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

FORM 10-Q

(Mark One)

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

For the quarterly period ended December 31, 2017

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

For the transition period from _____ to _____.

Commission File No.: 001-34839

Electromed, Inc.

(Exact Name of Registrant as Specified in its Charter)

Minnesota

(State or other jurisdiction of incorporation or organization)

41-1732920

(I.R.S. Employer Identification No.)

**500 Sixth Avenue NW
New Prague, Minnesota**

(Address of principal executive offices)

56071

(Zip Code)

(952) 758-9299

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer
(Do not check if smaller reporting company)

Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

There were 8,286,409 shares of Electromed, Inc. common stock, par value \$0.01, outstanding as of the close of business on February 12, 2018.

Electromed, Inc.
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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements.

Electromed, Inc.
Condensed Balance Sheets

	December 31, 2017 (Unaudited)	June 30, 2017
Assets		
Current Assets		
Cash	\$ 6,840,237	\$ 5,573,709
Accounts receivable (net of allowances for doubtful accounts of \$45,000)	9,680,369	9,949,759
Inventories	2,393,639	2,559,485
Prepaid expenses and other current assets	379,713	393,319
Total current assets	<u>19,293,958</u>	<u>18,476,272</u>
Property and equipment, net	3,215,369	3,303,233
Finite-life intangible assets, net	674,704	721,276
Other assets	102,577	99,868
Deferred income taxes	417,000	460,000
Total assets	<u>\$ 23,703,608</u>	<u>\$ 23,060,649</u>
Liabilities and Shareholders' Equity		
Current Liabilities		
Current maturities of long-term debt, net of debt issuance costs	\$ 1,124,745	\$ 50,703
Accounts payable	704,105	663,376
Accrued compensation	835,907	946,623
Income tax payable	84,110	156,524
Warranty reserve	670,000	640,000
Other accrued liabilities	360,538	438,748
Total current liabilities	<u>3,779,405</u>	<u>2,895,974</u>
Long-term debt, less current maturities and net of debt issuance costs	–	1,097,125
Total liabilities	<u>3,779,405</u>	<u>3,993,099</u>
Commitments and Contingencies		
Shareholders' Equity		
Common stock, \$0.01 par value; authorized: 13,000,000 shares; 8,270,167 and 8,230,167 issued and outstanding at December 31, 2017 and June 30, 2017, respectively	82,702	82,302
Additional paid-in capital	14,414,450	14,028,602
Retained earnings	5,427,051	4,956,646
Total shareholders' equity	<u>19,924,203</u>	<u>19,067,550</u>
Total liabilities and shareholders' equity	<u>\$ 23,703,608</u>	<u>\$ 23,060,649</u>

See Notes to Condensed Financial Statements (Unaudited).

Electromed, Inc.
Condensed Statements of Operations (Unaudited)

	Three Months Ended December 31,		Six Months Ended December 31,	
	2017	2016	2017	2016
Net revenues	\$ 6,984,626	\$ 6,372,243	\$ 13,366,405	\$ 11,917,606
Cost of revenues	1,398,001	1,445,786	2,843,286	2,663,522
Gross profit	<u>5,586,625</u>	<u>4,926,457</u>	<u>10,523,119</u>	<u>9,254,084</u>
Operating expenses				
Selling, general and administrative	4,759,652	4,096,197	9,463,163	7,784,107
Research and development	56,794	100,801	127,458	451,641
Total operating expenses	<u>4,816,446</u>	<u>4,196,998</u>	<u>9,590,621</u>	<u>8,235,748</u>
Operating income	<u>770,179</u>	<u>729,459</u>	<u>932,498</u>	<u>1,018,336</u>
Interest expense, net of interest income of \$8,888, \$3,603, \$18,517 and \$6,969, respectively	4,894	15,598	9,093	32,304
Net income before income taxes	<u>765,285</u>	<u>713,861</u>	<u>923,405</u>	<u>986,032</u>
Income tax expense	416,000	270,000	453,000	351,000
Net income	<u>\$ 349,285</u>	<u>\$ 443,861</u>	<u>\$ 470,405</u>	<u>\$ 635,032</u>
Income per share:				
Basic	<u>\$ 0.04</u>	<u>\$ 0.05</u>	<u>\$ 0.06</u>	<u>\$ 0.08</u>
Diluted	<u>\$ 0.04</u>	<u>\$ 0.05</u>	<u>\$ 0.05</u>	<u>\$ 0.08</u>
Weighted-average common shares outstanding:				
Basic	<u>8,200,167</u>	<u>8,167,112</u>	<u>8,200,167</u>	<u>8,167,112</u>
Diluted	<u>8,648,866</u>	<u>8,426,996</u>	<u>8,645,987</u>	<u>8,440,698</u>

See Notes to Condensed Financial Statements (Unaudited).

Electromed, Inc.
Condensed Statements of Cash Flows (Unaudited)

	<u>Six Months Ended December 31,</u>	
	<u>2017</u>	<u>2016</u>
Cash Flows From Operating Activities		
Net income	\$ 470,405	\$ 635,032
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	329,719	312,075
Amortization of finite-life intangible assets	56,610	60,963
Amortization of debt issuance costs	4,394	9,216
Share-based compensation expense	386,248	234,634
Deferred income taxes	43,000	13,000
Loss on disposal of intangible assets	-	111,497
Changes in operating assets and liabilities:		
Accounts receivable	269,390	(673,458)
Inventories	183,617	(53,894)
Prepaid expenses and other assets	8,461	7,046
Income tax receivable	-	189,789
Income tax payable	(72,414)	-
Accounts payable and accrued liabilities	(149,647)	(807,188)
Net cash provided by operating activities	<u>1,529,783</u>	<u>38,712</u>
Cash Flows From Investing Activities		
Expenditures for property and equipment	(228,176)	(267,117)
Expenditures for finite-life intangible assets	(10,038)	(44,518)
Net cash used in investing activities	<u>(238,214)</u>	<u>(311,635)</u>
Cash Flows From Financing Activities		
Principal payments on long-term debt including capital lease obligations	(25,041)	(24,056)
Payment of deferred financing fees	-	(4,872)
Net cash used in financing activities	<u>(25,041)</u>	<u>(28,928)</u>
Net increase (decrease) in cash	<u>1,266,528</u>	<u>(301,851)</u>
Cash		
Beginning of period	5,573,709	5,123,355
End of period	<u>\$ 6,840,237</u>	<u>\$ 4,821,504</u>

See Notes to Condensed Financial Statements (Unaudited).

