

THE WALL STREET TRANSCRIPT

Connecting Market Leaders with Investors

Electromed, Inc. (ELMD)



KATHLEEN SKARVAN is Director and CEO of Electromed, Inc. Ms. Skarvan is known for transforming organizations through innovation, quality initiatives and improved productivity, and has broad experience managing high growth in both small and large, privately and publicly held organizations. She has served as Vice President of Operations at OEM Fabricators, President of Hutchinson Technology Incorporated Disk Drive Components Division, Vice President of Sales & Marketing of the Disk Drive Components Division, and Senior Vice President of Hutchison Technology Incorporated. Ms. Skarvan holds a Bachelor of Arts in mass communication with a minor in finance and business from St. Cloud State University.

SECTOR — HEALTH SERVICES

TWST: Could you provide an overview of the company?

Ms. Skarvan: Electromed is dedicated to designing, manufacturing and marketing innovative airway clearance products. For the body to function properly, it must routinely clear itself of mucus. However, a range of diseases and conditions, including genetic and immunological disorders, neuromuscular diseases, and obstructive pulmonary conditions such as asthma and COPD — chronic obstructive pulmonary disease — can hamper a person's ability to clear the airways. The inability to clear the body's airways is a major health risk since retained mucus in the respiratory tract often precedes a spiral of declining health effects including impaired breathing and lung infections, such as pneumonia. If not adequately treated, the cycle tends to repeat.

For people with impaired airway clearance, improved bronchial drainage is the best defense against airway inflammation, infections and other complications. To help patients in this battle, clinicians typically prescribe multiple therapies, including prescription medicines, chest physiotherapy, special coughing postures and techniques and cough-assist accessories.

If those therapies, in combination, don't provide adequate relief from symptoms, or fail to reduce or eliminate recurring breathing problems and respiratory infections, high-frequency chest-wall oscillation — HFCWO — including Electromed's SmartVest Airway Clearance System, is a proven therapy option for treating compromised airway clearance.

As mentioned previously, a range of diseases and conditions including many genetic, neuromuscular and immunological disorders can cause chronically compromised airway clearance. HFCWO is routinely

prescribed for amyotrophic lateral sclerosis — ALS — bronchiectasis, cerebral palsy, cystic fibrosis, muscular dystrophy, quadriplegia and the combination of emphysema and chronic bronchitis commonly known COPD. Electromed is a leader in developing products that address this issue.

We were the first to develop a truly portable system for HFCWO, making it easier for patients and their families to consistently fit HFCWO therapy into their daily routines. Electromed also pioneered the first programmable and multi-positional HFCWO generator. HFCWO is our primary product and focus. It is sold into the home care market for people with chronic lung issues and into the acute care setting, that is, a hospital or clinic, to promote airway clearance and improve bronchial drainage.

TWST: Explain a little bit more about how high-frequency chest-wall oscillation works, and what it's doing to promote airway clearance when there is mucus built up.

Ms. Skarvan: When bacteria, viruses, allergens and other irritants captured by mucus cannot be expectorated, the body's lung defenses take action. The inflammatory and immune systems boost mucus production. More mucus accumulates, inviting bacteria trapped in stagnant secretions to cause infection, such as pneumonia. If not adequately treated, the cycle tends to repeat. If one or more of the airway clearance therapies mentioned earlier fail to provide adequate relief or a patient continues to experience infections or breathing problems, the treating physician may prescribe a more powerful therapy: HFCWO, such as the SmartVest System from Electromed.

An HFCWO system is comprised of an inflatable garment connected to a programmable air pulse generator via a hose. During therapy, the generator creates and delivers rapidly repeating pulses of air

through the garment, alternately squeezing and releasing the upper torso of the body and chest wall. Each squeeze simulates a “mini cough,” which acts to loosen, thin and propel mucus toward major airways, where it can be more readily coughed up or suctioned away. That is the mechanism of high-frequency chest-wall oscillation.

TWST: Is this considered at this point in time standard of care and, if not, what are you trying to supplant? How is this different from alternative therapy that you may be trying to either augment or supplant?

Ms. Skarvan: HFCWO was originally developed at the University of Minnesota quite a few years ago. The original intent of HFCWO therapy was to provide people with cystic fibrosis a more consistent treatment and gain independence from the standard of care, chest physiotherapy — CPT. While effective, chest physiotherapy requires a caregiver or respiratory therapist to percuss or clap the chest wall rhythmically to loosen mucus and move it into larger airways to be expectorated. Individuals with cystic fibrosis have a defective gene that affects the movement of salt and water in out of the cells of several organs, including the lungs. The result is unusually thick, sticky mucus

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that is often difficult to mobilize. This is why HFCWO therapy was originally developed and, for the most part, it is considered a standard of care for people with cystic fibrosis.

