Company's pioneering scientific research of the natural healing cascade, OrthoLogic has become a leading company focused on bone and tissue repair. The Company owns exclusive worldwide rights to Chrysalin.

AZX100, the Company's second peptide, is a novel synthetic pre-clinical 24-amino acid peptide, one of a new class of compounds in the field of smooth muscle relaxation called Intracellular Actin Relaxing Molecules, or ICARMs™. AZX100 is currently being evaluated for medically and commercially significant applications, such as the treatment of vasospasm associated with subarachnoid hemorrhage, the prevention of keloid scarring, pulmonary fibrosis, and the treatment of asthma. OrthoLogic has an exclusive worldwide license to AZX100.

We continue to explore other biopharmaceutical compounds that can complement our research activity internally and broaden our potential pipeline for successful products.

Company History

Prior to November 26, 2003, we developed, manufactured and marketed proprietary, technologically advanced orthopedic products designed to promote the healing of musculoskeletal bone and tissue, with particular emphasis on fracture healing and spine repair. Our product lines included bone growth stimulation and fracture fixation devices including the OL1000 product line, SpinaLogic® and OrthoFrame/Mayo, which we sometimes refer to as our "Bone Device Business."

On November 26, 2003, we sold our Bone Device Business. Our principal business remains focused on tissue repair, although through biopharmaceutical approaches rather than through the use of medical devices.

On August 5, 2004, we purchased substantially all of the assets and intellectual property of Chrysalis Biotechnology, Inc. ("CBI"), including its exclusive worldwide license for Chrysalin for all medical indications, for $2.5 million in cash and $25.0 million in OrthoLogic common stock. We issued 3,462,124 shares of OrthoLogic common stock to CBI for this transaction, based on the 10-day average closing price of $7.221. Pursuant to the terms of the definitive agreement, we must issue an additional number of shares of OrthoLogic common stock valued at $7.0 million upon the occurrence of certain trigger events, which include the sale or other transactions that result in a change of control of OrthoLogic or the acceptance by the U.S. Food and Drug Administration of a NDA for a product based on Chrysalin, if either such trigger occurs within five years of the August 2004 closing. The largest portion of the purchase price ($25.8 million) was expensed as In-process Research and Development in 2004. In 2005 we paid an additional $400,000 to the Chrysalin licensor (University of Texas Medical Branch) to transfer ownership of the patents that are the subject of the license to OrthoLogic. Subsequently, all of our collective efforts were focused on research and development of our Chrysalin Product Platform, with the goal of commercializing our products.

On February 27, 2006 the Company purchased certain assets and assumed certain liabilities of AzERx, Inc. Under the terms of the transaction, OrthoLogic acquired an exclusive license for the core intellectual property relating to AZX100, a 24-amino acid synthetic peptide, and will continue to develop the new class of compounds in the field of smooth muscle relaxation called Intracellular Actin Relaxing Molecules, or ICARMs™, based on the unique technology developed by AzERx. The acquisition provides the Company with a new technology platform that diversifies the portfolio, and may provide more than one potential product. AZX100 is currently being evaluated for medically important and commercially significant applications such as the treatment of vasospasm associated with subarachnoid hemorrhage (SAH), prevention of keloid scarring, pulmonary fibrosis and the treatment of asthma. Preclinical and human *in vitro* studies have shown that this novel compound has the ability to relax smooth muscle in multiple tissue types. The Company will continue AZX100 pre-clinical development activities in 2006.

Our development activities for the Chrysalin Product Platform and AZX100 represent a single operating segment as they share the same product development path and utilize the same Company resources. As a result, we have determined that it is appropriate to reflect our operations as one reportable segment. Through December 31, 2006, we have incurred $91 million in net losses as a development stage company.

CHRYSALIN PRODUCT PLATFORM

Chrysalin, or TP508, is a 23-amino acid synthetic peptide representing a receptor-binding domain of the human thrombin molecule, a naturally occurring molecule in the body responsible for both blood clotting and initiating many of the cellular events responsible for tissue repair. Chrysalin mimics specific attributes of the thrombin molecule, stimulating the body's natural healing processes. Drugs based on the Chrysalin peptide can be used to mimic part of the thrombin response without stimulating the events associated with blood clotting and therefore has the potential to accelerate the natural cascade of healing events. The Chrysalin molecule serves as the basis for a group of potential therapeutic products we refer to collectively as the "Chrysalin Product Platform." We have conducted clinical trials for two potential Chrysalin products, acceleration of fracture repair, and diabetic foot ulcer. We previously conducted a pilot study for spine fusion. We have conducted pre-clinical testing for cartilage defect repair, cardiovascular repair, dental bone repair, and tendon repair. We recently commenced pre-clinical testing of the effects of Chrysalin on vascular endothelial dysfunction.

The development of each of our potential product candidates in the Chrysalin Product Platform is based on our collective knowledge and understanding of how the human thrombin molecule contributes to the repair of bone and soft tissue. While there are important differences in each of the product candidates in terms of purpose (fracture repair, diabetic foot ulcer healing, etc.) each product candidate is focused on accelerating and enhancing tissue repair and is based on the ability of Chrysalin to mimic specific attributes of the human thrombin molecule to stimulate the body's natural healing process.

Through December 31, 2006, the Company has focused most of its efforts on the development and commercialization of fracture repair and diabetic foot ulcer healing indications.

Acceleration of Fracture Repair

Every broken bone is called a fracture and approximately 30 million fractures are treated every year throughout the developed world, as reported by medical reimbursement records in countries with national healthcare systems. The treatment of a fracture depends on the severity of the break. Simple fractures often heal themselves, with more complex closed fractures potentially amenable to treatment by manipulation (also called "reduction") without requiring surgery. Fractures that break the skin (or "open fractures") or where the fragments cannot be lined up correctly usually require surgery. Sometimes plates, screws or pins are used for mechanical stabilization, occasionally with the use of bone grafts, all of which are invasive, expensive and time consuming procedures.

Chrysalin is a substance that, when injected through the skin into the fracture site at the time of fracture reduction, was shown in a preliminary clinical trial to accelerate the healing of the fracture. Chrysalin does this by mimicking certain stimulatory aspects of the thrombin molecule. Fractures that heal faster lead to earlier return of function for the patient and potentially improved clinical outcomes.

In pre-clinical animal studies, a single injection of Chrysalin into the fracture gap accelerated fracture healing by up to 50% as measured by mechanical testing. In late 1999, we initiated a combined Phase 1/2 human clinical trial to evaluate the safety of Chrysalin and its effect on the rate of healing in adult subjects with unstable distal radius fractures (fractures around and in the wrist joint). We presented the results of this Phase 1/2 human clinical trial for fracture repair at the 57th Annual Meeting of the American Society for Surgery of the Hand in October 2002. The data from x-ray evaluations revealed that a single injection of Chrysalin into the fracture gap resulted in a trend toward accelerated fracture healing compared with the saline placebo control. There were no reportable adverse events attributable to Chrysalin in the study.

We completed subject enrollment in our pivotal Phase 3 human clinical trial evaluating the efficacy of Chrysalin in subjects with unstable and/or displaced distal radius (wrist) fractures in May 2005. We enrolled a total of 503 study subjects in 27 health centers throughout the United States. The primary efficacy endpoint in the trial was to measure how quickly wrist fractures in subjects injected with Chrysalin heal, as measured by the removal of immobilization. Accelerated removal of immobilization allows patients to initiate hand therapy and regain full function of their wrists and hands sooner. The clinical trial's secondary efficacy endpoints include radiographic analysis of healing, as well as clinical, functional, and subject outcome parameters. On March 15, 2006, the Company reported results of an analysis of data from its Phase 3 clinical trial of the novel synthetic peptide Chrysalin® (TP508) in unstable, displaced distal radius (wrist) fractures. Treatment with 10µg Chrysalin did not demonstrate a statistically significant benefit compared to placebo in the primary efficacy endpoint of time to removal of immobilization. Within the secondary endpoints, radiographic evidence of time to radial cortical bridging, showed a statistically significant benefit for Chrysalin–treated subjects ($p = 0.046$). This benefit mirrored findings from the Phase 1/2 clinical trial that provided part of the foundation for the Phase 3 study. A statistically significant difference between Chrysalin treatment and placebo in the functional secondary endpoints was not observed. From a safety perspective, there were no adverse events related to Chrysalin reported in this Phase 3 trial, nor were there any differences in adverse event rates observed between the Chrysalin and placebo treated subjects.

The Company announced on February 16, 2007 findings of a *post-hoc* subgroup analysis of data from the Phase 3 clinical trial, which were presented at the American Academy of Orthopedic Surgeons Annual Meeting. This subgroup analysis was based on bone mineral density, a pre-specified stratification. Within the subset of female osteopenic subjects, treatment with 10 µg Chrysalin demonstrated a statistically significant benefit compared to

placebo in the primary efficacy endpoint of time to removal of immobilization. Secondary endpoints including time to clinical evaluation of healing, time to radial cortical bridging and time to overall radiographic healing also showed a significant effect of Chrysalin treatment.

The Company was assessing Chrysalin in a Phase 2b human clinical trial in distal radius fractures, which is a double-blind, randomized placebo controlled trial that explored a wider dose range of Chrysalin, including 1µg, 3 µg, 10 µg, or 30 µg doses. Our enrollment goal was 500 evaluable subjects in approximately 60 sites. On March 15, 2006, the Company temporarily interrupted enrollment in its Phase 2b fracture repair dosing human clinical trial to perform an interim analysis of the subjects enrolled up to that date.

On August 29, 2006, the Company reported the results of interim analysis of data from our Phase 2b dose ranging clinical trial of the novel synthetic peptide Chrysalin (TP508) in unstable, displaced distal radius (wrist) fractures and termination of the Phase 2b study. In the dataset of 240 subjects as a group that were evaluable in the Phase 2b interim analysis, treatment with Chrysalin did not demonstrate benefit compared to placebo in the primary efficacy endpoint of time to removal of immobilization. Individual findings of efficacy in secondary endpoints, including radiographic healing, were not seen in this interim analysis and no dose response relationship was observed. The Company stated at the time that the trial was not powered at the interim analysis stage to detect statistically significant differences among dose cohorts regarding the effect of Chrysalin. The Company stated at the time that the trial was not powered at the interim analysis stage to detect statistically significant differences among dose cohorts regarding the efficacy of Chrysalin. The trial met the pre-specified safety endpoint by demonstrating no significant difference in the incidence of adverse events between the Chrysalin and placebo groups.

Dermal Wound Healing

Our dermal wound healing studies are focused on healing diabetic foot ulcers, a common problem for diabetic patients. The World Health Organization (WHO) estimates that at least 171 million people worldwide have diabetes and that number is expected to double by 2030. Diabetic patients suffer from open wound foot ulcers because diabetes related nerve damage causes the patient to lose sensation. Patients thus may not notice an injury to the foot and neglect the injury. This fact and the diminished blood flow to extremities caused by diabetes cause a diabetic patient's wounds to heal more slowly or not at all.

Standard therapy for diabetic foot ulcer wounds includes sharp debridement, infection control, moisture/exudate management, and non-use of the foot (off loading) to allow for the body's natural healing processes to occur. These treatments require high patient compliance and effectively heal only approximately 33% of these ulcers. Wounds that do not respond to treatment can sometimes result in amputation of the affected limb.

We believe topical treatment of the wound with Chrysalin will promote new tissue growth necessary for healing of a diabetic foot ulcer. CBI conducted a multicenter Phase 1/2 double blind human trial with 60 subjects, the results of which were presented at the Wound Healing Society in May 2002. We found no drug related adverse events due to Chrysalin in this trial and complete wound closure occurred in 70% of Chrysalin-treated ulcers versus 33% in placebo controls, a statistically significant difference. Results of this trial were published January 2007 in *Wound Repair and Regeneration*.

Vascular Endothelial Dysfunction

Impaired nitric oxide (NO) production reduces the responsiveness of endothelial cells to angiogenic factors and causes loss of endothelial function in ischemic and inflamed blood vessels contributing to a number of chronic diseases. We hypothesize that TP508 may produce angiogenic and other tissue repair effects by activating or upregulating nitric oxide synthetase (NOS) in endothelial cells, and if so, that it may have potential therapeutic value in tissues and diseases exhibiting endothelial dysfunction. In 2007, we plan to continue pre-clinical testing on the effect of TP508 on vascular endothelial dysfunction.

We announced that we have no immediate plans to re-enter clinical trials for Chrysalin-based product candidates and a strategic shift in our development approach to our Chrysalin Product Platform. We currently intend to pursue development partnering or licensing opportunities for our Chrysalin-based product candidates, a change

from our previous development history of independently conducting human clinical trials necessary to advance our Chrysalin-based product candidates to market, and to continue efforts to explore the science behind and potential of Chrysalin.

AZX100

On February 23, 2006, the Company entered into an agreement to purchase certain assets and assume certain liabilities of AzERx, Inc. The transaction was completed (closed) on February 27, 2006. Under the terms of the transaction, OrthoLogic acquired an exclusive license for the core intellectual property relating to AZX100, and will continue to develop the new class of compounds in the field of smooth muscle relaxation called Intracellular Actin Relaxing Molecules, or ICARMs™, based on the unique technology developed by AzERx. The acquisition provides the Company with a new technology platform that diversifies the portfolio, and may provide more than one potential product. AzERx's lead compound is AZX100, a 24-amino acid synthetic peptide.

AZX100 relaxes smooth muscle, which modulates blood pressure and the function of blood vessels, airways, sphincters, the gastrointestinal tract and the genitourinary tract. Sustained abnormal contraction of any of these muscles is called spasm. Any disorders known to be associated with excessive constriction or inadequate dilation of smooth muscle represent potential applications for AZX100.