Electromed, Inc.
Notes to Condensed Financial Statements
(Unaudited)

Note 1. Interim Financial Reporting

Basis of presentation: Electromed, Inc. (the “Company”) develops, manufactures and markets innovative airway clearance products that apply High Frequency Chest Wall Oscillation (“HFCWO”) therapy in pulmonary care for patients of all ages. The Company markets its products in the U.S. to the home health care and institutional markets for use by patients in personal residences, hospitals and clinics. The Company also sells internationally both directly and through distributors. International sales were approximately \$267,000 and \$332,000 for the six months ended December 31, 2017 and 2016, respectively. Since its inception, the Company has operated in a single industry segment: developing, manufacturing and marketing medical equipment.

The accompanying unaudited condensed financial statements of the Company have been prepared in accordance with U.S. generally accepted accounting principles (“U.S. GAAP”) for interim financial statements and pursuant to the rules and regulations of the U.S. Securities and Exchange Commission. In the opinion of management, the accompanying unaudited condensed financial statements reflect all adjustments consisting of normal recurring adjustments necessary for a fair presentation of the Company’s financial position and results of operations as required by Regulation S-X. Interim results of operations are not necessarily indicative of the results that may be achieved for the full year. The financial statements and related notes do not include all information and footnotes required by U.S. GAAP for annual reports. This interim report should be read in conjunction with the financial statements included in the Company’s Annual Report on Form 10-K for the fiscal year ended June 30, 2017 (“fiscal 2017”).

A summary of the Company’s significant accounting policies follows:

Use of estimates: Management uses estimates and assumptions in preparing the condensed financial statements in accordance with U.S. GAAP. Those estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and the reported revenues and expenses. Actual results could vary from the estimates that were used. The Company believes the critical accounting policies that require the most significant assumptions and judgments in the preparation of its condensed financial statements include revenue recognition and the related estimation of selling price adjustments, allowance for doubtful accounts, inventory obsolescence, share-based compensation, income taxes and the warranty reserve.

Net income per common share: Net income is presented on a per share basis for both basic and diluted common shares. Basic net income per common share is computed using the weighted average number of common shares outstanding during the period, excluding any restricted stock awards which have not vested. The diluted net income per common share calculation includes outstanding restricted stock grants and assumes that all stock options were exercised and converted into common stock at the beginning of the period, unless their effect would be anti-dilutive. Common stock equivalents excluded from the calculation of diluted earnings per share because their impact was anti-dilutive was 177,750 and 196,500 for the three and six months ended December 31, 2017 and 2016, respectively.

New accounting pronouncements: In May 2014, the Financial Accounting Standards Board (“FASB”) issued guidance creating Accounting Standards Codification (“ASC”) Section 606, “Revenue from Contracts with Customers.” The new section will replace ASC Section 605, “Revenue Recognition,” and creates modifications to various other revenue accounting standards for specialized transactions and industries. The section is intended to conform revenue accounting principles to a concurrently issued International Financial Reporting Standards with previously differing treatment between U.S. practice and that of much of the rest of the world, as well as to enhance disclosures related to disaggregated revenue information. Entities will have the option to apply the standard retrospectively to all prior periods presented (“full retrospective”), or to apply it retrospectively only to contracts existing at the effective date (“modified retrospective”), with the cumulative effect of the standard recorded as an adjustment to beginning retained earnings. The updated guidance will be effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within that year. The Company is currently evaluating which of the alternative approaches it will apply and the potential impact of adoption of the revised revenue standards on its financial statements. The Company intends to complete its evaluation during its fiscal year ending June 30, 2018 (“fiscal 2018”).

In July 2015, FASB issued ASU 2015-11, “Inventory (Topic 330) Related to Simplifying the Measurement of Inventory,” which applies to all inventory except that which is measured using last-in, first-out (“LIFO”) or the retail inventory method. Inventory measured using first-in, first-out (“FIFO”) or average cost is within the scope of the new guidance and should be measured at the lower of cost and net realizable value. Net realizable value is the estimated selling price in the ordinary course of business, less reasonably predictable cost of completion, disposal, and transportation. Subsequent measurement is unchanged for inventory measured using LIFO or the retail inventory method. The amendments are effective for public business entities for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. The new guidance is applied prospectively, and earlier application is permitted as of the beginning of an interim or annual reporting period. The Company adopted ASU 2015-11 effective July 1, 2017, which had no material impact on its financial statements or financial statement disclosures.

In February 2016, FASB issued ASU 2016-02, “Leases (Topic 842).” This standard requires the recognition of all lease transactions with terms in excess of 12 months on the balance sheet as a lease liability and a right-of-use asset (as defined in the standard). ASU 2016-02 will be effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, with earlier application permitted. Upon adoption, the lessee will apply the new standard retrospectively to all periods presented or retrospectively using a cumulative effect adjustment in the year of adoption. The Company has evaluated ASU 2016-02 and expects that it will have no material impact on its financial statements or financial statement disclosures upon adoption based on current facts and circumstances.

In March 2016, FASB issued ASU 2016-09, “Compensation—Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting,” which reduces complexity in accounting standards related to share-based payment transactions, including, among others, (1) accounting for income taxes, (2) classification of excess tax benefits on the statement of cash flow, (3) forfeitures, and (4) statutory tax withholding requirements. ASU 2016-09 is effective for annual reporting periods beginning on or after December 15, 2016, and interim periods within those annual periods. The Company adopted ASU 2016-09 effective July 1, 2017, which had no material impact on its previously reported financial statements in the Company’s Annual Report on Form 10-K for fiscal 2017. The Company has elected to continue to recognize estimated forfeitures as stock-based compensation expense.

