

2013

letter to shareholders

Making life's important moments possible — one breath at a time.™

to our shareholders



It is a pleasure to write my first annual shareholder letter to you. It has been an exciting year at Electromed, Inc. and we've made changes that are positively affecting our long-term outlook. I'm proud to report that we are making progress against our plan to return the company to profitable growth and increase shareholder value.

Electromed serves a primary function – to provide airway clearance technologies that help people around the world breathe better and lead active and fulfilling lives. We achieve this through innovative products, as well as patient advocacy and care with our patient-first commitment. The Electromed team is focused on this mission of *Making life's important moments possible — one breath at a time.™* We are proud of this commitment and encouraged by the opportunities that lie ahead.

The year in review

During fiscal 2013, we concentrated on returning Electromed to its strong legacy of innovation and product development. This is one of our key growth strategies, as well as increasing our geographic footprint in the U.S. and internationally. During the year, we focused on better management of our expense base and we believe our working capital of approximately \$10 million and available borrowings will provide the necessary funds for growth in the next year.

Major accomplishments included:

- Improving the quality of our patient referrals. Our referral to approval ratio is improving due to educating clinicians on what diagnosis and medical history would qualify a patient as a good candidate for High-Frequency Chest Wall Oscillation (HFCWO).
- Growing international sales by 43 percent year-over-year, to \$782,000. This is attributable to the hard work of Electromed's new international sales manager, hired earlier in 2013, and our dedicated support team.
- Increasing institutional and governmental sales by 40 percent over 2012, to \$1.4 million. We responded to market conditions by implementing a new pricing strategy.

- Strengthening our balance sheet and improving our cash position. Our current ratio increased to 5.7 from 3.9. We improved our collections process, reduced inventory, and initiated cost reduction and avoidance strategies.
- Continuing to invest in research and development for future product innovations.
- Reducing SG&A costs by approximately \$1.0 million, excluding certain one-time expenses, through expense management and a keen focus on strategic sales and marketing initiatives.

Positioning us well for our success in 2014

We faced many challenges during the year with reimbursement including continuous downward pressure on pricing, longer approval and payment cycles and uncertain future government regulation of healthcare with the Affordable Care Act (ACA). Responding to these challenges, we realigned our Reimbursement Department with a focus on greater efficiency and improved throughput. Despite the challenges of the economic climate, our referral to approval ratio is improving. We are pleased with the improvements that we are seeing and the momentum that is building as we enter fiscal 2014.

One of the challenges this year came from our largest domestic third-party payer, Blue Cross and Blue Shield (BCBS), which decentralized its billing and contracting processes. We have made significant progress on obtaining contracts with the approximately 50 individual affiliates to maintain our national coverage.

The Company was impacted by the Sunshine Act, Health Insurance Portability and Accountability Act (HIPAA/HITECH), and the medical device excise tax. We have responded quickly to these ever increasing regulatory costs by developing and implementing the necessary processes as efficiently as possible to minimize the cost impact.

We continue our cost reduction initiatives to become more operationally efficient and return to overall profitability. In fiscal 2013, our operating expenses were down \$675,000, even with extra expenses for litigation. Net of these expenses, operating expenses would have been down an additional \$400,000. We recently resolved lawsuits initiated in 2012 with a certain shareholder and with the former Chief Executive Officer. Putting this matter behind us is positive for our shareholders and we expect

shareholder letter continued

significant decreases in our legal fees in subsequent quarters.

We also focused on strengthening our balance sheet. We have reduced certain expenses, inventory levels, and accounts receivable allowing us to be out of our line of credit. We believe our working capital combined with the availability on our line of credit will allow us to support our growth strategies.

Electromed is committed to growth and the compelling underlying demographics for our business gives us confidence in the future. The need for airway clearance products is increasing with an aging population that wants an improved quality of life in the later years. The ACA, while increasing our costs through regulation and the medical devices excise tax, may also support our growth as hospitals will be penalized under the ACA when certain patients return within 30 days for the same health condition. We believe the need for our product may rise as physicians look for more effective treatments of respiratory illnesses.

In many cases, significant history of patient illness is required for reimbursement. Our HFCWO therapy is not yet seen as a preventative measure in these cases. We believe reimbursement will trend toward preventative care in the future. For now, our goal is to transform the business and align with the current economic and reimbursement environment.

Going forward we are committed to:

- Returning to historical profitability through increased sales and expense control;
- Generating revenue growth through product development;
- Growing domestic and international sales by expanding our geographic footprint; and
- Treating our customers and patients with integrity and respect.

I am encouraged by the traction Electromed gained this year, and I am confident that we will continue to make progress growing our business. I want to thank you, our shareholders, for your continued support, our team of employees for their dedication, and our customers for their confidence in our product and service. I look forward to updating you on our progress throughout fiscal 2014.

Sincerely,



Kathleen Skarvan
Chief Executive Officer

testimonial

“The SmartVest is our treatment choice for High-Frequency Chest Wall Oscillation (HFCWO) therapy. It allows patients to have a better range of positions, and eliminates soreness that is associated with manual therapy. Further, the SmartVest is user friendly and easy to set up — providing our staff with more patient contact time. We use the SmartVest to treat serious conditions such as pneumonia, bronchitis and bronchiectasis. The combination of the SmartVest’s innovative technology and its disposable, single-patient use has been a game changer for our hospital.”

Dean Bleadorn

Respiratory Therapy Director
St. Lukes Methodist Hospital
Cedar Rapids, Iowa

Cautionary Statements

Certain statements found in this letter may constitute forward-looking statements as defined in the U.S. Private Securities Litigation Reform Act of 1995. Forward-looking statements reflect the speaker’s current views with respect to future events and financial performance and include any statement that does not directly relate to a current or historical fact. Forward-looking statements can generally be identified by the words “believe,” “expect,” “anticipate” or “intend” or similar words. Forward-looking statements made in this letter include the Company’s plans and expectations regarding the economic environment in which the Company operates, the adequacy of the Company’s working capital and available borrowings, referral and approval trends, sales growth and profitability, financial and operational performance, cost reductions, the impact of the medical device tax and other regulatory changes, and the Company’s strategic goals and focus for future periods. Forward-looking statements cannot be guaranteed and actual results may vary materially due to the uncertainties and risks, known and unknown, associated with such statements. Examples of risks and uncertainties for Electromed include, but are not limited to, the impact of emerging and existing competitors, the effectiveness of our sales and marketing initiatives, changes to reimbursement programs, our ability to effectively control costs, and our ability to obtain credit as needed, as well as other factors described from time to time in our reports to the Securities and Exchange Commission (including our Annual Report on Form 10-K). Investors should not consider any list of such factors to be an exhaustive statement of all of the risks, uncertainties or potentially inaccurate assumptions investors should take into account when making investment decisions. Shareholders and other readers should not place undue reliance on “forward-looking statements,” as such statements speak only as of the date of this letter.