AZX100 may also inhibit the fibrotic phenotype of fibroblasts and smooth muscle cells in a mechanism similar to that which causes vasorelaxation. Through phenotypic modulation of fibroblasts and smooth muscle cells, AZX100 may inhibit the scarring that results from wound healing and disease states in the dermis, blood vessels, lungs, liver and other organs.

We are currently evaluating AZX100 for applications such as the treatment of vasospasm associated with subarachnoid hemorrhage, prevention of keloid scarring, pulmonary fibrosis, the treatment of asthma and intimal hyperplasia. Preclinical and human *in vitro* studies have shown that this novel compound has the ability to relax smooth muscle in multiple tissue types and prevent dermal scarring. We will continue pre-clinical development activities on AZX100 in 2007, and intend to also explore development partnering or licensing opportunities for certain AZX100 potential applications.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires that management make a number of assumptions and estimates that affect the reported amounts of assets, liabilities, and expenses in our financial statements and accompanying notes. Management bases its estimates on historical experience and various other assumptions believed to be reasonable. Although these estimates are based on management's best knowledge of current events and actions that may impact the Company in the future, actual results may differ from these estimates and assumptions. Our critical accounting policies are those that affect, or could affect, our financial statements materially and involve a significant level of judgment by management.

Income Taxes:

SFAS No. 109 "Accounting for Income Taxes" requires that a valuation allowance be established when it is more likely than not that all or a portion of a deferred tax asset will not be realized. Changes in valuation allowances from period to period are included in the tax provision in the period of change. In determining whether a valuation allowance is required, we take into account all evidence with regard to the utilization of a deferred tax asset included in past earnings history, expected future earnings, the character and jurisdiction of such earnings, unsettled circumstances that, if unfavorably resolved, would adversely affect utilization of a deferred tax asset, carryback and carryforward periods, and tax strategies that could potentially enhance the likelihood of realization of a deferred asset. We have evaluated the available evidence about future taxable income and other possible sources of realization of deferred tax assets and have established a valuation allowance of approximately $33.2 million at December 31, 2006. The valuation allowance includes approximately $6.1 million for net operating loss carry forwards that relate to stock option compensation expense for income tax reporting purposes. Any utilization of these net operating loss carry forwards would be recorded as an increase to additional paid-in capital. The valuation allowance reduces deferred tax assets to an amount that management believes will more likely than not be realized. The results of

the Company's Phase 3 Chrysalin fracture repair human clinical trial resulted in a change in our planned clinical pathway and timeline for our Chrysalin fracture repair indication. This change, when factored with our current significant net operating loss carryovers and current period net loss, resulted in a revision of our estimate of the need for a valuation allowance for the previously recorded deferred tax asset related to a Alternative Minimum Tax credit carryover. Due to the uncertainty that the deferred tax asset will be realized, we recorded a valuation allowance for the full amount of the deferred tax asset ($1,106,000) in 2006.

We have accumulated approximately $80.2 million in federal and $67.7 million in state net operating loss carryforwards ("NOLs") and approximately $2.4 million of general business and alternative minimum tax credit carryforwards. The federal NOLs expire from 2021 and the state NOL's expire from 2009 and their availability for use to offset future taxable income would be limited should a change in ownership, as defined in Section 382 of the Internal Revenue Code, occur.

Accrued Clinical:

Accrued clinical represents the estimated liability recorded on a per patient basis of the costs incurred for our human clinical trials. Total patient costs are based on the specified clinical trial protocol, recognized over the period of time service is provided to the patient. We have committed to provide funding for patients at various stages in the ongoing clinical trials. We have $133,000 accrued as of December 31, 2006 for the clinical sites' completion of the trials.

Patents:

On November 2, 2006, the Company announced that it has no immediate plans to re-enter clinical trials for Chrysalin-based product candidates and a strategic shift in its development approach to its Chrysalin product platform. The Company currently intends to pursue development partnering or licensing opportunities for its Chrysalin-based product candidates, a change from its previous development history of independently conducting human clinical trials necessary to advance its Chrysalin-based product candidates to market. SFAS No. 142 requires an impairment loss be recognized for an amortizable intangible asset whenever the net cash in-flow to be generated from an asset is less than its carrying cost. Currently, the Company is unable to determine the timing or amount of net cash in-flow to be generated from Chrysalin-based product candidates. Accordingly, due to this uncertainty, the Company recognized an impairment loss for the amount of unamortized Chrysalin product platform patent costs of $2,100,000 in 2006. The impairment loss is included in research and development expenses in the Condensed Statements of Operations in 2006.

Stock based compensation:

Effective January 1, 2006, we adopted SFAS No. 123 (revised 2004), "Share-Based Payment", (SFAS 123(R)). SFAS 123(R) requires all share-based payments, including grants of stock options, restricted stock units and employee stock purchase rights, to be recognized in our financial statements based on their respective grant date fair values. Under this standard, the fair value of each employee stock option and employee stock purchase right is estimated on the date of grant using an option pricing model that meets certain requirements. We currently use the Black-Scholes option pricing model to estimate the fair value of our share-based payments. The determination of the fair value of share-based payment awards utilizing the Black-Scholes model is affected by our stock price and a number of assumptions, including expected volatility, expected life, risk-free interest rate and expected dividends. We use the historical volatility adjusted for future expectations. The expected life of the stock options is based on historical data and future expectations. The risk-free interest rate assumption is based on observed interest rates appropriate for the terms of our stock options and stock purchase rights. The dividend yield assumption is based on our history and expectation of dividend payouts. The fair value of our restricted stock units is based on the fair market value of our common stock on the date of grant. Stock-based compensation expense recognized in our financial statements in 2006 and thereafter is based on awards that are ultimately expected to vest. The amount of stock-based compensation expense in 2006 and thereafter will be reduced for estimated forfeitures. Forfeitures are required to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. We will evaluate the assumptions used to value stock awards on a quarterly basis. If factors change and we employ

different assumptions, stock-based compensation expense may differ significantly from what we have recorded in the past. To the extent that we grant additional equity securities to employees, our stock-based compensation expense will be increased by the additional compensation resulting from those additional grants.

RESULTS OF OPERATIONS COMPARING YEARS ENDED DECEMBER 31, 2006 AND 2005.

General and Administrative ("G&A") Expenses:

G&A expenses related to our ongoing development operations increased by $1,648,000 from $4,910,000 in 2005 to $6,558,000 in 2006. Our administrative expenses during 2006 were higher than 2005, primarily as a result of stock compensation expense of $1,946,000, as disclosed in Note 8 to the financial statements, a reduction in the allocation of general and administrative expenses to research and development due to the decline in clinical activity, partially offset by a general reduction of expenses due to cost containment efforts.

Research and Development Expenses:

Research and development expenses were $19,661,000 in 2006 compared to $25,444,000 in 2005. Our research and development expenses decreased $5,783,000 in 2006 over the same period in 2005 primarily due to the substantial completion of our Phase 3 human clinical trial for fracture repair and the temporary interruption and later termination of our Phase 2b dose-ranging human clinical trial for fracture repair. This decrease in clinical trial costs was partially offset by recognition of a $2,100,000 Chrysalin product platform patent impairment loss and stock compensation expense of $835,000. The primary focus of our research and development work was our Chrysalin-based fracture repair indication. On November 2, 2006, the Company announced that it has no immediate plans to re-enter clinical trials for Chrysalin-based product candidates and a strategic shift in its development approach to its Chrysalin Product Platform. The Company currently intends to pursue development partnering or licensing opportunities for its Chrysalin-based product candidates, a change from its previous development history of independently conducting human clinical trials necessary to advance its Chrysalin-based product candidates to market, and to continue to explore the science behind and potential of Chrysalin. We will also continue expenditures related to ongoing regulatory requirements for the Phase 2b clinical trial for Chrysalin in fracture repair and, as disclosed in Note 14 to the financial statements, the Company acquired and will continue pre-clinical and other development work on AZX100 in 2006.

Interest and Other Income, Net:

Interest and other income, net increased from $2,640,000 in 2005 to $3,883,000 in 2006 due primarily to the increase in interest rates between the two periods.

Net Loss:

We incurred a net loss in 2006 of $31.9 million compared to a net loss of $27.2 million in 2005. The $4.7 million increase in the net loss in 2006 compared to the same period in 2005, results primarily from $2.8 million of stock compensation expense, recognition of a $2.1 million Chrysalin product platform patent impairment loss, $8.4 million of in-process research and development costs related to the acquisition of the AZX100 technology platform and recognition of income tax expense related to the recording of a valuation allowance of $1.1 million for a deferred tax asset related to a Alternative Minimum Tax credit carryover. These items were partially offset by the decrease in fracture repair human clinical trial activity compared to the same period in 2005 and a general reduction of expenses due to cost containment efforts.

RESULTS OF OPERATIONS COMPARING YEAR ENDED DECEMBER 31, 2005 TO 2004

Overview:

The fracture repair product candidate is the most advanced in the development process. In 2005, we completed the enrollment of patients in a Phase 3 human clinical trial for acceleration of fracture repair and began enrolling patients in a Phase 2b dose-ranging human clinical trial for this same indication.

Revenues, Cost of Revenues and Gross profits:

We had no revenues, costs of revenues, cost of goods sold or gross profit for continuing operations in 2005 or 2004. The Bone Device Business revenue is included as discontinued operations.

General and Administrative ("G&A") Expenses:

G&A expenses related to our ongoing development operations increased from $3.3 million in 2004 to $4.9 million in 2005. Our administrative expenses in 2005 were higher as a result of costs related to the closure of our Galveston operations, former CEO severance expenses and providing services to a larger organization for the 12 months in 2005 compared to only 5 months in 2004 due to the acquisition of the operations of CBI on August 5, 2004.

Research and Development Expenses:

Research and development expenses were $25.4 million in 2005 compared to $17.1 million in 2004. Our research and development expenses rose significantly in 2005 resulting primarily from the completion of enrollment in our Phase 3 human clinical trial, commencement of enrollment of our Phase 2b dose-ranging trial for fracture repair and investment in research for the diabetic foot ulcer healing indication. Although we have not historically allocated our research and development expenses by indications and even though we have no data about CBI's historical expense allocations, we believe our fracture repair indication received the largest portion of our research and development funds because of its relative advanced stage in the research process.

Interest Income, Net:

Interest Income, net increased from $1.5 million in 2004 to $2.6 million in 2005, primarily as a result of the increases in investment interest rates from 2004 to 2005.

Net Loss:

We incurred a net loss in 2005 of $27.2 million compared to a net loss of $41.8 million in 2004. The net loss in 2004 included $25.8 million expense for in-process research and development for the acquisition of CBI offset by the gain on the sale of the Bone Device Business of $2.0 million. The increase in net loss in 2005 compared to 2004 (excluding CBI in-process research and development) is due primarily to the increased spending on our research and development programs.

LIQUIDITY AND CAPITAL RESOURCES

We have historically financed our operations through operating cash flows and the public and private sales of equity securities. However, with the sale of our Bone Device Business in November 2003, we sold all of our revenue producing operations. Since that time, we have relied on our cash and investments to finance all our operations, the focus of which was research and development of our Chrysalin Product Platform. We received approximately $93.0 million in cash from the sale of our Bone Device Business. On December 1, 2005, we received the additional $7.2 million, including interest, from the escrow balance related to the sale of the Bone Device Business. On February 27, 2006, the Company entered into an agreement with Quintiles (see Note 15 to the financial statements), which provided an investment by Quintiles in the Company's common stock, of which $2,000,000 was received on February 27, 2006 and $1,500,000 was received on July 3, 2006. The Company also received net proceeds of $2,962,000 from the exercise of stock options during the twelve months ended December 31, 2006. At December 31, 2006, we had cash and cash equivalents of $18.0 million, short-term investments of $36.0 million and long-term investments of $16.2 million.

On November 2, 2006, the Company announced that it has no immediate plans to re-enter clinical trials for Chrysalin-based product candidates and a strategic shift in its development approach to its Chrysalin Product Platform. The Company currently intends to pursue development partnering or licensing opportunities for its Chrysalin-based product candidates, a change from its previous development history of independently conducting human clinical trials necessary to advance its Chrysalin-based product candidates to market. We will continue expenditures related

to ongoing regulatory requirements for the Phase 2b clinical trial for Chrysalin in fracture repair, and expenditures necessary to continue to explore the science behind and potential of Chrysalin. We will also continue research and development expenditures for further pre-clinical studies for AZX100.

Our future research and development expenses may vary significantly from prior periods depending on the Company's decisions on its future Chrysalin and AZX100 development plans.

In March 2007, we entered into an agreement to purchase a 34,440 square foot single story office building in Phoenix, Arizona, for $3,615,000 (see Note 16 to the financial statements). The transaction is subject to standard due diligence and closing conditions and the transaction is expected to close in the second quarter of 2007. We also anticipate spending an additional $400,000 to $800,000 to construct internal improvements to the building.

We anticipate that our cash and short-term investments will be sufficient to meet our presently projected cash and working capital requirements for the next year. However, the timing and amounts of cash used will depend on many factors, including our ability to continue to control our expenditures related to our current research and development programs. If we decide to expand our clinical trials or if we consider other opportunities in the market, our expense levels may change, which could require us to seek other sources of capital. If additional funding is required, we would be required to seek new sources of funds, including raising capital through the sales of securities or licensing agreements. These sources of funds may not be available or could only be available at terms that would have a material adverse impact on our existing stockholders' interests.