Note 2. Inventories

The components of inventory were approximately as follows:

	December 31, 2017	June 30, 2017
Parts inventory	\$ 1,743,000	\$ 1,789,000
Work in process	377,000	205,000
Finished goods	544,000	745,000
Less: Reserve for obsolescence	(270,000)	(180,000)
Total	<u>\$ 2,394,000</u>	<u>\$ 2,559,000</u>

Note 3. Finite-life Intangible Assets

The carrying value of patents and trademarks includes the original cost of obtaining the patents, periodic renewal fees, and other costs associated with maintaining and defending patent and trademark rights. Patents and trademarks are amortized over their estimated useful lives, generally 15 and 12 years, respectively. There were no abandonments of domestic or foreign patents that occurred during the six months ended December 31, 2017. During fiscal 2017, the Company abandoned certain domestic and foreign patents with net values of approximately \$133,000, which were included as an expense in selling, general and administrative expense on the statements of operations. The majority of the pending patents that were abandoned related to the initial development of the Company’s SQL SmartVest technology. During a review of the Company’s patent portfolio it was determined that certain patents proved redundant to a subsequent SQL patent filing and were therefore abandoned. A smaller portion of expense was related to patents that covered technology that management considered outdated, and was no longer in use. Accumulated amortization was \$847,000 and \$790,000 at December 31, 2017 and June 30, 2017, respectively.

The activity and balances of finite-life intangible assets were approximately as follows:

	Six Months Ended December 31, 2017	Fiscal Year Ended June 30, 2017
Balance, beginning	\$ 721,000	\$ 904,000
Additions	10,000	68,000
Abandonments	-	(133,000)
Amortization expense	(56,000)	(118,000)
Balance, ending	<u>\$ 675,000</u>	<u>\$ 721,000</u>

Note 4. Warranty Liability

The Company provides a lifetime warranty on its products to the prescribed patient for sales within the U.S. and a three-year warranty for all institutional sales and sales to individuals outside the U.S. The Company estimates the costs that may be incurred under its warranty and records a liability in the amount of such costs at the time the product is shipped. Factors that affect the Company's warranty liability include the number of units shipped, historical and anticipated rates of warranty claims, the product's useful life and cost per claim. The Company periodically assesses the adequacy of its recorded warranty liability and adjusts the amounts as necessary.

Changes in the Company's warranty liability were approximately as follows:

	Six Months Ended December 31, 2017	Fiscal Year Ended June 30, 2017
Beginning warranty reserve	\$ 640,000	\$ 660,000
Accrual for products sold	108,000	129,000
Expenditures and costs incurred for warranty claims	(78,000)	(149,000)
Ending warranty reserve	<u>\$ 670,000</u>	<u>\$ 640,000</u>

Note 5. Income Taxes

On December 22, 2017, the U.S. government enacted comprehensive tax legislation commonly referred to as the Tax Cuts and Jobs Act (the "Tax Act"). The Tax Act significantly revises future and ongoing U.S. corporate tax obligations by, among other things, lowering U.S. corporate income tax rates. Since the Company has a June 30 fiscal year-end, the lower corporate income tax rate will be phased in, resulting in a blended U.S. statutory federal rate of approximately 28% for fiscal 2018, and 21% for subsequent fiscal years. The Tax Act also eliminates the domestic production manufacturing deduction effective for the Company's tax year beginning July 1, 2018. For the six months ended December 31, 2017, these changes under the Tax Act resulted in a net income tax expense of approximately \$160,000.

On a quarterly basis, the Company estimates its effective tax rate for the full fiscal year and records a quarterly income tax provision based on the anticipated rate. As the year progresses, the Company refines its estimate based on the facts and circumstances by each tax jurisdiction. Income tax expense was estimated at approximately \$416,000 and \$453,000, respectively, and the effective tax rates were 54.4% and 49.1%, respectively, for the three and six months ended December 31, 2017. Estimated income tax expense for the three and six months ended December 31, 2017 includes a discrete deferred tax expense of approximately \$160,000 as a result of re-measuring certain deferred tax assets and liabilities based on the rates at which they are expected to reverse in future periods under the Tax Act. Additionally, a discrete tax benefit of approximately \$2,000 and \$27,000 was recognized during the three and six months ended December 31, 2017, respectively, as a result of greater federal and state research and development tax credits than what was originally estimated in the Company's tax provision for fiscal 2017. The net impact of these discrete events increased the effective tax rate by 20.6% and 14.4% during the three and six months ended December 31, 2017, respectively.

Income tax expense was estimated at \$351,000 and the effective tax rate was 35.6% for the six months ended December 31, 2016. Income tax expense for the six months ended December 31, 2016 included a recognized tax benefit of approximately \$22,000 as a result of the lapse of the statute of limitations on uncertain tax positions, which reduced the effective tax rate for the period by 2.2%.

Note 6. Financing Arrangements

The Company has a credit facility that provides for a revolving line of credit and a term loan. Effective December 18, 2017, the Company renewed its \$2,500,000 revolving line of credit. There was no outstanding principal balance on the line of credit as of December 31, 2017 or June 30, 2017. Interest on borrowings under the line of credit, if any, would accrue at the prime rate less 0.25% (4.25% at December 31, 2017) and is payable monthly. The amount eligible for borrowing on the line of credit is limited to the lesser of \$2,500,000 or 57.00% of eligible accounts receivable and the line of credit expires on December 18, 2018, if not renewed. At December 31, 2017, the maximum \$2,500,000 was eligible for borrowing. The line of credit is secured by a security interest in substantially all of the tangible and intangible assets of the Company.

In connection with the credit facility, the Company also has a term loan, which had an outstanding principal balance of approximately \$1,129,000 at December 31, 2017 and \$1,154,000 as of June 30, 2017. The term loan was refinanced effective December 18, 2016, reducing the interest rate from 5.00% to 3.88%. The unamortized debt issuance cost associated with this debt was approximately \$4,000 and \$6,000 as of December 31, 2017 and June 30, 2017, respectively. The term loan bears interest at 3.88%, with monthly payments of principal and interest of approximately \$7,900 and a final payment of principal and interest of approximately \$1,085,000 due on the maturity date of December 18, 2018. Payment obligations under the term loan are secured by a mortgage on the Company's real property.

