

# 2018 CEO Letter to Shareholders

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

## To My Fellow Shareholders



Fiscal 2018 was marked by several exciting milestones, as well as some insightful lessons, as we increased our investment in Electromed's business with the aim of serving a greater number of patients with our SmartVest® Airway Clearance System. Higher spending on growth initiatives across sales, marketing and reimbursement functions drove higher SG&A expense throughout the year, yet we remained profitable and generated significant operating cash flow. With the investments initiated in Fiscal 2018, Electromed has emerged a larger, stronger organization and we plan to deliver

profitable revenue growth in Fiscal 2019.

Underpinning our enthusiasm for long-term, sustainable profitable growth is the largest opportunity for our airway clearance therapy, patients with non-cystic fibrosis bronchiectasis ("NCFB"). NCFB is a chronic, progressive disease resulting in failure to clear sputum leading to inflammation that results in progressive destruction of the normal lung architecture—in particular, the elastic fibers of bronchi. Bronchiectasis patient prevalence is growing at approximately nine percent annually. Guided by our patient-centric mission of *making life's important moments possible—one breath at a time*®, we plan to grow annually at a faster rate.

### Fiscal 2018 financial highlights:

- Net revenues increased 11.0% to \$28.7 million from \$25.9 million in fiscal 2017;
- Gross profit rose 11.1% to \$22.9 million, or 79.6% of net revenues, from \$20.6 million, or 79.5% of net revenues, in fiscal 2017; and
- Cash flow from operating activities approximately doubled to \$2.4 million from \$1.2 million in fiscal 2017.

In fiscal 2018, we achieved several key milestones:

- **Longitudinal Bronchiectasis Outcomes-Based Study** – In support of our longer-term sales growth strategy, we expanded the body of clinical evidence with the publication of a longitudinal bronchiectasis outcomes-based study for High Frequency Chest Wall Oscillation ("HFCWO") therapy, the first of its kind. Published in the Spring 2018 issue of *Respiratory Therapy*, our study builds on previously published evidence and demonstrates that improved outcomes for bronchiectasis patients can be sustained 2.5 years after starting SmartVest HFCWO treatment.<sup>1</sup>
- **World Bronchiectasis Conference Abstract** – Similarly, in July 2018, during the third annual World Bronchiectasis Conference in Washington D.C., we announced the first independent study that suggests SmartVest HFCWO therapy significantly reduces severe exacerbations and hospitalizations—and may meaningfully slow the otherwise normal progression of NCFB. Compelling outcomes, such as stabilization of lung function, highlight the potential of SmartVest to improve quality of life for our patients.
- **SmartVest Connect®** – We expanded shipments of SmartVest Connect, our innovative wireless and patient monitoring solution, to select adult pulmonology clinics. We believe SmartVest Connect's unique patient-monitoring features, ease-of-use and comfort, along with our dedication to customer service, are distinguishing Electromed in the marketplace.

1. Sievert, CE et al. 2018. Incidence of Bronchiectasis-Related Exacerbation Rates After High Frequency Chest Wall Oscillation (HFCWO) Treatment — A Longitudinal Outcome-Based Study. *Respiratory Therapy*, 13(2), 30-33.

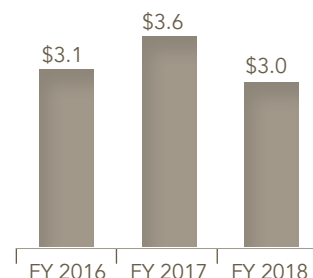
## Revenue

(in millions)



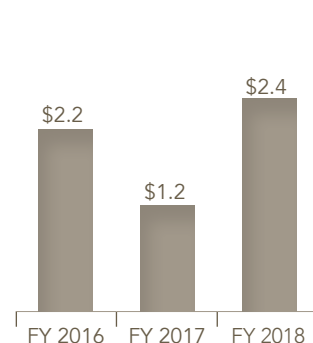
## Operating Income

(in millions)



## Operating Cash Flow

(in millions)



## 2018 CEO Letter to Shareholders, continued

Sales growth, however, did not meet our expectations in fiscal 2018 as it took longer than anticipated for the benefits of our expanded sales force investments to materialize. We took decisive actions and exited the year with clear signs that our investments are beginning to pay off. Fourth quarter home care sales grew 14.8% year-over-year even with a \$703,000 favorable CMS settlement agreement in the prior year period.