The following table sets forth all known commitments as of December 31, 2006 and the year in which these commitments become due or are expected to be settled:

	Payments due by period:			
	Total	Less than 1 year	1 - 3 years	3 to 5 years
Operating lease obligation	$ 1,133,000	$ 1,133,000	$ —	$ —
Research obligation	729,000	729,000	—	
Consulting contracts	334,000	334,000	—	—
Open purchase order for supplies	64,000	64,000		
	$ 2,260,000	$ 2,260,000	$ —	$ —

(1) A lease commitment of $1.1 million refers to our real property lease in Tempe, Arizona. We occupy approximately 20% of the building. Approximately 45% of the Tempe facility is subleased through December 2007.

(2) We anticipate paying all our liabilities with our cash resources.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We had no debt and no derivative instruments at December 31, 2006. Our investment portfolio is used to preserve our capital until it is required to fund our operations. Our investment instruments are classified as held-to-maturity. We do not own derivative financial instruments in our investment portfolio. We maintain a non-trading investment portfolio of investment grade securities that limits the amount of credit exposure of any one issue, issuer or type of instrument. Due to the short duration and conservative nature of these instruments, we do not believe that we have a material exposure to interest rate risk.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Balance sheets, as of December 31, 2006 and 2005, and statements of operations, stockholders' equity and cash flows for each of the three years in the period ended December 31, 2006, and for the statement of operations and cash flow for the period of August 5, 2004 through December 31, 2006, together with the related notes and the reports of Ernst & Young, LLP and Deloitte & Touche LLP, independent registered public accounting firms, are set forth on the "F-1 – F-2" pages of the Form 10-K.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of our disclosure controls and procedures, as such term is defined under Rules 13a-15(e) and 15d – 15(e) promulgated under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Based on this evaluation, our principal executive officer and our principal financial officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this annual report.

Management's Annual Report on Internal Control Over Financial Reporting

The management of OrthoLogic Corp. (a development stage company) is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rule 13a-15(f). Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation under the framework in Internal Control - Integrated Framework, our management concluded that our internal control over financial reporting was effective as of December 31, 2006.

Our management's assessment of the effectiveness of our internal control over financial reporting as of December 31, 2006 has been audited by Ernst & Young, LLP an independent registered public accounting firm, as stated in their attestation report which is included herein.

Management's Annual Report on Changes in Internal Controls

There have not been any changes in our internal controls over financial reporting during the fiscal quarter ended December 31, 2006, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders of OrthoLogic Corp.

We have audited management's assessment, included in the accompanying Management's Annual Report on Internal Control Over Financial Reporting, that OrthoLogic Corp. (a development stage company) maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). OrthoLogic Corp.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the company's internal control over financial reporting based on our audit.

We conducted our audit 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 effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that OrthoLogic Corp. (a development stage company) maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, OrthoLogic Corp. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Balance Sheet of OrthoLogic Corp. (a development stage company) as of December 31, 2006 and the related statements of operations, stockholders' equity and cash flows for the year ended December 31, 2006 and our report dated March 9, 2007 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Phoenix, Arizona
March 9, 2007

ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required herein is incorporated by reference pursuant to General Instruction G(3) of Form 10-K, since the Registrant will file its definitive proxy statement with the Securities and Exchange Commission on for the 2007 Annual Meeting of Stockholders to be held on May 10, 2007, no later than 120 days after the close of its fiscal year ended December 31, 2006.

ITEM 11. EXECUTIVE COMPENSATION

The information required herein is incorporated by reference pursuant to General Instruction G(3) of Form 10-K, since the Registrant will file its definitive proxy statement with the Securities and Exchange Commission for the 2007 Annual Meeting of Stockholders to be held on May 10, 2007, no later than 120 days after the close of its fiscal year ended December 31, 2006.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDERS MATTERS

The information required herein is incorporated by reference pursuant to General Instruction G(3) of Form 10-K, since the Registrant will file its definitive proxy statement with the Securities and Exchange Commission for the 2007 Annual Meeting of Stockholders to be held on May 10, 2007, no later than 120 days after the close of its fiscal year ended December 31, 2006.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required herein is incorporated by reference pursuant to General Instruction G(3) of Form 10-K, since the Registrant will file its definitive proxy statement with the Securities and Exchange Commission for the 2007 Annual Meeting of Stockholders to be held on May 10, 2007, no later than 120 days after the close of its fiscal year ended December 31, 2006.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The information required herein is incorporated by reference pursuant to General Instruction G(3) of Form 10-K, since the Registrant will file its definitive proxy statement with the Securities and Exchange Commission for the 2007 Annual Meeting of Stockholders to be held on May 10, 2007, no later than 120 days after the close of its fiscal year ended December 31, 2006.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) The following documents are filed as part of this report:

1. Financial Statements

   The following financial statements of OrthoLogic Corp. and Reports of Independent Registered Public Accounting Firms are presented in the "F" pages of this report:

   Reports of Independent Registered Public Accounting Firms.

   Balance Sheets - December 31, 2006 and 2005.

   Statements of Operations - Each of the three years in the period ended December 31, 2006 and for the period of August 5, 2004 through December 31, 2006.

   Statements of Stockholders' Equity - Each of the three years in the period ended December 31, 2006.

   Statements of Cash Flows - Each of the three years in the period ended December 31, 2006 and for the period of August 5, 2004 through December 31, 2006.

   Notes to Financial Statements.

2. Financial Statement Schedule II Valuation and Qualifying Accounts for 2004. The information for Schedule II for 2006 and 2005 as well as other Schedules has been omitted since they are not applicable.

3. All management contracts and compensatory plans and arrangements are specifically identified on the attached Exhibit Index.

(b) Exhibits

See the Exhibit Index following the signature page of this report, which Index is incorporated herein by reference.

(c) Financial Statements and Schedule - See Item 15(a)(1) and Item 15(a)(2) above.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

ORTHOLOGIC CORP.

Date: March 14, 2007

By /s/ JOHN M. HOLLIMAN, III
JOHN M. HOLLIMAN, III
Executive Chairman

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature	Title	Date
/s/ JOHN M. HOLLIMAN, III JOHN M. HOLLIMAN, III	*Executive Chairman (Principal Executive Officer) and Director*	March 14, 2007
/s/ MICHAEL D. CASEY MICHAEL D. CASEY	*Director*	March 14, 2007
/s/ FREDRIC J. FELDMAN FREDRIC J. FELDMAN, PH.D.	*Director*	March 14, 2007
/s/ ELWOOD D. HOWSE, JR. ELWOOD D. HOWSE, JR.	*Director*	March 14, 2007
/s/ WILLIAM M. WARDELL WILLIAM M. WARDELL, MD, PH.D.	*Director*	March 14, 2007
/s/ AUGUSTUS A. WHITE, III AUGUSTUS A. WHITE III, MD.	*Director*	March 14, 2007
/s/ RANDOLPH C. STEER RANDOLPH C. STEER, MD, PH.D.	*President*	March 14, 2007
/s/ LES M. TAEGER LES M. TAEGER	*Senior Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)*	March 14, 2007

ORTHOLOGIC CORP.
Exhibit Index to Annual Report on Form 10-K
For the Year Ended December 31, 2006

Exhibit No.	Description	Incorporated by Reference To:	Filed Herewith
2.1	Asset Purchase Agreement and Plan of Reorganization by and between OrthoLogic Corp. and Chrysalis Biotechnology, dated April 28, 2004 (*)	Exhibit 2.1 to the Company's Registration Statement on Form S-4 filed with the SEC on June 3, 2004 ("June 2004 S-4")	
2.2	Amendment No. 1 to Asset Purchase Agreement and Plan of Reorganization by and between OrthoLogic Corp. and Chrysalis Biotechnology, dated June 1, 2004 (*)	Exhibit 2.2 to the Company's June 2004 S-4	
2.3	Amendment No. 2 to Asset Purchase Agreement and Plan of Reorganization between OrthoLogic Corp. and Chrysalis Biotechnology, Inc., dated August 5, 2004 (*)	Exhibit 2.1 to the Company's Current Report on Form 8-K filed on August 6, 2004	
2.4	Asset Purchase Agreement and Plan of Reorganization by and between OrthoLogic Corp. and AzERx, Inc., dated February 23, 2006	Exhibit 10.1 to the Company's Registration Statement on Form S-3 filed with the SEC on April 25, 2006	
3.1	Restated Certificate of Incorporation, executed April 15, 2005	Exhibit 3.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2005, filed with the SEC on May 10, 2005 ("March 2005 10-Q")	
3.2	Amended Certificate of Designation of Series A Preferred Stock, executed April 15, 2005	Exhibit 3.2 to the March 2005 10-Q	
3.3	Bylaws of the Company	Exhibit 3.4 to the Company's Amendment No.2 to Registration Statement on Form S-1 (No. 33-47569) filed with the SEC on January 25, 1993 ("January 1993 S-1")	
4.1	Rights Agreement dated as of March 4, 1997, between the Company and Bank of New York, and Exhibits A, B and C thereto	Exhibit 4.1 to the Company's Registration Statement on Form 8-A filed with the SEC on March 6, 1997	
4.2	First Amendatory Agreement to March 4, 1997 Rights Agreement	Exhibit 10.1 to the Company's Current Report on Form 8-K filed August 24, 1999	
4.3	Amendment No. 2 to March 4, 1997 Rights Agreement	Exhibit 4.1 to the Company's Current Report on Form 8-K filed October 20, 2003	
4.4	Class A Warrant Agreement dated February 24, 2006, between OrthoLogic Corp. and PharmaBio Development Inc.	Exhibit 4.1 to the Company's Current Report on Form 8-K filed with the SEC on March 3, 2006	
4.5	Form of Additional Class A Warrant Agreement related to the Common Stock and Warrant Purchase Agreement by and between OrthoLogic Corp. and PharmaBio Development, Inc.	Exhibit 4.8 to the Company's Registration Statement on Form S-3 filed with the SEC on April 13, 2006 ("April 2006 S-3")	
4.6	Class A Warrant Agreement dated June 30, 2006 by and between OrthoLogic Corp. and PharmaBio Development, Inc (d/b/a NovaQuest)	Exhibit 4.1 to the Company's Current Report on Form 8-K filed with the SEC on July 6, 2006	

4.7	Amended and Restated Class B Warrant Agreement related to the Common Stock and Warrant Purchase Agreement by and between OrthoLogic Corp. and PharmaBio Development, Inc. (2)	Exhibit 4.5 to the Company's Amendment No. 1 to Registration Statement on Form S-3 filed with the SEC on September 22, 2006 ("September 2006 S-3/A")
4.8	Amended and Restated Class C Warrant Agreement related to the Common Stock and Warrant Purchase Agreement by and between OrthoLogic Corp. and PharmaBio Development, Inc. (2)	Exhibit 4.6 to the Company's Amendment No. 1 to Registration Statement on Form S-3 filed with the SEC on September 22, 2006 ("September 2006 S-3/A")
4.9	Amended and Restated Class D Warrant Agreement related to the Common Stock and Warrant Purchase Agreement by and between OrthoLogic Corp. and PharmaBio Development, Inc. (2)	Exhibit 4.7 to the Company's Amendment No. 1 to Registration Statement on Form S-3 filed with the SEC on September 22, 2006 ("September 2006 S-3/A")
10.1	Form of Indemnification Agreement(**)	Exhibit 10.16 to the Company's January 1993 S-1
10.2	1987 Stock Option Plan of the Company, as amended and approved by stockholders (1)	Exhibit 4.4 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1997
10.3	1997 Stock Option Plan of the Company, as amended and approved by the stockholders (1)	Exhibit 4.3 to the Company's Registration Statement on Form S-8, filed with the SEC on March 2, 2005
10.4	Employment Agreement between the Company and Dr. James M. Pusey, dated March 3, 2005 (1)	Exhibit 10.1 to the Company's Current Report on Form 8-K, filed with the SEC on March 4, 2005 (the "March 4th, 2005 8-K")
10.5	Confidential Information and Assignment of Inventions Agreement between the Company and Dr. James M. Pusey, dated March 3, 2005 (1)	Exhibit 10.2 to the March 4th, 2005 8-K
10.6	Single-tenant Lease dated June 12, 1997, by and between the Company and Chamberlain Development, L.L.C.	Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1997
10.7	Employment Agreement effective June 1, 2001 between the Company and James Ryaby (1)	Exhibit 10.21 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2001
10.8	Patent License Agreement between the Board of Regents of The University of Texas System through its component institution The University of Texas Medical Branch at Galveston and Chrysalis Biotechnology, Inc., dated April 27, 2004 and exhibits thereto (2)	Exhibit 10.1 to the Company's Amendment No. 1 to its Registration Statement on Form S-4, filed July 14, 2004
10.9	Third Amended and Restated Employment Agreement effective November 8, 2004, between the Company and Sherry A. Sturman (1)	Exhibit 10.3 to the Company's September 2004 10-Q
10.10	Form of Incentive Stock Option Grant Letter for use in connection with the Company's 1997 Stock Option Plan (***)	Exhibit 10.1 to the Company's Current Report on Form 8-K filed on January 4, 2005
10.11	Form of Non-qualified Stock Option Grant Letter for use in connection with the Company's 1997 Stock Option Plan (***)	Exhibit 10.1 to the Company's Current Report on Form 8-K filed on January 19, 2006