The documents governing the line of credit and term loan contain certain financial and nonfinancial covenants that include a minimum tangible net worth covenant of not less than \$10,125,000 and restrictions on the Company's ability to incur certain additional indebtedness or pay dividends.

Note 7. Stock-Based Compensation

In November 2017, the Company's shareholders approved the 2017 Omnibus Incentive Plan (the "2017 Plan") which supersedes the 2014 Equity Incentive Plan (the "2014 Plan"). The 2017 Plan allows the Company's Board of Directors to grant stock options, stock appreciation rights, restricted stock, restricted stock units and other stock-based awards, as well as cash incentive awards to all employees, non-employee directors, and advisors or consultants of the Company. The vesting schedule and term for each award are determined by the Board upon each grant. The maximum number of shares of common stock available for issuance under the 2017 Plan is 900,000. There were 918,300 options granted under the 2014 Plan and prior plans outstanding as of December 31, 2017. There were no options and 10,000 restricted shares issued under the 2017 Plan outstanding and 890,000 available for grant under the 2017 Plan as of December 31, 2017.

The Company recorded approximately \$386,000 and \$235,000 of compensation expense related to current and past grants of stock options and restricted stock for the six months ended December 31, 2017 and 2016, respectively. This expense is included in selling, general and administrative expense. As of December 31, 2017, approximately \$1,026,000 of total unrecognized compensation expense related to non-vested equity awards is expected to be recognized over a weighted average period of approximately 0.9 years.

The Company recognizes compensation expense related to share-based payment transactions in the financial statements based on the estimated fair value of the award issued. The fair value of each option is estimated using the Black-Scholes pricing model at the time of award grant. The Company estimates the expected life of options based on the expected holding period by the option holder. The risk-free interest rate is based upon observed U.S. Treasury interest rates for the expected term of the options. The Company makes assumptions with respect to expected stock price volatility based upon the volatility of its stock price. Forfeitures are estimated at the time of grant and revised in subsequent periods if actual forfeitures differ from initial estimates. Forfeitures are estimated based on the percentage of awards expected to vest, taking into consideration the seniority level of the award recipient.

The following assumptions were used to estimate the fair value of options granted:

	Six Months Ended December 31, 2017	Fiscal Year Ended June 30, 2017
Risk-free interest rate	1.77% - 2.07%	1.14% - 1.27%
Expected term (years)	6	6
Expected volatility	125.2% - 141.2%	100.5% - 105.8%

Stock Options

The Company issued 182,250 stock options pursuant to the 2014 Plan during the six months ended December 31, 2017. Stock option transactions during the six months ended December 31, 2017 are summarized as follows:

	Number of Shares	Weighted Average Exercise Price per Share
Outstanding at June 30, 2017	747,634	\$ 2.91
Granted	182,250	\$ 5.64
Exercised	—	—
Cancelled or Forfeited	(11,584)	\$ 3.51
Outstanding at December 31, 2017	<u>918,300</u>	<u>\$ 3.44</u>

The intrinsic value of an option is the amount by which the fair value of the underlying stock exceeds its exercise price. At December 31, 2017, the weighted average remaining contractual term for all outstanding stock options was 5.70 years and their aggregate intrinsic value was approximately \$2,817,000. Outstanding at December 31, 2017 were 918,300 stock options issued to employees, of which 586,303 were exercisable and had an aggregate intrinsic value of approximately \$2,178,000.

Restricted Stock

The 2017 Plan permits, and the 2014 Plan permitted, the grant of other stock-based awards. Historically, the Company makes restricted stock grants to key employees and non-employee directors that vest over six months to three years.

During the six months ended December 31, 2017, the Company issued restricted stock awards to employees totaling 40,000 shares of common stock, with a vesting term of one to three years and a fair value of \$5.59 per share. The restricted stock's fair value per share represents the closing price of the Company's common stock on the date the grants were made. Restricted stock transactions during the six months ended December 31, 2017 are summarized as follows:

	Number of Shares	Weighted Average Grant Date Fair Value per Share
Unvested shares at June 30, 2017	29,998	\$ 3.15
Granted	40,000	\$ 5.59
Vested	—	—
Forfeited	—	—
Unvested at December 31, 2017	<u>69,998</u>	<u>\$ 4.54</u>

Note 8. Commitments and Contingencies

The Company is occasionally involved in claims and disputes arising in the ordinary course of business. The Company insures its business risks where possible to mitigate the financial impact of individual claims, and establishes reserves for an estimate of any probable cost of settlement or other disposition.

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our condensed financial statements and related notes thereto included in Item 1 of Part I of this Quarterly Report on Form 10-Q and the audited financial statements, related notes thereto and Management’s Discussion and Analysis of Financial Condition and Results of Operations contained in our Annual Report on Form 10-K for the fiscal year ended June 30, 2017, or “fiscal 2017.”

Overview

Electromed, Inc. (“we,” “our,” “us,” “Electromed” or the “Company”) develops and provides innovative airway clearance products applying High Frequency Chest Wall Oscillation (“HFCWO”) technologies in pulmonary care for patients of all ages.

We manufacture, market and sell products that provide HFCWO, including the SmartVest® Airway Clearance System (“SmartVest System”) that includes our newest generation SmartVest SQL® and previous generation SV2100, and related products, to patients with compromised pulmonary function. The SmartVest SQL is smaller, quieter and lighter than our previous product, with enhanced programmability and ease of use. Our products are sold in both the home health care market and the institutional market for use by patients in hospitals, which we refer to as “institutional sales.” The SmartVest SQL has been sold in the domestic home care market since the fiscal quarter ended March 31, 2014. In the fourth quarter of our fiscal year ended June 30, 2015, we launched the SmartVest SQL into the institutional and certain international markets. During February 2017, we entered into an agreement with Monaghan Medical Corporation to distribute and sell the Aerobika® Oscillating Positive Expiratory Pressure (OPEP) Device in the U.S. home care market. In June 2017, we announced the launch of the SmartVest SQL with SmartVest Connect™ wireless technology, which allows data connection between physicians and patients to track therapy performance and collaborate in treatment decisions. SmartVest Connect is currently available to pediatric and cystic fibrosis patients and was made available to certain targeted adult pulmonary clinics starting in November 2017. Since 2000, we have marketed the SmartVest System and its predecessor products to patients suffering from cystic fibrosis, bronchiectasis and repeated episodes of pneumonia. Additionally, we offer our products to a patient population that includes neuromuscular disorders such as cerebral palsy, muscular dystrophies, amyotrophic lateral sclerosis (“ALS”), the combination of emphysema and chronic bronchitis commonly known as chronic obstructive pulmonary disease (“COPD”), and patients with post-surgical complications or who are ventilator dependent or have other conditions involving excess secretion and impaired mucus transport.