In the last few years, physicians have found additional benefits for HFCWO therapy, meaning applicability for diseases and conditions beyond cystic fibrosis. A disease for which our device is frequently prescribed is bronchiectasis, a condition characterized by an irreversible widening of one or more of the bronchi, whereby there is difficulty clearing the lungs of retained secretions. It’s a condition that can occur as part of COPD. Further, individuals with neuromuscular disease or neuromotor conditions such as ALS, spinal cord injury and muscular dystrophy may also benefit from the therapy delivered by HFCWO.

We typically say that the best airway clearance therapy is a therapy that works best for the individual, so we aren’t necessarily supplanting a different therapy. However, when someone has repeated hospitalizations, has used oscillating PEP devices or other prescribed breathing techniques and still is having lung infections and subsequent clinic visits, then this person may benefit from HFCWO therapy.

TWST: Your net revenues for fiscal 2014 were \$15.5 million, an increase of 2.5% compared to fiscal 2013. Are all those revenues from the product you’re just describing, the SmartVest?

Ms. Skarvan: Yes, all of our revenues are from a single product, the SmartVest Airway Clearance System, HFCWO therapy. Our revenues come from two market segments, although we primarily sell into the home care market, which is about 85% to 90% of revenue. That occurs by physician prescription; it is a reimbursement model.

The other portion of revenue is derived from institutional sales whereby we sell to a hospital. The hospital purchases the generator as a capital sale and buys single-patient-use garments for use during a patient’s hospital stay. So it is used in the acute care setting.

TWST: How do you expect revenues to change in terms of this composition of revenues over the next year?

Ms. Skarvan: We will continue to focus primarily on the home care reimbursement model. We have the strongest competency in our sales force in selling directly to primarily pulmonology clinics and physicians in those clinics. We also have a very strong competency in home care reimbursement. In the home care model, there are three things that have to occur before revenue is realized. We have to assure that a physician will prescribe the SmartVest System, assure that the patient wants the therapy and will use it, and then assure that Medicare, Medicaid or commercial private insurer will agree to pay for it.

We believe our business model is supported by many market trends having to do with the aging population such as the projected 10-year increase in lifespan by 2050, when the age group of 65 or older is projected to be greater than 83 million, almost double the number there were in 2012. In addition, there also is a focus on moving treatment to lower-cost settings, meaning to move patients from a hospital or a skilled nursing home into their homes and use our device there, which feeds into our home care model.

There is a growing awareness by physicians of diseases and conditions where patients can benefit from using HFCWO therapy. Additionally, there is also a growing trend for this device to be used in the institutional market. Certainly, many are aware of the Affordable Care Act. Elements of the Affordable Care Act are designed to lower cost, which include financial penalties for institutions for certain readmissions within a certain time frame.

Pneumonia and chronic obstructive pulmonary disease are two of those conditions. Often they are the original reason the individual was admitted to the hospital, and that the person was released and readmitted within 30 days for that same condition. It is possible that there will be penalties for that second readmission, and the hospital will not receive full Medicare coverage or reimbursement. Hospitals have a very strong incentive to manage patient care to reduce the potential for readmissions. This correlates with the possibility of discharging certain patients with our device so that they will stay healthy and not be readmitted.

Our expectations for the coming year, and other similar statements made today, are forward-looking statements and are subject to known and unknown risks and uncertainties that can cause our actual results to differ materially from these statements. These risks and uncertainties are further discussed in our filings with the Securities and Exchange Commission.

TWST: Particularly for the home care, do you have all the reimbursement privileges that you need in terms of insurance plans? Tell us where you stand with that and what you’re working on.

Ms. Skarvan: We have broad third-party payer coverage, including Medicare, for HFCWO as a reimbursed therapy for certain diseases and conditions. Many state Medicaid programs also recognize HFCWO as a reimbursable treatment option for people with chronic lung issues. Though we have very broad coverage with large third-party

reimbursement companies, we still have an ongoing effort to add certain commercial payers. But we're very pleased with the progress we've made in assuring patients with in-network coverage are reimbursed for the highest percentage of the device.

TWST: What would you call your top strategic objectives for the next year to two years?