10.12	Patent Assignment Agreement dated June 28, 2005, between the Company and the University of Texas	Exhibit 10.3 to the Company's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2005, filed with the SEC on August 9, 2005 (the "June 2005 10-Q")
10.13	Amendment No. 1 to the Employment Agreement between the Company and Dr. James M. Pusey, dated August 8, 2005 (1)	Exhibit 10.4 to the June 2005 10-Q
10.14	Amendment No. 1 to the Third Amended and Restated Employment Agreement between the Company and Sherry A. Sturman, dated August 7, 2005 (1)	Exhibit 10.5 to the June 2005 10-Q
10.15	Director Compensation Plan, effective June 10, 2005 (1)	Exhibit 10.2 to the June 2005 10-Q
10.16	Letter of Stock Option Grant to Dr. James M. Pusey for 200,000 shares of the Company's common stock, dated March 3, 2005 (1)	Exhibit 10.3 to the March 4th, 2005 8-K
10.17	Letter of Stock Option Grant to Dr. James M. Pusey for 300,000 shares of the Company's common stock, dated March 3, 2005 (1)	Exhibit 10.4 to the March 4th, 2005 8-K
10.18	Letter of Restricted Stock Grant to Dr. James M. Pusey, dated March 3, 2005 (1)	Exhibit 10.5 to the March 4th, 2005 8-K
10.19	Termination and Severance Agreement between the Company and Thomas R. Trotter dated December 27, 2005 (1)	Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the SEC on December 28, 2005
10.20	Employment Agreement between the Company and Dana Shinbaum dated October 17, 2005 (1)	Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the SEC on October 27, 2005
10.21	Employment Agreement dated January 10, 2006 between the Company and Les M. Taeger (1)	Exhibit 10.1 to the Company's Form 8-K filed with the SEC on January 11, 2006 (the "January 11th 8-K")
10.22	Intellectual Property, Confidentiality and Non-Competition Agreement between the Company and Les M. Taeger dated January 10, 2006 (1)	Exhibit 10.2 to the January 11th 8-K
10.23	Separation Agreement and Release dated April 5, 2006 by and between OrthoLogic Corp. and James M. Pusey (1)	Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the SEC on April 11, 2006
10.24	Common Stock and Warrant Purchase Agreement by and between OrthoLogic Corp. and PharmaBio Development, Inc., dated February 24, 2006.	Exhibit 10.1 to the Company's April 2006 S-3
10.25	Registration Rights Agreement by and between OrthoLogic Corp. and PharmaBio Development, Inc., dated February 24, 2006	Exhibit 10.2 to the Company's April 2006 S-3
10.26	Registration Rights Agreement by and between OrthoLogic Corp., AzERx, Inc., and Certain Shareholders, dated February 27, 2006	Exhibit 10.3 to the Company's April 2006 S-3
10.27	Amended and Restated License Agreement dated February 23, 2006 by and between OrthoLogic Corp. and Arizona Science Technology Enterprises, LLC	Exhibit 10.5 to the Company's Registration Statement on Form S-3 filed with the SEC on April 25, 2006

10.28	2005 Equity Incentive Plan (2005 Plan) (1)	Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the SEC on May 18, 2006	
10.29	Form of Incentive Stock Option Grant Letters for Grants under the 2005 Plan (***)	Exhibit 10.1 to the Company's Report on Form 10-Q for the quarterly period ended June 30, 2006, filed on August 8, 2006 ("June 2006 10-Q")	
10.30	Form of Non-Qualified Stock Options Grant Letter for Grants under the 2005 Plan (***)	Exhibit 10.2 to the Company's June 2006 10-Q	
10.31	Form of Restricted Stock Grant Letters for Grants under the 2005 Plan	Exhibit 10.4 to the Company's Current Report on Form 8-K filed with the SEC on May 18, 2006	
10.32	Action by the Board related to the 2006 Salary and 2005 cash bonus of Dr. James M. Pusey and Dr. James T. Ryaby (1)	Report on Form 8-K filed with the SEC on February 16, 2006	
10.33	Amendment to Employment Agreement dated January 10, 2006 between OrthoLogic Corp. and Les Taeger (1)	Exhibit 10.3 to the Company's June 2006 10-Q	
10.34	Amendment to Employment Agreement dated January 1, 2001 between OrthoLogic Corp. and James T. Ryaby, Ph.D. (1)	Exhibit 10.4 to the Company's June 2006 10-Q	
10.35	Employment Agreement between Randolph C. Steer, MD, Ph.D., President, and OrthoLogic Corp., effective May 12, 2006 (1)	Exhibit 10.7 to the Company's June 2006 10-Q	
10.36	Management Service Agreement between Valley Venture III, Management LLC, John M. Holliman, III, Executive Chairman and OrthoLogic Corp., effective May 12, 2006 (1)	Exhibit 10.8 to the Company's June 2006 10-Q	
10.37	Amendment No.1 to Registration Rights Agreement dated June 30, 2006 by and between PharmaBio Development, Inc., and OrthoLogic Corp.	Exhibit 10.4 to the Company's September 2006 S-3/A	
10.38	Separation Agreement and Release dated November 17, 2006 by and between OrthoLogic Corp., and James T. Ryaby, Ph.D. (1)	Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the SEC on November 24, 2006 ("November 24th 8-K")	
10.39	Consulting Agreement dated November 17, 2006 by and between James T. Ryaby, Ph.D., and OrthoLogic Corp. (1)	Exhibit 10.2 to the Company's November 24th 8-K	
16.1	Letter from Deloitte and Touche, LLP, to the SEC dated June 19, 2006	Exhibit 16.1 to the Company's Current Report on Form 8-K filed with the SEC on June 20, 2006	
21.1	List of subsidiaries		
23.1	Consent of independent registered public accounting firm.		X
23.2	Consent of independent registered public accounting firm.		X
31.1	Certification of Principal Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.		X
31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.		X

32.1	Certification of Principal Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. (****)

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(1) Management contract or compensatory plan or arrangement.

(2) Portions of this agreement have been redacted and filed under confidential treatment request with the Securities and Exchange Commission.

* Upon the request of the Securities and Exchange Commission, OrthoLogic Corp. agrees to furnish supplementally a copy of any schedule to the Asset Purchase Agreement and Plan of Reorganization between the Company and Chrysalis Biotechnology, Inc., dated as of April 28, 2004, as amended.

** OrthoLogic has entered into separate indemnification agreements with each of its current directors and executive officers that differ only in party names and dates. Pursuant to the instructions accompanying Item 601 of Regulation S-K, OrthoLogic has filed the form of such indemnification agreement.

*** OrthoLogic from time to time issues stock options to its employees, officers and directors pursuant to its 1997 and 2005 Stock Option Plan, as amended. The incentive stock option grant letters and non-qualified stock option grant letters that evidence these issuances differ only in such terms as the identity of the recipient, the grant date, the number of securities covered by the award, the price(s) at which the recipient may acquire the securities and the vesting schedule. Pursuant to the instructions accompanying Item 601 of Regulation S-K, OrthoLogic has filed the form of such incentive stock option grant letter and non-qualified stock option grant letter.

**** Furnished herewith.

FINANCIAL STATEMENTS

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders of OrthoLogic Corp.

We have audited the accompanying balance sheet of OrthoLogic Corp. (a development stage company) as of December 31, 2006, and the related statements of operations, changes in stockholders' equity, and cash flows for the year then ended, and for the period August 5, 2004 (inception) through December 31, 2006. 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 audit. The financial statements as of December 31, 2005, and for the period August 5, 2004 (inception) through December 31, 2005, were audited by other auditors whose report dated March 9, 2006 expressed an unqualified opinion on those statements. Our opinion on the statement of operations, stockholders' equity and cash flows for the period August 5, 2004 (inception) through December 31, 2006, insofar as it relates to the amounts for prior periods through December 31, 2005, is based solely on the report of other auditors.

We conducted our audit 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 audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of OrthoLogic Corp. (a development stage company) as of December 31, 2006 and the results of their operations and their cash flows for the then year ended and the period from August 5, 2004 (inception) through December 31, 2006, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of OrthoLogic Corp's internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 9, 2007, expressed an unqualified opinion thereon.

As discussed in Note 1 to the consolidated financial statements, effective January 1, 2006, the Company adopted the provisions of Statement of Financial Accounting Standards ("SFAS") No. 123 (revised 2004), *Share-Based Payment*.

/s/ Ernst & Young LLP

Phoenix, Arizona
March 9, 2007

FINANCIAL STATEMENTS

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of OrthoLogic Corp.
Tempe, Arizona

We have audited the accompanying balance sheets of OrthoLogic Corp. (a development stage company) (the "Company") as of December 31, 2005, and the related statements of operations, stockholders' equity, and cash flows for the years ended December 31, 2005 and 2004, and for the period of August 5, 2004 (inception) through December 31, 2005 (the financial statements for the period from August 5, 2004 (inception) to December 31, 2005 are not presented separately herein). Our audits also included the financial statement schedule listed in the Index at Item 15 for the year ended December 31, 2004. These financial statements and the financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and the financial statement schedule 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, such 2005 and 2004 financial statements present fairly, in all material respects, the financial position of OrthoLogic Corp. (a development stage company) as of December 31, 2005, and the results of its operations and its cash flows for the years ended December 31, 2005 and 2004, and for the period of August 5, 2004 (inception) through December 31, 2005, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such 2004 financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

The Company is in the development stage at December 31, 2005. As discussed in Note 1 to the financial statements, the Company has not yet completed product development.

/s/ DELOITTE & TOUCHE LLP

Phoenix, Arizona
March 9, 2007

ORTHOLOGIC CORP
(A Development Stage Company)

Balance Sheets

	December 31, 2006	December 31, 2005
	(in thousands)	
Current assets		
Cash and cash equivalents	$ 18,047	$ 35,111
Short-term investments	35,977	46,437
Prepaids and other current assets	1,950	857
Total current assets	55,974	82,405
Furniture and equipment, net	409	525
Long-term investments	16,206	2,084
Deferred income taxes	—	1,106
Patents, net	—	2,223
Total assets	$ 72,589	$ 88,343
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Accounts payable	$ 1,621	$ 1,036
Accrued compensation	584	711
Accrued clinical	133	544
Accrued severance and other restructuring costs	366	602
Other accrued liabilities	737	1,089
Total current liabilities	3,441	3,982
Deferred rent and other non-current liabilities	—	183
Total liabilities	3,441	4,165
Stockholders' Equity		
Common Stock $.0005 par value; 100,000,000 shares authorized; 41,564,291 and 38,124,742 shares issued and outstanding in 2006 and 2005, respectively	21	19
Additional paid-in capital	188,236	171,355
Accumulated deficit	(119,109)	(87,196)
Total stockholders' equity	69,148	84,178
Total liabilities and stockholders' equity	$ 72,589	$ 88,343

See notes to financial statements

ORTHOLOGIC CORP.
(A Development Stage Company)

Statements of Operations

	Years Ended December 31,			As a Development Stage Company August 5, 2004- December 31,
	2006	2005	2004	2006
OPERATING EXPENSES	(in thousands, except per share data)			
General and administrative	$ 6,558	$ 4,910	$ 3,306	$ 13,346
Research and development	19,661	25,444	17,116	53,185
Other divestiture and related gains	—	(250)	(347)	(375)
Purchased in-process research and development	8,471	—	25,840	34,311
Total operating expenses	34,690	30,104	45,915	100,467
Interest and other income, net	(3,883)	(2,640)	(1,464)	(7,274)
Loss from continuing operations before taxes	30,807	27,464	44,451	93,193
Income tax expense (benefit)	1,106	(108)	(642)	356
Loss from continuing operations	31,913	27,356	43,809	93,549
Discontinued operations - net gain on the sale of the bone device business, net of taxes of $0, $96, ($363), ($267), respectively	—	(154)	(2,048)	(2,202)
NET LOSS	$31,913	$27,202	$41,761	$ 91,347
Net loss per share from continuing operations, basic and diluted	$0.78	$ 0.72	$ 1.22	
Net (gain) per share from discontinued operations, basic and diluted	$ —	$ —	$ (0.06)	
Net loss per share, basic and diluted	$ 0.78	$ 0.72	$ 1.16	
Basic and diluted shares outstanding	40,764	38,032	35,899	

See notes to financial statements

ORTHOLOGIC CORP.
(A Development Stage Company)

Statements of Stockholders' Equity

	Common Stock		Additional Paid in Capital	Accumulated Deficit	Treasury Stock	Total
	Shares	Amount				
			(in thousands)			
Balance December 31, 2003	33,533	$16	$142,329	$ (18,233)	$(137)	$123,975
Exercise of common stock options	1,231	1	5,256	—	—	5,257
Treasury stock at cost	—	—	(137)	—	137	—
Performance based options	—	—	6	—	—	6
Acquisition of CBI	3,248	2	23,451	—	—	23,453
Net loss	—	—	—	(41,761)	—	(41,761)
						—
Balance December 31, 2004	38,012	19	170,905	(59,994)	—	110,930
Exercise of common stock options	113	—	288	—	—	288
Compensation earned on restricted stock	—	—	162	—	—	162
Net loss	—	—	—	(27,202)	—	(27,202)
Balance December 31, 2005	38,125	19	171,355	(87,196)	—	84,178
Exercise of common stock options	670	—	2,962	—	—	2,962
Sales of common stock	1,263	1	3,375	—	—	3,376
Stock option compensation cost	—	—	2,150	—	—	2,150
Compensation earned on restricted stock	151	—	631	—	—	631
Acquisition of AzERx	1,355	1	7,763	—	—	7,764
Net loss	—	—	—	(31,913)	—	(31,913)
Balance December 31, 2006	41,564	$21	$188,236	$(119,109)	$ —	$ 69,148

See notes to financial statements

ORTHOLOGIC CORP.
(A Development Stage Company)