The SmartVest System is often eligible for reimbursement from major private insurance providers, health maintenance organizations (“HMOs”), state Medicaid systems, and the federal Medicare system, which is an important consideration for patients considering an HFCWO course of therapy. For domestic sales, the SmartVest System may be reimbursed under the Medicare-assigned billing code for HFCWO devices if the patient has cystic fibrosis, bronchiectasis (including chronic bronchitis or COPD that has resulted in a diagnosis of bronchiectasis), or any one of certain enumerated neuromuscular diseases, and can demonstrate that another less expensive physical or mechanical treatment did not adequately mobilize retained secretions. Private payers consider a variety of sources, including Medicare, as guidelines in setting their coverage policies and payment amounts.

Critical Accounting Policies and Estimates

For a description of our critical accounting policies, estimates and assumptions used in the preparation of our financial statements, including the condensed financial statements in this report, see Part II, Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” and Note 1 to our audited financial statements, included in Part II, Item 8, of our Annual Report on Form 10-K for fiscal 2017.

Some of our accounting policies require us to exercise significant judgment in selecting the appropriate assumptions for calculating financial statements. Such judgments are subject to an inherent degree of uncertainty. These judgments are based upon our historical experience, known trends in our industry, terms of existing contracts and other information from outside sources, as appropriate. We believe the critical accounting policies that require the most significant assumptions and judgments in the preparation of our financial statements, including the condensed financial statements in this report, include: revenue recognition and the estimation of selling price adjustments, allowance for doubtful accounts, inventory obsolescence, share-based compensation, income taxes and warranty liability.

Results of Operations

Revenues

Revenue for the three and six month periods ended December 31, 2017 and 2016 are summarized in the table below (dollar amounts in thousands).

	Three Months Ended December 31,			Change	Six Months Ended December 31,			Change
	2017	2016			2017	2016		
Total Revenue	\$ 6,985	\$ 6,372	\$ 613	9.6%	\$ 13,367	\$ 11,918	\$ 1,449	12.2%
Home Care Revenue	6,506	5,502	1,004	18.2%	12,486	10,635	1,851	17.4%
Institutional Revenue	313	605	(292)	(48.3%)	614	951	(337)	(35.4%)
International Revenue	166	265	(99)	(37.4%)	267	332	(65)	(19.6%)

Home Care Revenue. Home care revenue for the three months ended December 31, 2017 was approximately \$6,506,000, an increase of approximately \$1,004,000 compared to the same period in fiscal 2017, or 18.2%. For the six months ended December 31, 2017, home care revenue was approximately \$12,486,000, an increase of approximately \$1,851,000, or 17.4%, compared to the same period in fiscal 2017. During the three months ended December 31, 2016, home care revenue was negatively impacted by the retroactive repayment of previously collected and recognized revenue to a state Medicaid program totaling approximately \$212,000. The repayment resulted from the state Medicaid program's reinterpretation of its reimbursement process and a reduction in its allowable payments. We believe that the repayment was a one-time event and is not reflective of other state Medicaid reimbursement processes.

After taking into consideration the negative impact of the retroactive repayment during the three months ended December 31, 2016, home care revenue for the three months ended December 31, 2017 increased predominantly due to growth in approvals as a result of continued improvements in our reimbursement operations that led to a greater referral to approval percentage as compared to the prior year. The increase in home care revenue for the six months ended December 31, 2017 was primarily driven by a greater referral to approval percentage and a higher level of referrals as compared to the prior year. The increase in referrals was primarily due to growth in the number of field sales employees as compared to the comparable prior year period.

Institutional Revenue. Institutional revenue for the three and six months ended December 31, 2017 was approximately \$313,000 and \$614,000, respectively, representing a decrease of approximately \$292,000 and \$337,000, or 48.3% and 35.4%, compared to the same periods in fiscal 2017. The decrease in revenue for the three and six months ended December 31, 2017 was due to a decrease in the number of units and single patient use garments sold compared to the same periods in the prior year. Institutional revenue includes sales to distributors, group purchasing organization ("GPO") members and other institutions.

International Revenue. International revenue for the three months ended December 31, 2017 was approximately \$166,000, representing a decrease of approximately \$99,000, or 37.4%, compared to the same period in fiscal 2017. For the six months ended December 31, 2017, international revenue was approximately \$267,000, a decrease of approximately \$65,000, or 19.6%, from the same period in fiscal 2017. International sales are affected by the timing of distributor purchases that can cause significant fluctuations in reported revenue on a quarterly basis.

Gross profit

Gross profit increased to approximately \$5,587,000, or 80.0% of net revenues, for the three months ended December 31, 2017, from approximately \$4,926,000, or 77.3% of net revenues, in the same period in fiscal 2017. Gross profit increased to approximately \$10,523,000, or 78.7% of net revenues, for the six months ended December 31, 2017, from approximately \$9,254,000, or 77.7% of net revenues, in the same period in fiscal 2017. The increase in gross profit for the three and six months ended December 31, 2017 was primarily related to increases in domestic home care revenue. The increase in gross profit as a percentage of net revenue was driven by a higher level of net revenue recognized per new device placement as compared to the prior year, which was partially offset by the additional costs to manufacture the SmartVest SQL with SmartVest Connect™ wireless technology. Additionally, gross profit for the three and six months ended December 31, 2016 was negatively impacted by the retroactive repayment of previously collected and recognized revenue to a state Medicaid program totaling approximately \$212,000.