### The Bronchiectasis Opportunity

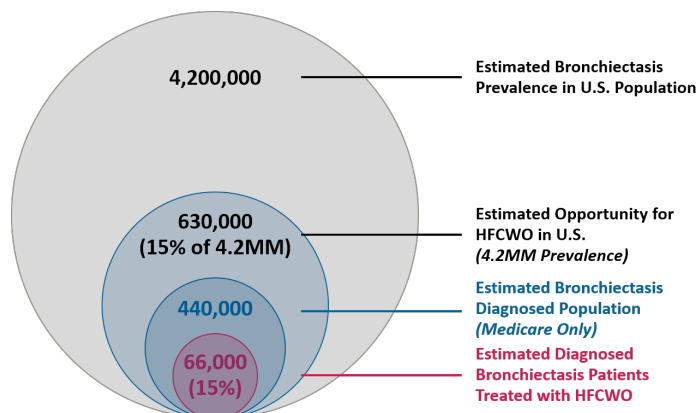
We remain focused on the significant opportunity to serve the aging U.S. population, which is experiencing higher incidences of chronic lung diseases. Bronchiectasis is experiencing a surge in clinical interest and awareness, including the relationship to COPD, commonly referred to as bronchiectasis COPD overlap syndrome ("BCOS"). Third-party studies have found that the overlap between bronchiectasis and COPD ranges from 20% to 57%, of the approximately 16 million to 24 million cases of chronic obstructive pulmonary disease ("COPD").

An independent study estimated that, as of 2013 approximately 4.2 million adults over 40 years of age in the United States may have bronchiectasis, suggesting there may be a large pool of patients with the undiagnosed disease. Using this figure as baseline, we estimate the market opportunity for HFCWO in the United States may be 630,000 units, which compares to an estimate of only 66,000 patients treated with HFCWO therapy to date.

### **Estimated HFCWO Market Opportunity - Bronchiectasis Patients (U.S.)**

To address this exciting market opportunity, in the coming fiscal year we plan to:

- > focus on increasing referrals in the largest, fastest growing segments: adult pulmonology/bronchiectasis;
- > increase sales productivity through deeper clinic penetration and market share growth;
- > enhance reimbursement support to provide best-in-class customer care;
- > expand and promulgate the body of clinical evidence to increase utilization of SmartVest for patients with bronchiectasis;
- > continue to develop innovative device features that appeal to patients; and
- > grow institutional market share to support home care growth.



Our growth is dependent on not only gaining market share but also expanding this large, developing market opportunity for HFCWO for bronchiectasis. In Fiscal 2019, we plan to evaluate additional sales channels with a focus on accelerating growth, including a potential hybrid sales strategy utilizing selected Homecare Medical Equipment ("HME") distributors.

In conclusion, I would like to thank our employees and clinicians for once again this year enabling us to improve quality of life and outcomes for a greater number of patients with compromised pulmonary function, while reducing overall healthcare utilization, through the use of SmartVest airway clearance therapy. I also would like to thank you, our shareholders, for your continued support as we execute our strategic plan for Electromed. We are very excited about our prospects for revitalized profitable growth in the coming year.

Sincerely,

Kathleen S. Skarvan  
President and CEO



## 2018 CEO Letter to Shareholders, continued

### **Forward-Looking Statements**

*Certain statements contained in this letter that are not statements of historical fact should be considered forward-looking statements within the meaning of the U.S. Private Securities Litigation Reform Act of 1995. Forward-looking reflect 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, including, but not limited to, statements regarding the future challenges and uncertainties we may face, resulting performance, market opportunities, delivery and market recognition of our value proposition, and goals for fiscal 2019 and beyond. Forward-looking statements can generally be identified by words such as "believe," "estimate," "expect," "may," "plan," "potential," "should," "will," and similar expressions, including the negative of these terms, but they are not the exclusive means of identifying such statements. Forward-looking statements cannot be guaranteed and actual results may vary materially due to the uncertainties and risks, known or unknown associated with such statements. Examples of risks and uncertainties for the Company include, but are not limited to: the competitive nature of our market; risks associated with expansion into international markets; changes to Medicare, Medicaid, or private insurance reimbursement policies; new drug or pharmaceutical discoveries; 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; our ability to protect and expand our intellectual property portfolio; our ability to renew our line of credit or obtain additional credit as necessary; and general economic and business conditions, as well as other factors described from time to time in our reports to the Securities and Exchange Commission. 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.*

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