Statements of Cash Flow

	Years Ended December 31,			As a Development Stage Company August 5th 2004- December 31, 2006
	2006	2005	2004	
			(in thousands)	
OPERATING ACTIVITIES				
Net loss	$(31,913)	$(27,202)	$ (41,761)	$ (91,347)
Non-cash items:				
Deferred taxes	1,106	—	(336)	770
Depreciation and amortization	2,833	392	187	3,265
Non-cash stock compensation	2,781	162	6	2,943
Gain on sale of bone stimulator business	—	(250)	(2,048)	(2,298)
Purchased in-process research and development	8,471	—	25,840	34,311
Change in other operating items:				
Prepaids and other current assets	(1,094)	424	827	(241)
Accounts payable	334	203	632	650
Accrued liabilities	(1,422)	(294)	(2,284)	(933)
Cash flows used in operating activities	(18,904)	(26,565)	(18,937)	(52,880)
INVESTING ACTIVITIES				
Expenditures for furniture and equipment, net	(196)	(268)	(86)	(515)
Proceeds from sale of assets	—	7,000	—	7,000
Cash paid for assets of AzERx/CBI	(390)	—	(3,668)	(4,058)
Cash paid for patent assignment rights	(250)	(400)	—	(650)
Purchases of investments	(56,509)	(48,823)	(91,092)	(145,894)
Maturities of investments	52,847	65,502	62,547	151,649
Cash flows provided by (used in) investing activities	(4,498)	23,011	(32,299)	7,532
FINANCING ACTIVITIES				
Net proceeds from stock option exercises	2,962	288	5,256	4,612
Net proceeds from sale of stock	3,376	—	—	3,376
Cash flows provided by financing activities	6,338	288	5,256	7,988
NET DECREASE IN CASH AND CASH EQUIVALENTS	(17,064)	(3,266)	(45,980)	(37,360)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	35,111	38,377	84,357	55,407
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 18,047	$ 35,111	$ 38,377	$ 18,047
Supplemental Disclosure of Non-Cash Investing Activities				
Cash paid during the year for interest	$ —	$ —	$ 4	
Cash paid during the year for income taxes	$ —	$ —	$ 2,679	
AzERx and CBI Acquisition:				
Current assets acquired	$ —	$ —	$ 29	$ 29
Patents acquired	—	—	2,142	2,142
Liabilities acquired and accrued acquisition costs	(317)	—	(140)	(457)
Original investment reversal	—	—	(750)	(750)
In-process research and development acquired	8,471	—	25,840	34,311
Common stock issued for acquisition	(7,764)	—	(23,453)	(31,217)
Cash paid for acquisition	$ 390	$ —	$3,668	$ 4,058

See notes to financial statements

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of the business

OrthoLogic is a biotechnology company committed to developing a pipeline of novel peptides and other molecules aimed at helping patients with under-served conditions. We are focused on the development and commercialization of two product platforms: Chrysalin® (TP508) and AZX100.

Chrysalin, the Company's first novel synthetic peptide, is being studied in two lead indications, both of which represent areas of significant unmet medical need – fracture repair and diabetic foot ulcer healing. Based on the Company's pioneering scientific research of the natural healing cascade, OrthoLogic has become a leading company focused on bone and tissue repair. The Company owns exclusive worldwide rights to Chrysalin.

AZX100, the Company's second peptide, is a novel synthetic pre-clinical 24-amino acid peptide, one of a new class of compounds in the field of smooth muscle relaxation called Intracellular Actin Relaxing Molecules, or ICARMs™. AZX100 is currently being evaluated for medically and commercially significant applications, such as the treatment of vasospasm associated with subarachnoid hemorrhage, the prevention of keloid scarring, pulmonary fibrosis, and the treatment of asthma. OrthoLogic has an exclusive worldwide license to AZX100.

We continue to explore other biopharmaceutical compounds that can complement our research activity internally and broaden our potential pipeline for successful products.

Company History

Prior to November 26, 2003, we developed, manufactured and marketed proprietary, technologically advanced orthopedic products designed to promote the healing of musculoskeletal bone and tissue, with particular emphasis on fracture healing and spine repair. Our product lines included bone growth stimulation and fracture fixation devices including the OL1000 product line, SpinaLogic® and OrthoFrame/Mayo, which we sometimes refer to as our "Bone Device Business."

On November 26, 2003, we sold our Bone Device Business. Our principal business remains focused on tissue repair, although through biopharmaceutical approaches rather than through the use of medical devices.

On August 5, 2004, we purchased substantially all of the assets and intellectual property of Chrysalis Biotechnology, Inc. ("CBI"), including its exclusive worldwide license for Chrysalin for all medical indications, for $2.5 million in cash and $25.0 million in OrthoLogic common stock plus an additional $7.0 million in OrthoLogic common stock upon the occurrence of certain triggering events. We became a development stage entity commensurate with the acquisition. Subsequently, all of our collective efforts were focused on research and development of our Chrysalin Product Platform, with the goal of commercializing our products.

On February 27, 2006 the Company purchased certain assets and assumed certain liabilities of AzERx, Inc. Under the terms of the transaction, OrthoLogic acquired an exclusive license for the core intellectual property relating to AZX100, a 24-amino acid synthetic peptide, and will continue to develop the new class of compounds in the field of smooth muscle relaxation called Intracellular Actin Relaxing Molecules, or ICARMs™, based on the unique technology developed by AzERx. The acquisition provides the Company with a new technology platform that diversifies the portfolio, and may provide more than one potential product. AZX100 is currently being evaluated for medically important and commercially significant applications such as the treatment of vasospasm associated with subarachnoid hemorrhage (SAH), prevention of keloid scarring, pulmonary fibrosis and the treatment of asthma. Preclinical and human *in vitro* studies have shown that this novel compound has the ability to relax smooth muscle in multiple tissue types.

Our development activities for the Chrysalin Product Platform and AZX100 represent a single operating segment as they share the same product development path and utilize the same Company resources. As a result, we have determined that it is appropriate to reflect our operations as one reportable segment. Through December 31, 2006, we have incurred $91 million in net losses as a development stage company.

In these notes, references to "we", "our" and the "Company" refer to OrthoLogic Corp. References to our Bone Device Business refer to our former business line of bone growth stimulation and fracture fixation devices, including the OL1000 product line, SpinaLogic®, OrthoFrame® and OrthoFrame/Mayo.

Use of estimates

The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires that management make a number of assumptions and estimates that affect the reported amounts of assets, liabilities, and expenses in our financial statements and accompanying notes. Management bases its estimates on historical experience and various other assumptions believed to be reasonable. Although these estimates are based on management's assumptions regarding current events and actions that may impact the Company in the future, actual results may differ from these estimates and assumptions. Our critical accounting policies are those that affect, or could affect, our financial statements materially and involve a significant level of judgment by management.

The significant estimates include the Chrysalis Biotechnology, Inc. and AzERx purchase price allocations, valuation of intangibles, income taxes, contingencies, litigation, accrued clinical reserves and accounting for stock-based compensation.

Cash and cash equivalents

Cash and cash equivalents consist of cash on hand and cash deposited with financial institutions, including money market accounts, and investments purchased with a remaining maturity of three months or less when acquired.

Furniture and equipment

Furniture and equipment are stated at cost. Depreciation is calculated on a straight-line basis over the estimated useful lives of the various assets, which range from three to seven years. Leasehold improvements and leased assets under capital leases are amortized over the life of the asset or the period of the respective lease using the straight-line method, whichever is the shortest.

Patents

Patent costs relate to the acquisition of CBI and rights associated with the Chrysalin platform and the costs were being amortized over the estimated life of the patents, 6 – 17 years. On November 2, 2006, the Company announced that it has no immediate plans to re-enter clinical trials for Chrysalin-based product candidates and a strategic shift in its development approach to its Chrysalin product platform. The Company currently intends to pursue development partnering or licensing opportunities for its Chrysalin-based product candidates, a change from its previous development history of independently conducting human clinical trials necessary to advance its Chrysalin-based product candidates to market. SFAS No. 142 requires an impairment loss be recognized for an amortizable intangible asset whenever the net cash in-flow to be generated from an asset is less that it's carrying cost. The Company is unable to determine the timing or amount of net cash in-flow to be generated from Chrysalin-based product candidates. Accordingly, due to this uncertainty, the Company recognized an impairment loss for the amount of unamortized Chrysalin product platform patent costs of $2,100,000 in 2006. The impairment loss is included in research and development expenses in the Condensed Statements of Operations in 2006. Subsequent to the recognition of the impairment loss, the Company incurred and expensed $250,000 in 2006 for payments made under existing agreements for additional patent rights. Patent amortization costs charged to research and development totaled $2,473,000 in 2006.

Income taxes

Under SFAS No. 109, "Accounting for Income Taxes," income taxes are recorded based on current year amounts payable or refundable, as well as the consequences of events that give rise to deferred tax assets and liabilities. We base our estimate of current and deferred taxes on the tax laws and rates that are estimated to be in effect in the periods in which deferred tax liabilities or assets are expected to be settled or realized. Pursuant to SFAS No. 109, we have determined that the deferred tax assets at December 31, 2006 require a valuation allowance.

Research and development

Research and development represents both costs incurred internally for research and development activities, as well as costs incurred to fund the research activities with which we have contracted and certain milestone payments regarding the continued clinical testing of Chrysalin and AZX100. All research and development costs are expensed when incurred.

Accrued Clinical

Accrued clinical represents the liability recorded on a per patient basis of the costs incurred for our human clinical trials. Total patient costs are based on the specified clinical trial protocol, recognized over the period of time service is provided to the patient. We have committed to provide funding for patients at various stages in the ongoing clinical trials. We have $133,000 accrued at December 31, 2006 for amounts due to the clinical sites for the completion of the trials.

Stock-based compensation

At December 31, 2005, we had two stock-based employee compensation plans described more fully in Note 8. Prior to January 1, 2006, we accounted for those plans under the recognition and measurement principles of Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations. Stock-based employee compensation cost was normally not recognized , as all options granted under the 1987 and 1997 plans had an exercise price equal to the market value of the underlying common stock on the date of grant.

Effective January 1, 2006, we adopted SFAS No. 123 (revised 2004), Share-Based Payment, (SFAS 123(R)). SFAS 123(R) requires all share-based payments, including grants of stock options, restricted stock units and employee stock purchase rights, to be recognized in our financial statements based on their respective grant date fair values. Under this standard, the fair value of each employee stock option and employee stock purchase right is estimated on the date of grant using an option pricing model that meets certain requirements. We currently use the Black-Scholes option pricing model to estimate the fair value of our share-based payments. The determination of the fair value of share-based payment awards utilizing the Black-Scholes model is affected by our stock price and a number of assumptions, including expected volatility, expected life, risk-free interest rate and expected dividends. We use the historical volatility adjusted for future expectations. The expected life of the stock options is based on historical data and future expectations. The risk-free interest rate assumption is based on observed interest rates appropriate for the terms of our stock options and stock purchase rights. The dividend yield assumption is based on our history and expectation of dividend payouts. The fair value of our restricted stock units is based on the fair market value of our common stock on the date of grant. Stock-based compensation expense recognized in our financial statements in 2006 and thereafter is based on awards that are ultimately expected to vest. We recognize compensation cost for an award with only service conditions that has a graded vesting schedule on a straight line basis over the requisite service period as if the award was, in-substance, a multiple award. However, the amount of compensation cost recognized at any date must at least equal the portion of grant-date fair value of the award that is vested at that date. The amount of stock-based compensation expense in 2006 and thereafter will be reduced for estimated forfeitures. Forfeitures are required to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. We will evaluate the assumptions used to value stock awards on a quarterly basis. If factors change and we employ different assumptions, stock-based compensation expense may differ significantly from what we have recorded in the past. The Company chose the modified-prospective transition alternatives in adopting SFAS 123(R). Under the modified-prospective transition method, compensation cost is recognized in financial statements issued subsequent to the date of adoption for all stock-based payments granted,

modified or settled after the date of adoption, as well as for any unvested awards that were granted prior to the date of adoption. Because the Company previously adopted only the pro forma disclosure provisions of SFAS 123, we recognize compensation cost relating to the unvested portion of awards granted prior to January 1, 2006, the date of adoption, using the same estimate of the grant-date fair value and the same attribution method used to determine the pro forma disclosure under SFAS 123, except that a forfeiture rate will be estimated for all options, as required by SFAS 123(R).

SFAS 123(R) requires the benefits associated with tax deductions that are realized in excess of recognized compensation cost to be reported as a financing cash flow rather than as an operating cash flow as previously required. In 2006, we did not record any excess tax benefit generated from option exercises, due to our net operating loss carryforwards which cause such excess to be unrealized.

We have provided the required additional disclosures below which illustrates the effect on net loss and loss per share if the Company had applied the fair value recognition provisions of SFAS No. 123(R), to stock-based employee compensation (in thousands, except per share data) prior to January 1, 2006, the date of adoption of SFAS No. 123(R).

	Year Ended December 31,	
	2005	2004
Net loss attributable to common stockholders:		
As reported	$ (27,202)	$ (41,761)
Stock based compensation included in net loss	162	6
Stock based compensation expense, net of tax	(932)	(824)
Pro forma	$ (27,972)	$ (42,579)
Basic and diluted net loss per share:		
As reported	$ (0.72)	$ (1.16)
Pro forma	$ (0.74)	$ (1.18)
Black Scholes model assumptions:		
Risk free interest rate	4.29%	3.30%
Expected volatility	51%	45%
Expected term (from vesting date)	2.6 Years	2.7 Years
Dividend yield	0%	0%
Estimated weighted-average fair value of options granted during the year	$ 3.07	$ 2.45

As disclosed in Note 8 the Company recorded stock option based compensation of $2,149,000. Net loss for the year ended December 31, 2006 increased by $2,149,000 and loss per weighted average basic and diluted shares outstanding increased by $0.05 per share due to the adoption of SFAS 123(R) in 2006.