Operating expenses

Selling, general and administrative expenses. Selling, general and administrative (“SG&A”) expenses were approximately \$4,760,000 and \$9,463,000 for the three and six months ended December 31, 2017, respectively, representing an increase of approximately \$664,000 and \$1,679,000, or 16.2% and 21.6%, respectively, compared to the same periods in the prior year.

Payroll and compensation-related expenses were approximately \$2,712,000 and \$5,398,000 for the three and six months ended December 31, 2017, respectively, representing an increase of approximately \$362,000 and \$1,011,000, or 15.4% and 23.0%, respectively, compared to the same periods in the prior year. The increases in the current year periods were due to additional employees in sales, annual salary increases, higher share-based equity compensation expense, and additional sales incentives on higher revenue accruals.

Professional fees for the three and six months ended December 31, 2017 were approximately \$516,000 and \$1,016,000, respectively, an increase of approximately \$191,000 and \$344,000, or 58.8% and 51.2%, respectively, compared to the same periods in the prior year. These fees are primarily for services related to legal costs, shareowner services and reporting requirements, general and administrative temporary labor, information technology (“IT”) security and backup, and consulting fees for sales training. The increase in professional fees was primarily due to increases in general and administrative temporary labor, IT, legal costs and consulting fees.

Recruiting fees for the three and six months ended December 31, 2017 were approximately \$133,000 and \$298,000, respectively, an increase of approximately \$46,000 and \$140,000, or 52.9% and 88.6%, respectively, compared to the same period in the prior year. The increase in recruiting fees was due primarily to adding more employees in sales and administrative roles as compared to the prior year.

Travel, meals and entertainment expenses were approximately \$537,000 and \$1,014,000 for the three and six months ended December 31, 2017, respectively, representing an increase of approximately \$123,000 and \$159,000, or 29.7% and 18.6%, respectively, compared to the same periods in the prior year. The increase was due primarily to additional sales personnel.

SG&A expenses included a loss on the abandonment of certain domestic and foreign patents with net values of approximately \$111,000 during both the three and six months ended December 31, 2016. No losses on the abandonment of patents were recognized during the three and six months ended December 31, 2017.

Research and development expenses. Research and development (“R&D”) expenses were approximately \$57,000 and \$127,000 for the three and six months ended December 31, 2017, respectively, representing an decrease of approximately \$44,000 and \$325,000 compared to the same periods in the prior year. R&D expenses for the three and six months ended December 31, 2017 were 0.8% and 1.0% of revenue, respectively, compared to 1.6% and 3.8% of revenue for the same periods in the prior year. During the fiscal year ended June 30, 2016, we began developing SmartVest Connect, a new wireless connectivity feature for our HFCWO device which allows data connection between physicians and patients. We believe SmartVest Connect will strengthen our patient and clinician partnerships, leading to greater therapy adherence and improved quality of life for individuals with compromised pulmonary function. We launched this feature in June 2017. As a percentage of net revenues, we expect spending on R&D expenses to remain consistent through the remainder of our fiscal year ending June 30, 2018. Certain expenses related to our innovation investments are not always captured in R&D expenses. These expenses may be included in cost of sales as in the case of depreciation of tooling, or for SG&A, in the case of professional fees or higher labor expenses, as we improve our internal processes or enhance our customer service.

Interest expense

Interest expense, net, was approximately \$5,000 and \$9,000 for the three and six months ended December 31, 2017, respectively, compared to \$16,000 and \$32,000 in the same periods in the prior year. The decrease in net interest expense during both the three and six months ended December 31, 2017 as compared to the prior year was driven by an increase in interest income, a lower effective interest rate on outstanding borrowings, lower deferred financing costs and a lower level of debt as compared to the prior year.

Income tax expense

Income tax expense was estimated at approximately \$416,000 and \$453,000 and the effective tax rates were 54.4% and 49.1%, respectively, for the three and six months ended December 31, 2017. Estimated income tax expense for the three and six months ended December 31, 2017 includes a discrete deferred tax expense of approximately \$160,000 as a result of re-measuring certain deferred tax assets and liabilities based on the rates at which they are expected to reverse in future periods under the Tax Cuts and Jobs Act (the "Tax Act") that was enacted by the U.S. federal government on December 22, 2017. Additionally, a discrete tax benefit of approximately \$2,000 and \$27,000 was recognized during the three and six months ended December 31, 2017, respectively, as a result of greater federal and state R&D tax credits than what was originally estimated in our tax provision for fiscal 2017. The net impact of these discrete events increased the effective tax rate by 20.6% and 14.4% during the three and six months ended December 31, 2017, respectively.

Income tax expense was estimated at approximately \$270,000 and \$351,000 and the effective tax rates were 37.8% and 35.6%, respectively, for the three and six months ended December 31, 2016. Income tax expense during the six months ended December 31, 2016 includes a recognized tax benefit of approximately \$22,000 as a result of the lapse of the statute of limitations on uncertain tax positions, which reduced the effective tax rate by 2.2% for that period.

Net income

Net income for the three and six months ended December 31, 2017 was approximately \$349,000 and \$470,000, respectively, compared to net income of approximately \$444,000 and \$635,000 for the same periods in the prior year. The year-over-year decrease in net income was driven primarily by higher SG&A expenses related to hiring additional new employees, which was partially offset by an increase in gross profit driven by higher revenue and lower R&D expenses as compared to the prior year. Additionally, net income for the three and six months ended December 31, 2017 was affected by discrete tax events including the \$160,000 re-measurement of certain deferred tax assets and liabilities.

Liquidity and Capital Resources

Cash Flows and Sources of Liquidity

Cash Flows from Operating Activities

For the six months ended December 31, 2017, net cash provided by operating activities was approximately \$1,530,000. Cash flows provided by operating activities consisted of net income of approximately \$470,000, non-cash expenses of \$820,000 and decreases in accounts receivable, inventory and prepaid expenses and other assets of \$269,000, \$184,000 and \$9,000, respectively. These cash flows from operating activities were offset by a decrease in accounts payable and accrued liabilities of approximately \$150,000 and a decrease in income tax payable of \$72,000.