Ms. Skarvan: Our top strategic objective is to continue to lead in HFCWO innovation. In 2013, we received clearance on our latest-generation high-frequency chest-wall oscillation system, the SmartVest SQL. It is 25% smaller, five decibels quieter and 25% lighter than previous versions, and has enhanced programmability with a more user friendly interface. Our value proposition is around comfort and ease of use, because the HFCWO device designed with these key features is the device patients are going to use most consistently, which leads to more optimal therapeutic outcomes. Then patients' quality of life will improve.

Next, we are focused on our patient-first culture. That's really what we're all about at Electromed — to assure that we are meeting patients' needs and improving quality of life, which will lead to fewer hospitalizations and clinic visits. We continue to improve our overall skill level and knowledge in our reimbursement team to improve our effectiveness working on behalf of the patient. Additionally, we want to be able to provide needed information to the physician and the clinics about particular patients. Many physicians want to be assured that patients are adhering to their prescribed therapy and rely on us to provide that information.

TWST: What is your overall or overarching growth strategy? Is it to expand the types of patients that can possibly use the device as well as the settings?

Ms. Skarvan: We have a two-pronged approach for growth. It is to expand referral volume and the diseases and conditions that physicians are prescribing within the clinics that we consider strongholds. Referrals are the prescriptions physicians write for the use of a HFCWO device.

The second strategy would be further market development, because there are still physicians who don't prescribe high-frequency chest-wall oscillation, so there is opportunity there. In particular, we are hearing more about the condition that I mentioned earlier, bronchiectasis, and that it is underdiagnosed within that chronic obstructive pulmonary disease segment. With a CT scan, one can identify whether someone suffers from bronchiectasis or not. We believe that is an opportunity for high-frequency chest-wall oscillation growth. Additionally, we believe that there is an opportunity to gain market share with our innovative SmartVest SQL System, and also with continuing to offer exceptional service to our referring clinics and patients who use our device.

TWST: Why would a physician be hesitant or decide not to use high-frequency chest-wall oscillation?

Ms. Skarvan: The number one objection from a physician is typically the perceived cost burden for their patient. To give you an example, the Medicare reimbursement for a high-frequency chest-wall oscillation device is over \$12,000. Many individuals even with Medicare may have a co-pay. So that typically is the primary objection.

That's why our service level and having reimbursement support as core competencies are so important, because we want to be there advocating for the patient to assure that we can maximize reimbursement and minimize the financial burden that this will have

on them. We also think about this as a lifetime therapy, which it is. There are studies that we can share with them. We have an opportunity to reduce the number of hospitalizations and clinic visits, which long term will be a total cost savings.

TWST: What challenges do you see on the horizon, and how do you plan to meet them? Are any of them regulatory in nature?

Ms. Skarvan: I think the greatest challenge that we face is the potential for reimbursement to change without notice. Although we watch the market very carefully and monitor what third-party private commercial insurers are doing or what Medicare is doing, there is the possibility that the amount of reimbursement and the conditions for reimbursement can change without much notice.

For example, in 2012 we received notice from Blue Cross Blue Shield that here in Minnesota they were going to be decentralizing all of their billing. Up until that point, if you were a Minnesota company, you could bill all Blue Cross Blue Shield patients, clients or customers through Blue Cross Blue Shield of Minnesota. When they made the decision to decentralize their billing, we then had to contract with over 45 new third-party payers. That took us about 18 months to complete. So one of my biggest concerns and potential risks for the organization is that there could be a change in that overall reimbursement schedule.

TWST: What would you like a potential investor in Electromed to know?

Ms. Skarvan: It is important to know about the opportunity for HFCWO to really make a therapeutic difference. It goes back to understanding the drivers for this expanding market. As I mentioned earlier, the aging population and increasing lifespan expectancy are two factors. Also, just the number of individuals who suffer from chronic lung disease, such as COPD, in the United States, is estimated to be over 12 million. So it is a market that is ripe for this type of therapy.

Also, there is an opportunity for cost reduction in that this therapy has been proven to reduce hospitalizations and keep people healthier. Those are very important items I believe that an investor should be aware of. The strength of Electromed is having one of the most innovative products on the market that is smaller, quieter, lighter and easy-to-use with additional programmability features. Further, the competency that we have in home care reimbursement is a strength that will continue to drive revenue growth.

TWST: Is there anything you'd like to add that we haven't covered?

Ms. Skarvan: I'd like to mention the focus the Electromed team has on improving the quality of each patient's life. Our people get up each day with that mission in mind, and they have been doing an exceptional job delivering on that promise.

TWST: Thank you. (KJL)

KATHLEEN SKARVAN
Director & CEO
Electromed, Inc.
500 6th Ave. NW
New Prague, MN 56071
(800) 462-1045
www.smartvest.com