Loss per common share

Loss per common share is computed on the weighted average number of common or common and equivalent shares outstanding during each year. Basic earnings per share is computed as net loss divided by the weighted average number of common shares outstanding during the period. Diluted earnings per share reflects the potential dilution that could occur from common shares issuable through stock options, warrants, and non-vested restricted stock when the effect would be dilutive. At December 31, 2006 options and warrants to purchase 1,397,000 shares were excluded from the calculations of diluted earnings per share because they were anti-dilutive.

Discontinued operations

Under FASB Statement No. 144, "Accounting for the impairment and Disposal of Long-Lived Assets," discontinued operations are reported if a component of the entity is held for sale or sold during the period. The Bone Device Business qualified as a component of the entity under the standard. Therefore, the gains on the sale of the Bone Device Business have been presented as discontinued operations in the financial statements.

New Accounting Pronouncements

In June 2006, the FASB issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" ("FIN 48"), which clarifies the relevant criteria and approach for the recognition, de-recognition and measurement of uncertain tax positions. FIN 48 will be effective for the Company beginning January 1, 2007. We are currently in the process of assessing the provisions of FIN 48, but do not expect the adoption of FIN 48 to have a material impact on our financial statements.

In September 2006, the FASB issued SFAS 157, Fair Value Measurements, which defines fair value, establishes a framework for measuring fair value and requires enhanced disclosures about fair value measurements. SFAS 157 requires companies to disclose the fair value of its financial instruments according to a fair value hierarchy, as defined and may be required to provide additional disclosures based on that hierarchy. SFAS 157 is effective for financial statements issued for fiscal years beginning November 15, 2007 and interim periods within those fiscal years. We are currently evaluating the impact adoption of SFAS 157 may have on our consolidated financial statements.

2. ASSET ACQUISITION OF CHRYSALIS BIOTECHNOLOGY, INC

In January 1998, we acquired a minority equity investment (less than 10%) in Chrysalis BioTechnology, Inc. ("CBI") for $750,000. As part of the transaction, we were awarded a worldwide exclusive option to license the orthopedic applications of Chrysalin, a patented 23-amino acid synthetic peptide that had shown promise in accelerating the healing process.

On August 5, 2004, we purchased substantially all of the assets and intellectual property of CBI, including its exclusive worldwide license for Chrysalin for all medical indications for $2.5 million in cash, excluding acquisition costs, and $25.0 million in OrthoLogic common stock issued. We issued 3,462,124 shares of OrthoLogic common stock to CBI for this transaction based on the 10-day average closing price of $7.221. Pursuant to the terms of the definitive agreement, we must issue an additional number of shares of OrthoLogic common stock valued at $7.0 million upon the occurrence of certain trigger events, which include the sale or other transactions that result in a change of control of OrthoLogic or the acceptance by the U.S. Food and Drug Administration of a new drug application for a product based on Chrysalin, if either such trigger occurs within five years of closing. The largest portion of the purchase price and acquisition costs was expensed as in-process research and development of $25.8 million. The remainder of the purchase price was allocated to patents totaling $2.1 million, liabilities of $140,000 and other assets of $29,000.

The initial $750,000 investment was recognized as part of the purchase price of the transaction. In return for the initial investment in CBI, we received 214,234 shares of OrthoLogic common stock as the prorated share of the purchase price, in accordance with the liquidation plan adopted by CBI at the time of the asset acquisition. The shares of OrthoLogic common stock, valued at $1.5 million, were accumulated with the other 41,800 shares of treasury stock previously outstanding and reverted back into the authorized but unissued common stock during the third quarter of 2004.

Pursuant to the Asset Purchase Agreement, fifteen percent of the shares of OrthoLogic common stock issued for the acquisition of CBI were placed in escrow for 18 months from the closing date to cover indemnifications for the representations and warranties made by CBI. No indemnification claims were made and in February 2006 the shares were released from escrow. We assumed the CBI lease for the location in Galveston, Texas, with approximately 4,400 sq. ft. of office space and laboratory space. We hired eight of the eleven full time CBI employees, and retained the President and founder of the company through a two-year consulting agreement.

The CBI acquisition has been accounted for using the purchase method of accounting whereby the total purchase price has been allocated to tangible and intangible assets acquired and liabilities assumed based on their estimated fair market values as of the acquisition date.

The purchase price was comprised of the following (in thousands):

Cash paid, including acquisition costs	$ 3,668
Common stock issued (less treasury stock received)	23,453
Original investment in CBI	750
Total purchase price	$27,871
The fair value of CBI net assets acquired:	
Patents	$ 2,142
In-process research and development	25,840
Furniture, equipment and other	29
Liabilities acquired	(140)
Fair value of the assets purchased	$27,871

The following unaudited pro forma condensed statements of operations are based on the historical financial statements of OrthoLogic, adjusted to give effect to the acquisition of substantially all the assets of CBI for the fiscal year ending December 31, 2004 and 2003 as if the transaction had occurred on January 1, 2003.

The pro forma financial information is presented for illustrative purposes only, and is not necessarily indicative of the operating results or financial position that would have occurred if all the events described had occurred on the first day of the respective periods presented, nor is it necessarily indicative of future operating results or financial position.

Selected Pro Forma Historical Financial Data
(unaudited)
(in thousands, except per share data)

	Twelve months ended December 31,	
	2004	2003
Total operating expenses	$ 47,612	$ 13,519
Loss from continuing operations	(45,552)	(8,537)
Gain from discontinued operations	2,048	80,050
Net loss (income)	$(43,504)	$ 71,513
Basic loss per share for continuing operations	$ (1.27)	$ (0.26)
Basic income per share for discontinued operations	$ 0.06	$ 2.43
Basic loss per share	$ (1.21)	$ 2.17

3. ASSET SALE OF THE BONE DEVICE BUSINESS – DISCONTINUED OPERATIONS

On November 26, 2003, we completed the sale of the Bone Device Business assets and related liabilities (including the rights to produce and market the OL1000, OL1000 SC, SpinaLogic and OrthoFrame/Mayo) to dj Orthopedics, LLC. Pursuant to the asset purchase agreement, we sold substantially all of the assets of the Bone Device Business (other than our Medicare accounts receivable, which were $1.2 million in the aggregate), including substantially all of the related machinery, equipment, inventory, work in process, licenses, customer lists, intellectual property, certain agreements and contracts. dj Orthopedics paid $93.0 million in cash at closing and assumed substantially all of the Bone Device Business trade payables and other current liabilities less payables in an amount approximately equal to the amount of retained Medicare receivables. Upon the closing of the sale, we assigned and dj Orthopedics agreed to assume and perform the obligations outstanding on November 26, 2003, related to the operation of the Bone Device Business (including various liabilities related to the Company's employees). The net gain on the sale of the Bone Device Business was $72.7 million, recognized in fiscal year 2003, at the time of the sale.

Of the $93.0 million we received in the sale, $7.5 million was placed in an escrow account. The funds were divided into two accounts: $7.0 million from which dj Orthopedics, LLP was eligible for indemnity and breach of contract claims, if any, and $0.5 million from which a portion of the agreed upon incentive stay bonuses was paid by dj Orthopedics to former OrthoLogic executives on November 26, 2004, the first anniversary of the closing. The funds in the $7.0 million escrow account, in excess of the amount of any pending claims, was to be released to us on the second anniversary of the closing. The amount reserved for the potential liability at closing was $1.9 million related to the fair value of the representation and warranties in the Asset Purchase Agreement. We received updated information during the third quarter of 2004 that eliminated most of the potential exposure of the representations and warranties in the Asset Purchase Agreement, substantiating a decrease in the reserve of approximately $1.7 million, leaving a net reserve of approximately $233,000. This decrease in the reserve resulted in an additional $1.7 million gain, combined with a tax benefit of $363,000 totaling a gain recognized on the sale of the Bone Device Business in discontinued operations during fiscal year 2004 of $2.0 million. The Company received the entire escrow and recognized an additional gain of $154,000, net of tax during fiscal year 2005.

The sale of the Bone Device Business was considered an accelerating event for our stock-based compensation plans. Terminated employees' unvested options vested immediately upon the sale. Our directors and employees who were retained had 75% of their unvested options vest upon the sale, with the remainder vesting over a 12 month period or on their regular vesting period, whichever was earlier.

The sale of the Bone Device Business is accounted for as discontinued operations. The income from the divested business and related tax effects is summarized as discontinued operations in the statement of operations.

4. CPM DIVESTITURE IN 2001 AND RELATED GAINS IN 2005 AND 2004

In 2001, we sold our continuous passive motion ("CPM") business to OrthoRehab, Inc. We received $12.0 million in cash, with OrthoRehab, Inc. assuming approximately $2.0 million in liabilities in connection with the sale of certain CPM related assets that we had recorded in our financial statements at a carrying value of approximately

$20.7 million. We recorded a $6.9 million charge to write down the CPM assets to their fair value less direct costs of selling the assets. Under the CPM Asset Purchase Agreement, we were eligible to receive up to an additional $2.5 million of cash if certain objectives were achieved by OrthoRehab, Inc.

We settled litigation over the $2.5 million payment and other matters in April 2003. OrthoRehab, Inc. agreed to pay $1.2 million to settle the contingent payment due to us, and all outstanding claims between the two companies. All payments due had been received as of December 31, 2005.

The combination of settlement payments and additional collection of the divested receivables is included in the "Other divestiture and related gains" line item in the 2005 Statement of Operations.

5. INVESTMENTS AND FAIR VALUE DISCLOSURES

At December 31, 2006, marketable securities consisted of municipal and corporate bonds and were classified as held-to-maturity securities. Such classification requires these securities to be reported at amortized cost unless they are deemed to be permanently impaired in value.

A summary of the fair market value and unrealized gains and losses on these securities is as follows (in thousands):

Investments with maturities – Short-term	December 31	
	2006	2005
Amortized cost	$35,977	$46,437
Gross unrealized (loss) gain	(29)	(140)
Fair value	$35,948	$46,297

Investments with maturities – Long term	December 31	
	2006	2005
Amortized cost	$16,206	$ 2,084
Gross unrealized (loss) gain	(1)	—
Fair value	$16,205	$ 2,084

For our cash and cash equivalents and short-term investments, the carrying amount is assumed to be the fair market value because of the liquidity of these instruments. The carrying amount is assumed to be the fair value for accounts receivable, accounts payable and other accrued expenses because of their short maturity. Our long-term investments carry a market interest rate and the fair market value of the investments approximated the carrying values (as shown above) at December 31, 2006.

6. FURNITURE AND EQUIPMENT

Furniture and equipment consisted of the following (in thousands):

	December 31,	
	2006	2005
Machinery and equipment	$ 266	$ 110
Computer equipment	1,491	1,460
Furniture and fixtures	140	138
Leasehold improvements	1,411	1,395
	3,308	3,103
Less accumulated depreciation and amortization	(2,899)	(2,578)
Total	$ 409	$ 525

Depreciation expense for the years ended December 31, 2006, 2005, 2004, and for the period of August 5, 2004 through December 31, 2006 was $370,000, $222,000, $187,000, and $647,000 respectively.

7. INCOME TAXES

The components of deferred income taxes at December 31 are as follows (in thousands):

	December 31,	
	2006	2005
Other accruals and reserves	$ 20	$ 475
Valuation allowance	(20)	(475)
Total current	$ —	$ —
NOL, AMT and general business credit carryforwards	32,873	25,938
Difference in basis of fixed assets	61	(25)
Other accruals and reserves	684	315
Difference in basis of intangibles	142	(692)
Valuation allowance	(33,760)	(24,430)
Total non current	$ —	$ 1,106
Total deferred income taxes	$ —	$ 1,106

	Years Ended December 31			As a Development Stage Company August 5, 2004 - December 31, 2006
	2006	2005	2004	
The provisions (benefits) for income taxes are as follows *(in thousands)*:				
Current	$ —	$ (108)	$ (642)	$ (750)
Deferred	1,106	—	—	1,106
Income tax provision (benefit)	$1,106	$ (108)	$ (642)	$ 356

SFAS No. 109 requires that a valuation allowance be established when it is more likely than not that all or a portion of a deferred tax asset will not be realized. Changes in valuation allowances from period to period are included in the tax provision in the period of change. In determining whether a valuation allowance is required, we take into account all evidence with regard to the utilization of a deferred tax asset including past earnings history, expected future earnings, the character and jurisdiction of such earnings, unsettled circumstances that, if unfavorably resolved, would adversely affect utilization of a deferred tax asset, carryback and carryforward periods, and tax strategies that could potentially enhance the likelihood of realization of a deferred tax asset. Management has evaluated the available evidence about future taxable income and other possible sources of realization of deferred tax assets and has established a valuation allowance of approximately $33.8 million at December 31, 2006. The valuation allowance includes approximately $6.1 million for net operating loss carry forwards that relate to stock option compensation expense for income tax reporting purposes. The results of the Company's Phase 3 Chrysalin fracture repair human clinical trial resulted in a change in our planned clinical pathway and timeline for our Chrysalin fracture repair indication. This potential change, when factored with our current significant net operating loss carryovers and current period net loss, resulted in a revision of our estimate of the need for a valuation allowance for the previously recorded deferred tax asset related to a Alternative Minimum Tax credit carryover. Due to the uncertainty that the deferred tax asset will be realized, we recorded a valuation allowance for the full amount of the deferred tax asset ($1,106,000) in 2006. The valuation allowance reduces deferred tax assets to an amount that management believes will more likely than not be realized.

We have accumulated approximately $80.3 million in federal and $68.2 million in state net operating loss carryforwards ("NOLs") and approximately $2.4 million of general business and alternative minimum tax credit carryforwards. The federal NOLs expire from 2021 and the state NOL's expire from 2009 and their availability to offset future taxable income would be limited should a change in ownership, as defined in Section 382 of the Internal Revenue Code, occur.