For the six months ended December 31, 2016, net cash provided by operating activities was approximately \$39,000. Cash flows provided by operating activities consisted of net income of approximately \$635,000, non-cash expenses of \$741,000, a decrease in prepaid expenses and other assets of \$7,000 and a decrease in income tax receivable of \$190,000. These cash flows from operating activities were offset by a decrease of approximately \$807,000 in accounts payable and accrued liabilities, an increase in accounts receivable of \$673,000 and an increase in inventory of \$54,000.

Cash Flows from Investing Activities

For the six months ended December 31, 2017, cash used in investing activities was approximately \$238,000. Cash used in investing activities consisted of approximately \$228,000 in expenditures for property and equipment and \$10,000 in payments for patent costs.

For the six months ended December 31, 2016, cash used in investing activities was approximately \$312,000. Cash used in investing activities consisted of approximately \$267,000 in expenditures for property and equipment and \$45,000 in payments for patent costs. The expenditures for property and equipment consisted primarily of costs associated with the development of software associated with SmartVest Connect.

Cash Flows from Financing Activities

For the six months ended December 31, 2017, cash used in financing activities was approximately \$25,000, which consisted of principal payments on long-term debt.

For the six months ended December 31, 2016, cash used in financing activities was approximately \$29,000, which consisted of principal payments on long-term debt of \$24,000 and payments of deferred financing fees of \$5,000.

Adequacy of Capital Resources

Our primary working capital requirements relate to adding employees to our sales force and support functions, continuing R&D efforts, and supporting general corporate needs, including financing equipment purchases and other capital expenditures incurred in the ordinary course of business. Based on our recent operational performance, we believe our working capital of approximately \$15,515,000 as of December 31, 2017 and available borrowings under our existing credit facility will provide adequate liquidity for the next year.

Effective December 18, 2017, we renewed our credit facility, which provides us with a revolving line of credit and a term loan. Interest on borrowings on the line of credit accrues at the prime rate less 0.25% and is payable monthly. The amount eligible for borrowing on the line of credit is limited to the lesser of \$2,500,000 or 57.00% of eligible accounts receivable, and the line of credit expires on December 18, 2018, if not renewed. At December 31, 2017, the maximum \$2,500,000 was available under the line of credit and the applicable interest rate (the prime rate) was 4.50%. Payment obligations under the line of credit are secured by a security interest in substantially all of our tangible and intangible assets.

In connection with the credit facility, we also have a term loan, which had an outstanding principal balance of approximately \$1,129,000 at December 31, 2017 and \$1,154,000 as of June 30, 2017. The term loan was refinanced effective December 18, 2016, reducing the interest rate from 5.00% to 3.88%. The unamortized debt issuance cost associated with this debt was approximately \$4,000 and \$6,000 as of December 31, 2017 and June 30, 2017, respectively. The term loan bears interest at 3.88%, with monthly payments of principal and interest of approximately \$7,900 and a final payment of principal and interest of approximately \$1,085,000 due on the maturity date of December 18, 2018. Payment obligations under the term loan are secured by a mortgage on our real property.

The documents governing our line of credit and term loan contain certain financial and nonfinancial covenants that include a minimum tangible net worth of not less than \$10,125,000 and restrictions on our ability to incur certain additional indebtedness or pay dividends. We were in compliance with these covenants as of December 31, 2017.

Any failure to comply with these covenants in the future may result in an event of default, which if not cured or waived, could result in the lender accelerating the maturity of our indebtedness, preventing access to additional funds under the line of credit and/or term loan, requiring prepayment of outstanding indebtedness under either arrangement, or refusing to renew the line of credit. If the maturity of the indebtedness is accelerated or the line of credit is not renewed, sufficient cash resources to satisfy the debt obligations may not be available and we may not be able to continue operations as planned. The indebtedness under the line of credit and term loan are secured by a security interest in substantially all of our tangible and intangible assets and a mortgage on our real property, respectively. If we are unable to repay such indebtedness, the lender could foreclose on these assets.

For the six months ended December 31, 2017 and 2016, we spent approximately \$228,000 and \$267,000, respectively, on property and equipment. We currently expect to finance planned equipment purchases with cash flows from operations or borrowings under our credit facility. We may need to incur additional debt if we have an unforeseen need for additional capital equipment or if our operating performance does not generate adequate cash flows.

Off-Balance Sheet Arrangements

As of December 31, 2017, we had no off-balance sheet arrangements.

Cautionary Note Regarding Forward-Looking Statements

Statements contained in this Quarterly Report on Form 10-Q that are not statements of historical fact should be considered forward-looking statements within the meaning of the safe harbor provisions of Section 27A of the Securities Act of 1933, as amended (the “Securities Act”), and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). Forward-looking statements include, but are not limited to, statements regarding the following: our business strategy, including our intended level of investment in R&D and marketing activities; our expectations with respect to earnings, gross margins and sales growth, industry relationships, marketing strategies, distribution agreements with third parties and international sales; our business strengths and competitive advantages; our plans and expectations with respect to international sales growth; our intent to retain any earnings for use in operations rather than paying dividends; our expectation that our products will continue to qualify for reimbursement and payment under government and private insurance programs; our intellectual property plans and practices; the expected impact of applicable regulations on our business, including, but not limited to, the Tax Act; our beliefs about our manufacturing processes; our expectations and beliefs with respect to our employees and our relationships with them; our belief that our current facilities are adequate to support our growth plans; our expectations with respect to ongoing compliance with the terms of our credit facility; our expectations regarding the ongoing availability of credit and our ability to renew our line of credit; the expansion and availability of our SmartVest Connect technology; and our anticipated revenues, expenses, capital requirements and liquidity. Words such as “anticipate,” “believe,” “continue,” “could,” “estimate,” “expect,” “goal,” “intend,” “may,” “ongoing,” “plan,” “potential,” “project,” “should,” “target,” “will,” “would,” and similar expressions, including the negative of these terms, are intended to identify forward-looking statements but are not the exclusive means of identifying such statements. Although we believe these forward-looking statements are reasonable, they involve risks and uncertainties that may cause actual results to differ materially from those projected by such statements. Such statements involve known and unknown risks, uncertainties and other factors that may cause our actual results or our industry’s actual results, levels of activity, performance or achievements to be materially different from the information expressed or implied by the forward-looking statements.