The AzERx and CBI acquisitions were treated as tax free reorganizations under Internal Revenue Code Section 368 and therefore resulted in a carryover basis and no income tax benefit for the related acquisition costs, including in-process research and development costs.

A reconciliation of the difference between the provision (benefit) for income taxes and income taxes at the statutory U.S. federal income tax rate is as follows for the year ended December 31, and for the period of August 5, 2004 through December 31, 2006 (in thousands):

	Years Ended December 31,			As a Development Stage Company August 5, 2004 - December 31, 2006
	2006	2005	2004	
Income tax (benefit) as statutory rate	$(10,474)	$ (9,336)	$(15,113)	$(31,683)
State income taxes (benefit)	(990)	(975)	(1,550)	(3,182)
Purchased in process research and development	2,843	—	9,690	12,533
Research credits		(545)	(1,240)	(1,785)
Other	844	126	345	1,315
Change in valuation allowance	8,883	10,622	7,226	23,158
Net provision (benefit)	$ 1,106	$ (108)	$ (642)	$ 356

8. STOCKHOLDERS' EQUITY

The number of common shares reserved for issuance under the OrthoLogic 1987 option plan is 4,160,000 shares. This plan expired during October 1997. In May 1997, the stockholders adopted a new stock option plan (the "1997 Plan"). The 1997 Plan reserved for issuance 1,040,000 shares of Common Stock. Subsequent to its original adoption, the Board and Shareholders approved amendments to the 1997 Plan that increased the number of shares of common stock reserved for issuance to 4,190,000. The 1997 Plan expires in March 2007. At December 31, 2006, 277,811 shares remained available to grant under the 1997 Plan. In May 2006, the stockholders approved the 2005 Equity Incentive Plan (2005 Plan) and reserved 2,000,000 shares of our common stock for issuance. At December 31, 2006, 753,083 shares remained available to grant under the 2005 Plan. Two types of options may be granted under the 1997 and 2005 Plans: options intended to qualify as incentive stock options under Section 422 of the Internal Revenue Code ("Code") and other options not specifically authorized or qualified for favorable income tax treatment by the Code. All eligible employees may receive more than one type of option. Any director or consultant who is not an employee of the Company shall be eligible to receive only nonqualified stock options under the Plans.

The Plans provide that in the event of a takeover or merger of the Company in which 100% of the equity of the Company is purchased or a sale of all or substantially all of OrthoLogic's assets (an "Accelerating Event"), 75% of all unvested employee options will vest and the remaining 25% vest over the following twelve month period. If an employee or holder of stock options is terminated as a result of or subsequent to the acquisition, 100% of that individual's stock option will vest immediately upon employment termination.

Stock Options issued prior to December 31, 2005:

Unrecognized non-cash stock compensation expense related to unvested options outstanding as of December 31, 2005 was approximately $1 million (includes 328,124 shares valued at $500,000 unvested and cancelled on April 5, 2006 upon the resignation of James M. Pusey, MD). Because of the significant expected forfeiture rate (54%) caused by the options cancelled at the time of Dr. Pusey's resignation, the expected compensation cost for unvested options at December 31, 2005, was approximately $388,000. Compensation cost recorded for the year ended December 31, 2006 for the options outstanding and unvested at December 31, 2005 was $203,000. At December 31, 2006 the remaining compensation cost related to unvested options outstanding at December 31, 2005, is approximately $185,000, which will be recognized over the remaining vesting period of approximately three years, with an estimated weighted average period of 1.4 years.

2006 Stock Options

On June 2, 2006, the Board of Directors granted options to purchase 800,000 shares of the Company's common stock, at an exercise price of $1.70 per share, to certain Company employees. These options vest pro rata over a two-year period.

On May 12, 2006, The Board of Directors granted each Director a fully vested option to purchase 25,000 shares of the Company's common stock at an exercise price of $1.75.

As part of their service agreements, on May 12, 2006, the Board of Directors granted options to John M. Holliman, III, Executive Chairman, and Randolph C. Steer, MD, Ph.D., President, to each purchase 200,000 shares of the Company's common stock, at an exercise price of $1.75 per share. The options vest pro rata over a two-year period.

During the three months ended March 31, 2006, the Board of Directors granted employees options to purchase 584,000 shares of the Company's common stock at exercise prices ranging from $4.73 to $5.39 per share. These options vest over a four-year period. On January 1, 2006, the Board of Directors also granted each Director a fully vested option to purchase 10,000 shares of the Company's common stock at an exercise price of $4.90 per share.

The Company used the Black-Scholes model with the following assumptions, to determine the total fair market value of $3,555,000 for options to purchase 1,994,000 shares of the Company's common stock issued during the year ended December 31, 2006:

	Three months ended March 31, 2006	Three months ended June 30, 2006
Risk free interest rate	4.8%	5.2%
Volatility	73%	70%
Expected term from vesting	2.9 years	2.9 years
Dividend yield	0%	0%

Using an estimated forfeiture rate of 5%, compensation cost recorded for the year ended December 31, 2006, for options issued in 2006, was $1,946,000. The options granted generally vest over a two to four-year period from the date of grant and, accordingly, the remaining unamortized cost at December 31, 2006 of approximately $1,609,000 will be amortized ratably over the period ending December 31, 2009, with an estimated weighted average period of one year.

2006 Restricted Stock

On May 12, 2006, the Shareholders of the Company approved the 2005 Equity Incentive Plan, which reserves an additional 2,000,000 shares of the Company's common stock for equity incentive awards. In conjunction with the approval, on May 12, 2006, the Board of Directors of the Company awarded 117,750 shares of restricted stock, which are fully vested at December 31, 2006. All of the restricted stock awards had been conditionally awarded in 2005, subject to shareholder approval of the 2005 Equity Incentive Plan. Of the restricted shares awarded, 62,750 shares related to annual awards to the Board of Directors, and 55,000 shares were performance based awards to officers of the Company. The total fair market value of the grants, determined using the closing price of the Company's common stock on the date of grant, was $206,000, which has been recognized as compensation cost in the year ended December 31, 2006.

In connection with the employment of James M. Pusey, MD, President and CEO, in March 2005, the Company granted Dr. Pusey 200,000 shares of restricted stock, which vested if certain milestones were reached. In March 2006, 100,000 shares of restricted stock vested resulting in total compensation expense of $588,000, of which $426,000 was recorded in the quarter ended March 31, 2006 and $162,000 in fiscal year 2005, as general and administrative expenses. The compensation cost was determined using the closing price of the Company's common stock on March 3, 2005, the date of grant. The remaining unvested 100,000 shares of restricted stock were cancelled upon Dr. Pusey's resignation on April 5, 2006 of his employment with the Company.

Summary

Non-cash stock compensation cost for the year ended December 31, 2006 totaled $2,781,000 of which $632,000 related to restricted stock, as described above. In the condensed Statements of Operations for the year ended December 31, 2006, non-cash stock compensation expense of $1,946,000 was recorded as a general and administrative expense and $835,000 was recorded as a research and development expense.

During the year ended December 31, 2006, options to purchase 670,400 shares of the Company's common stock were exercised resulting in the receipt by the Company of net cash proceeds of $2,962,000. The intrinsic value of options exercised in 2006 was $689,000.

A summary of option activity under our stock option plans for the years ended December 31, 2006, 2005 and 2004, is as follows:

	2006			2005		2004	
	Number of Options	Weighted average exercise price $	Weighted average remaining contractual term (years)	Number of Options	Weighted average exercise price $	Number of Options	Weighted average exercise price $
Options outstanding at the beginning of the year:	3,040,785	5.23		2,507,850	5.04	3,385,899	4.54
Plus: Options granted	1,994,000	2.85		650,000	5.21	381,200	7.09
Less:							
Options exercised	(670,400)	4.42		(113,100)	2.54	(1,230,309)	4.27
Options expired/forfeited	(926,259)	6.57		(3,965)	5.81	(28,940)	6.01
Options oustanding at the end of the year	3,438,126	3.69	7.32	3,040,785	5.17	2,507,850	5.04
Options exercisable at the end of the year	2,148,420	4.19	6.17	2,487,041	5.17	2,434,330	5.00
Options vested and expected to vest at December 31, 2006	3,379,249	3.70	7.30				

A summary of the status of the Company's unvested shares as of December 31, 2006, and changes during the year ended December 31, 2006, is presented below:

Unvested Shares	Number of Options	Weighted average Grant date Fair Value
Unvested shares at December 31, 2005	200,000	$5.88
Granted	117,750	$1.75
Vested	(217,750)	$3.65
Canceled/forfeited	(100,000)	$5.88
Unvested shares at December 31, 2006	—	

It is the Company's policy to issue options from shareholder approved incentive plans. However, if the options are issued as an inducement for an individual to join the Company, the Company may issue stock options outside of shareholder approved plans. The options granted under shareholder approved incentive plans have a ten-year term and vest over a two to four-year period of service. All options and stock purchase rights are granted with an exercise price equal to the current market value on the date of grant and, accordingly, options or stock purchase rights have no intrinsic value on the date of grant. Based on the closing market price of the Company's common stock at December 31, 2006 of $1.43, stock options exercisable or expected to vest at December 31, 2006, have no intrinsic value.

Warrants

At December 31, 2006, the Company has warrants outstanding to purchase 46,706 shares of the Company's common stock with an exercise price of $6.39 per share which expire in February 2016, and warrants outstanding to purchase 117,423 shares of the Company's common stock with an exercise price of $1.91 per share which expire in July 2016.

Additionally, as described in Note 15, performance based warrants to purchase 240,000 shares of the Company's common stock with an exercise price of $1.91, which expire in February 2016, are outstanding but unvested at December 31, 2006. The total cost of the performance based warrants will be charged to expense over the period of performance. The costs will be determined based on the fair market value of the warrants determined by using the Black-Scholes model, revalued at each Company reporting date until fully vested. The fair market value of the milestone warrants using the Black-Scholes model, 66% volatility, 0% dividend yield, expected term of 9.2 years, and 4.6% interest rate was $241,000 at December 31, 2006. No costs were charged to expense at December 31, 2006 as it is not yet probable that any milestone warrants will vest.

9. COMMITMENTS

We are obligated under non-cancelable operating lease agreements for our Tempe, Arizona office and research facilities through 2007. Rent expense for the years ended December 31, 2006, 2005, 2004 and for the period of August 5, 2004 through December 31, 2006 was $1,174,000, $1,135,000, $1,131,000 and $2,780,000, respectively. We currently sublease portions of the Tempe facility to other tenants and approximately 45% of the Tempe leased facility is subleased through December 2007, which offsets our lease expense. The Company recorded approximately $745,000, $517,000, $746,000, and $1,555,000 of sublease income for the years ended December 31, 2006, 2005, 2004, and for the period of August 5, 2004 through December 31, 2006, respectively.

Our obligated base payments for 2007 will be approximately $1,133,000.

Current subleases provide for the receipt of $743,000 of sublease income in fiscal 2007.

10. LITIGATION

The Company, along with similar affected property owners or lessees, contested certain property taxes levied by Maricopa County on Salt River Project leasehold improvements. In September 2006, the Superior Court of Arizona ruled in favor of the Company and in November of 2006, Maricopa County informed the Company it did not intend to appeal the decision. The property tax bills subject to the court's decision, totaled $466,000 and covered tax years 2004 and 2005. The Company has also been billed $240,000 for tax year 2006 for the same taxes, of which $120,000 had been paid at December 31, 2006. The Company recorded a receivable from Maricopa County in the amount of $690,000 at December 31, 2006. The Company treated the recovery as a reduction of current period property tax expense of which $462,000 was recorded as a reduction of research and development expense, and $228,000 was recorded as a reduction of general and administrative expenses in the statement of operations for 2006. The Company received a refund of these taxes paid plus interest at 10% on the amounts from the dates paid in February 2007. During 2006, the Arizona State Legislature repealed the property tax which is the subject of the dispute.

The Company is involved in various legal proceedings that arise in the ordinary course of business. In management's opinion, the ultimate resolution of these other legal proceedings are not likely to have a material adverse effect on the financial position, results of operations or cash flows of the Company.

11. 401(K) PLAN

We adopted a 401(k) plan (the "Plan") for our employees on July 1, 1993. We may make matching contributions to the Plan on behalf of all Plan participants, the amount of which is determined by the Board of Directors. We matched approximately $48,000, $34,000 and $31,000 in 2006, 2005, and 2004, respectively.

12. CONDENSED QUARTERLY RESULTS (UNAUDITED)

	First Quarter		Second Quarter		Third Quarter		Fourth Quarter	
	2006	2005	2006	2005	2006	2005	2006	2005
	(in thousands, except for per share data)							
Operating expenses	$17,243	$6,063	$6,303	$7,264	$7,067	$8,293	$4,077	$8,484
Loss from continuing operations	$16,481	$5,499	$6,542	$6,610	$5,817	$7,593	$3,073	$7,750
Net loss	$16,481	$5,499	$6,542	$6,610	$5,817	$7,593	$3,073	$7,500
Net loss per share basic and diluted	$ 0.42	$ 0.14	$ 0.16	$ 0.17	$ 0.14	$ 0.20	$ 0.07	$ 0.20

In August of 2004, we acquired substantially all the assets and intellectual property of CBI, resulting in a $25.8 million expense for in-process research and development. In February of 2006, we acquired certain assets of AzERx resulting in a $8.4 million expense for in-process research and development. Cross footing the quarterly data may not result in the yearly totals due to rounding.

13. AUTHORIZED PREFERRED STOCK

We have 2,000,000 shares of authorized preferred stock, the terms of which may be fixed by our Board of Directors. We presently have no outstanding shares of preferred stock. While we have no present plans to issue any additional shares of preferred stock, our Board of Directors has the authority, without stockholder approval, to create and issue one or more series of such preferred stock and to determine the voting, dividend and other rights of holders of such preferred stock. The issuance of any of such series of preferred stock may have an adverse effect on the holders of common stock.

In connection with the Rights Agreement dated as of March 4, 1997 between the Company and the Bank of New York, as amended (the "Rights Agreement"), our Board of Directors approved the designation of 500,000 shares of Series A Preferred Stock. The Rights Agreement and the exercise of rights to purchase Series A Preferred Stock pursuant to the terms thereof may delay, defer or prevent a change in control because the terms of any issued Series A Preferred Stock would potentially prohibit our consummation of certain extraordinary corporate transactions without the approval of the Board. In addition to the anti-takeover effects of the rights granted under the Rights Agreement, the issuance of preferred stock, generally, could have a dilutive effect on our stockholders. The Rights Agreement expires March 11, 2007.

14. ACQUISITION OF AZX100 - A NEW CLASS OF MOLECULES

On February 27, 2006, the Company purchased certain assets and assumed certain liabilities of AzERx, Inc. for $390,000 in cash and the issuance of 1,355,000 shares of the Company's common stock. Under the terms of the transaction, OrthoLogic acquired an exclusive license for the core intellectual property relating to AZX100, a 24-amino acid synthetic peptide, and will continue to develop the new class of compounds in the field of smooth muscle relaxation called Intracellular Actin Relaxing Molecules, or ICARMs™, based on the unique technology developed by AzERx.

The acquisition provides the Company with a new technology platform that diversifies the portfolio, and may provide more than one potential product. AZX100 is currently being evaluated for medically important and commercially significant applications such as the treatment of vasospasm associated with subarachnoid hemorrhage, prevention of keloid scarring, pulmonary fibrosis and the treatment of asthma. Preclinical and human in vitro studies have shown that this novel compound has the ability to relax smooth muscle in multiple tissue types.

The Company deemed the cost of the acquisition to be in-process research and development costs and, accordingly, charged the acquisition costs to research and development expense in the year ended December 31, 2006.

The costs associated with the acquisition were as follows:

Cash	$ 390,000
Fair market value of the Company's common stock issued (1)	7,764,000
Transaction costs	242,000
Liabilities assumed	75,000
In-process research and development costs	$ 8,471,000

(1) The fair market value of the Company's common stock ($5.73) was determined by reference to the closing market price of the Company's common stock for a reasonable period before and after February 24, 2006.

Valley Ventures III, L.P., an investment fund affiliated with the Executive Chairman of OrthoLogic, John M. Holliman, III, is a minority stockholder of AzERx. Mr. Holliman did not participate in the evaluation or approval of this transaction on behalf of OrthoLogic.

15. SALE OF SHARES OF COMPANY STOCK, ISSUANCE OF WARRANTS AND ENTRY INTO MASTER SERVICES AGREEMENT

On February 24, 2006, the Company entered into agreements with PharmaBio Development Inc., (dba NovaQuest), an affiliate of Quintiles, Inc., and Quintiles, Inc. (collectively "Quintiles"), which provided for the purchase of $2,000,000 of the Company's common stock, with the number of shares (359,279) determined by the

15-day average closing stock price prior to February 24, 2006 ($5.56). The transaction was completed (closed) on February 27, 2006. Additionally, under the terms of the agreements, at the election of the Company, Quintiles would have been required to purchase $1,500,000 of the Company's common stock on June 30, 2006, (Second Closing) with the number of shares determined by the 15-day average closing stock price prior to June 30, 2006, and would have been required to purchase $1,500,000 of the Company's common stock on September 29, 2006, with the number of shares determined by the 15-day average closing stock price prior to September 29, 2006 (Third Closing). Each stock purchase would include the issuance of fully vested warrants, exercisable for a ten-year period from the date of issuance, for an amount of shares equal to 13% of the shares purchased and with the exercise price set at 115% of the share price of each respective share purchase. (For the February 27, 2006 investment, warrants to purchase 46,706 shares at $6.39 were issued).

On July 3, 2006, the Company closed the transaction contemplated by the agreements on the Second Closing Date. Pursuant to the agreements, on July 3, 2006, the Company issued a total of 903,252 shares of its common stock to Quintiles for a purchase price of $1,500,000 and issued a fully vested warrant to purchase 117,423 shares of the Company's common stock at $1.91 a share.

On September 14, 2006, the Company notified Quintiles that the Company would not offer for sale or issue to Quintiles the shares contemplated in the Third Closing. Accordingly, the Company has no further right to request Quintiles purchase shares of its common stock and Quintiles has no further obligation to purchase such shares under the agreements.

Summary of the stock sale transactions:

	February 27, 2006	July 3, 2006
Capital stock and additional paid-in capital	$ 1,913,000	$ 1,463,000
Accrued transaction costs	87,000	37,000
Cash proceeds	$ 2,000,000	$ 1,500,000

Accrued transaction costs represent direct costs of the transaction (legal and accounting fees) and are treated as reduction of additional paid-in capital.

As part of the transaction, the Company and Quintiles also entered into a Master Services Agreement whereby Quintiles agreed to become the Company's exclusive contract research organization service provider for the Company's Chrysalin Product Platform and to provide certain other technical assistance. The Company may enter into a variety of contracts over the five-year term of the agreement as determined by the development and clinical progress of its Chrysalin products. In return for this agreement, the Company has granted Quintiles the right of first negotiation to promote Chrysalin with a specialty sales force under a fee-for-service or risk-based structure. Additionally, the Company has granted Quintiles warrants to purchase up to 240,000 shares of the Company's common stock, with the exercise price set at 115% of the Second Closing stock price ($1.91). The shares will be exercisable for a ten-year period from February 27, 2006 and the warrants will vest based on the achievement of certain milestones (milestone warrants).

The total cost of the milestone warrants will be charged to expense over the period of performance. The costs will be determined based on the fair market value of the milestone warrants determined by using the Black-Scholes model, revalued at each Company reporting date until fully vested. The fair market value of the milestone warrants using the Black-Scholes model, 66% volatility, 0% dividend yield, expected term of 9.2 years, and 4.6% interest rate was $241,000 at December 31, 2006. No costs were charged to expense at December 31, 2006 as it is not yet probable that any milestone warrants will vest.

16. SUBSEQUENT EVENT – PURCHASE OF OPERATING FACILITY

In March 2007, we entered into an agreement to purchase a 34,440 square foot single story office building in Phoenix, Arizona, for $3,615,000. The transaction is subject to standard due diligence and closing conditions and the transaction is expected to close in the second quarter of 2007. The lease on our current operating facility in Tempe, Arizona expires in early January 2008. We expect to relocate to the Phoenix facility in the fourth quarter of 2007.

Schedule II Valuation and Qualifying Accounts 2006, 2005 and 2004

Allowance for doubtful accounts:

Balance December 31, 2003	(556)			
2004 Adjustments to expense		61		
2004 Deductions to allowance			495	
Balance December 31, 2004				0

No activity after December 31, 2004

Exhibit 21.1

Subsidiaries of OrthoLogic Corp.

None

Exhibit 23.1

Consent of Independent Registered Public Accounting Firm

We consent to the incorporation by reference in the following Registration Statements:

(1) Registration Statement (Form S-3 No. 333-137754) of OrthoLogic Corp.

(2) Registration Statement (Form S-3 No. 333-133530) of OrthoLogic Corp.

(3) Registration Statement (Form S-3 No. 333-82050) of OrthoLogic Corp.

(4) Registration Statement (Form S-3 No. 333-01558) of OrthoLogic Corp.

(5) Registration Statement (Form S-3 No. 333-62321) of OrthoLogic Corp.

(6) Registration Statement (Form S-4 No. 333-116153) pertaining to OrthoLogic Corp.'s Asset Purchase Agreement

(7) Registration Statement (Form S-8 No. 333-134980) pertaining to the OrthoLogic Corp.'s 2005 Stock Option Plan

(8) Registration Statement (Form S-8 No. 333-127358) pertaining to the OrthoLogic Corp.'s Restricted Stock Letter Grant

(9) Registration Statement (Form S-8 No. 333-123086) pertaining to the OrthoLogic Corp.'s 1997 Stock Option Plan

(10) Registration Statement (Form S-8 No. 333-87334) pertaining to the OrthoLogic Corp.'s 1997 Stock Option Plan

(11) Registration Statement (Form S-8 No. 333-79010) pertaining to the OrthoLogic Corp.'s Stock Option Plan

(12) Registration Statement (Form S-8 No. 333-01268) pertaining to the OrthoLogic Corp.'s Stock Option Plan

(13) Registration Statement (Form S-8 No. 333-35505) pertaining to the OrthoLogic Corp.'s Stock Option Plan

(14) Registration Statement (Form S-8 No. 333-35507) pertaining to the OrthoLogic Corp.'s Stock Option Plan

(15) Registration Statement (Form S-8 No. 333-09785) pertaining to the OrthoLogic Corp.'s Stock Option Plan of our reports dated March 9, 2007, with respect to the financial statements of OrthoLogic Corp. (a development stage company), OrthoLogic Corp. management's assessment of the effectiveness of internal control over financial reporting, and the effectiveness of internal control over financial reporting of OrthoLogic Corp., included in this Annual Report (Form 10-K) for the year ended December 31, 2006.

/s/ Ernst & Young LLP

Phoenix, Arizona
March 9, 2007

Exhibit 23.2

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in Registration Statements No. 333-134980, No. 333-127358, No. 333-123086, No. 33-79010, No. 333-01268, No. 333-09785, No. 333-35505, No. 333-35507 and No. 333-87334 on Form S-8, Registration Statements No. 333-137754, No. 333-133530, No. 33-82050, No. 333-01558 and No. 333-62321 on Form S-3 and Registration Statement No. 333-116153 on Form S-4 of our report dated March 9, 2006 relating to (1) the financial statements of OrthoLogic Corp. (a development stage company) as of December 31, 2005, and for the years ended December 31, 2005 and 2004 and for the period of August 5, 2004 (inception) through December 31, 2005 (the financial statements for the period of August 5, 2004 (inception) through December 31, 2005 are not presented separately herein) and (2) the financial statement schedule of OrthoLogic Corp. (a development stage company) for the year ended December 31, 2004 (which report expresses an unqualified opinion and includes an explanatory paragraph regarding the fact that OrthoLogic Corp. is in the development stage at December 31, 2005), appearing in this Annual Report on Form 10-K of OrthoLogic Corp. (a development stage company) for the year ended December 31, 2006.

/s/ DELOITTE & TOUCHE, LLP

Phoenix, Arizona
March 12, 2007

Exhibit 31.1

CERTIFICATION

I, John M. Holliman, III, certify that:

1. I have reviewed this Annual Report on Form 10-K of OrthoLogic Corp.;

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

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

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

    a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

    b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

    c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

    d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

    a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

    b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

March 14, 2007

By: /s/ John M. Holliman, III
John M. Holliman, III
Executive Chairman
Principal Executive Officer

Exhibit 31.2

CERTIFICATION

I, Les Taeger, certify that:

1. I have reviewed this Annual Report on Form 10-K of OrthoLogic Corp.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
    a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
    b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
    c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
    d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
    a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
    b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 14, 2007

By: /s/ Les M. Taeger
Les M. Taeger
Chief Financial Officer

Exhibit 32.1

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report of OrthoLogic Corp. (the "Company") on Form 10-K for the period ended December 31, 2006 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), each of John M. Holliman, III, Executive Chairman and Principal Executive Officer of the Company and Les Taeger, Chief Financial Officer of the Company, certifies, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that to the best of his knowledge:

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

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

By: /s/ John M. Holliman, III
John M. Holliman, III
Executive Chairman and Principal Executive Officer
March 14, 2007

By: /s/ Les M. Taeger
Les M. Taeger
Chief Financial Officer
March 14, 2007

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signatures that appear in typed form within the electronic version of this written statement required by Section 906, has been provided to OrthoLogic Corp. and will be retained by OrthoLogic Corp. and furnished to the Securities and Exchange Commission or its staff upon request.

DIRECTORS OF ORTHOLOGIC

John M. Holliman, III
Chairman of the Board
General Partner, Valley Ventures,
Venture Capital

Michael D. Casey (term expires May 10, 2007)
Director

Fredric J. Feldman, Ph.D.
Director

Elwood D. Howse, Jr.
Director

William M. Wardell, MD, Ph.D.
Director
President, Wardell Associates International, LLC

Augustus A. White, III, MD, Ph.D.
Director
Ellen and Melvin Gordon Professor of Medical Education, Professor of Orthopaedic Surgery, Master, Oliver Wendell Holmes Society
Harvard Medical School

OFFICERS OF ORTHOLOGIC

John M. Holliman, III
Principal Executive Officer

Randolph C. Steer, MD, Ph.D.
President

Les M. Taeger
Senior Vice President
Chief Financial Officer

Dana B. Shinbaum
Vice President
Business Development

CORPORATE INFORMATION

Corporate Counsel
Quarles & Brady LLP
Phoenix, Arizona

Independent Auditors
Ernst & Young LLP
Phoenix, Arizona

Investor Relations
OrthoLogic Corp.
kstruck@olgc.com

Transfer Agent
Bank of New York
800-524-4458
www.stockbny.com

Shareholders inquiries to:
The Bank of New York
Shareholder Relations Department
P.O. Box 11258
New York, New York 10286
shareowners@bankofny.com

Send Certificates for Transfer
and address changes to:
The Bank of New York
Receive and Deliver Department
P.O. Box 11002
New York, New York 10286

Annual Meeting of Stockholders
8:00 a.m. Local Time
Thursday, May 10, 2007

Corporate Offices:
1275 West Washington Street
Tempe, Arizona 85281

www.orthologic.com