Factors that could cause actual results to differ from those discussed in the forward-looking statements include, but are not limited to:

- the competitive nature of our market;
- changes to Medicare, Medicaid, or private insurance reimbursement policies;
- changes to health care laws;
- changes affecting the medical device industry;
- our need to maintain regulatory compliance and to gain future regulatory approvals and clearances;
- new drug or pharmaceutical discoveries;
- general economic and business conditions;
- our ability to renew our line of credit or obtain additional credit as necessary;
- our ability to protect and expand our intellectual property portfolio; and
- the risks associated with expansion into international markets.

This list of factors is not exhaustive, however, and these or other factors, many of which are outside of our control, could have a material adverse effect on us and our results of operations. Therefore, you should consider these risk factors with caution and form your own critical and independent conclusions about the likely effect of these risk factors on our future performance. Forward-looking statements speak only as of the date on which the statements are made, and we undertake no obligation to update any forward-looking statement for any reason, even if new information becomes available or other events occur in the future. You should carefully review the disclosures and the risk factors described in this and other documents we file from time to time with the Securities and Exchange Commission (the “SEC”), including our Annual Report on Form 10-K and subsequent reports we file with the SEC. All forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by the cautionary statements set forth herein.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

As a smaller reporting company, we are not required to provide disclosure pursuant to this Item.

Item 4. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

Our principal executive officer and principal financial officer evaluated the effectiveness of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) promulgated under the Exchange Act, as of the end of the period subject to this Quarterly Report on Form 10-Q. Based on this evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures were effective as of the date of such evaluation to provide reasonable assurance that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified by the SEC’s rules and forms.

Changes to Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting that occurred during the six months ended December 31, 2017 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II – OTHER INFORMATION

Item 1. Legal Proceedings.

Occasionally, we may be party to legal actions, proceedings, or claims in the ordinary course of business, including claims based on assertions of patent and trademark infringement. Corresponding costs are accrued when it is probable that loss will be incurred and the amount can be precisely or reasonably estimated. We are not aware of any undisclosed actual or threatened litigation that would have a material adverse effect on our financial condition or results of operations.

Item 1A. Risk Factors.

As a smaller reporting company, we are not required to provide disclosure pursuant to this Item.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

None.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Mine Safety Disclosures.

None.

Item 5. Other Information.

None.

Item 6. Exhibits.

Unless otherwise indicated, all documents incorporated into this Quarterly Report on Form 10-Q by reference to a document filed with the SEC pursuant to the Exchange Act are located under SEC file number 001-34839.

Exhibit Number	Description	Method of Filing
3.1	Composite Articles of Incorporation, as amended through November 8, 2010 (incorporated by reference to Exhibit 3.1 to Annual Report on Form 10-K for the fiscal year ended June 30, 2015)	Incorporated by Reference
3.2	Composite Bylaws, as amended through June 30, 2012 (incorporated by reference to Exhibit 3.2 to Annual Report on Form 10-K for the fiscal year ended June 30, 2015)	Incorporated by Reference
10.1	Electromed, Inc. 2017 Omnibus Incentive Plan (incorporated by reference to Exhibit 99.1 to Registration Statement on Form S-8 filed December 4, 2017)	Incorporated by Reference
10.2	Rider to Business Loan Agreement (Asset Based) with Venture Bank, dated December 18, 2017 (incorporated by reference to Exhibit 10.1 to Current Report on Form 8-K filed December 12, 2017)	Incorporated by Reference
10.3	Change in Terms Agreement with Venture Bank, dated December 18, 2017 (incorporated by reference to Exhibit 10.2 to Current Report on Form 8-K filed December 12, 2017)	Incorporated by Reference
<u>31.1</u>	<u>Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u>	Filed Electronically
<u>31.2</u>	<u>Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u>	Filed Electronically
<u>32.1</u>	<u>Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</u>	Filed Electronically
<u>32.2</u>	<u>Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</u>	Filed Electronically
101	Financial statements from the Quarterly Report on Form 10-Q for the period ended December 31, 2017, formatted in XBRL: (i) Condensed Balance Sheets, (ii) Condensed Statements of Income, (iii) Condensed Statements of Cash Flows, and (iv) Notes to Condensed Financial Statements	Filed Electronically

SIGNATURES

Pursuant to the requirements 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.

ELECTROMED, INC.

Date: February 13, 2018

/s/ Kathleen S. Skarvan

Kathleen S. Skarvan, President and Chief Executive Officer
(duly authorized officer)

Date: February 13, 2018

/s/ Jeremy T. Brock

Jeremy T. Brock, Chief Financial Officer
(principal financial officer and principal accounting officer)

Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Kathleen S. Skarvan, certify that:

1. I have reviewed this report on Form 10-Q of Electromed, Inc.;
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 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: February 13, 2018

/s/ Kathleen S. Skarvan

Kathleen S. Skarvan
President and Chief Executive Officer

Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Jeremy T. Brock, certify that:

1. I have reviewed this report on Form 10-Q of Electromed, Inc.;
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 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: February 13, 2018

/s/ Jeremy T. Brock

Jeremy T. Brock
Chief Financial Officer

**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 Quarterly Report of Electromed, Inc. (the "Company") on Form 10-Q for the quarter ended December 31, 2017, as filed with the Securities and Exchange Commission (the "Report"), I, Kathleen S. Skarvan, President and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: February 13, 2018

/s/ Kathleen S. Skarvan

Kathleen S. Skarvan

President and Chief Executive Officer

**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 Quarterly Report of Electromed, Inc. (the "Company") on Form 10-Q for the quarter ended December 31, 2017, as filed with the Securities and Exchange Commission (the "Report"), I, Jeremy T. Brock, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: February 13, 2018

/s/ Jeremy T. Brock

Jeremy T. Brock
Chief Financial Officer
