

2019 CEO Letter to Shareholders

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

To My Fellow Shareholders:



Electromed's fiscal 2019 proved to be a year of transition and success as we helped more patients breathe easier and live better with our SmartVest® Airway Clearance System. We achieved record revenue for the year, capped off with record revenue and profitability in the fourth quarter. We are well positioned for long-term low double-digit revenue growth and improved profitability as we continue to share powerful, individual patient success stories with physicians, leverage a recently published independent bronchiectasis outcomes study featuring the SmartVest System, position our service

as an extension of the clinic office, improve the quality of our referrals and carefully manage our expenses.

Fiscal 2019 financial highlights:

- > Net revenues increased 10.6% to \$31.3 million from \$28.3 million in fiscal 2018;
- > Gross profit rose 9.5% to \$23.8 million, or 76.2% of net revenues, from \$21.8 million, or 76.9% of net revenues, in fiscal 2018;
- > Net income totaled approximately \$2.0 million, or \$0.23 per diluted share, compared to \$1.8 million, or \$0.21 per diluted share, in fiscal 2018; and
- > Cash flows from operating activities were approximately \$2.6 million, compared to \$2.4 million in fiscal 2018.

Transition and Success — Enhanced Sales Productivity

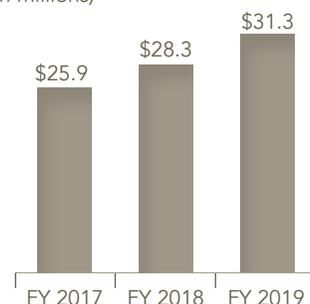
In fiscal 2019 we focused sharply on improving the productivity of our sales force, which at the start of the year fell below levels we deemed acceptable. In the first quarter of fiscal 2019, annualized homecare revenue per average direct field sales employee approximated \$659,000, below our target range of between \$750,000 and \$850,000. We took decisive action, pausing our sales force expansion and implementing a sales restructuring in March 2019 that realigned our sales regions from five to four. Throughout the year, we emphasized strategic high prescribing clinics and homecare referrals from hospitals, while upgrading our sales training programs, improving account planning tools and increasing our customer relationship management ("CRM") utilization. We exited the year with clear evidence that our actions are working, with annualized homecare revenue per average field sales employee totaling \$908,000 during the fourth quarter, well above both our target range and where we commenced the year. While full year profitability did not meet our expectations during this transitional period, we believe our record fourth quarter represents an inflection point for improving profitability and revenue growth entering fiscal 2020.

In fiscal 2019, we made progress in several other key areas:

- > Improved homecare metrics - This year we achieved growth in three critical categories: *referrals*, or prescriptions; *approvals*, or referrals that qualify for insurance coverage; and *referral quality*, or the percent of referrals converting to approvals.

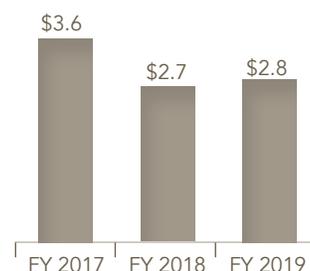
Revenue

(in millions)



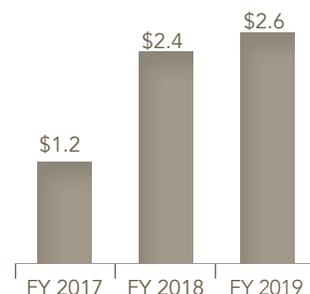
Operating Income

(in millions)



Operating Cash Flow

(in millions)



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- > Increased homecare referrals from institutions - This year we repositioned our sales team's targeted accounts to include a higher number of call points in the hospital setting to encourage hospital inpatient sales as well as prescription of the SmartVest System at the time of patient discharge. As a result, our discharge referrals from hospitals in fiscal 2019 increased by approximately 35% compared to the prior fiscal year.
- > Expanded the body of clinical evidence - In April 2019, *BMC Pulmonary Medicine* published an independent clinical outcomes study conducted by the University of Alabama at Birmingham ("UAB") that concluded use of the SmartVest System as part of a treatment algorithm decreased severe exacerbations, reduced antibiotic use, and stabilized lung function for bronchiectasis patients. We are leveraging this study to create greater physician awareness of the benefits of the SmartVest System and further develop the market. We believe that many pulmonologists are looking for data, such as the UAB study, to support prescribing high frequency chest wall oscillation (HFCWO) therapy.
- > Homecare Medical Equipment ("HME") distributor agreements - In the fourth quarter of fiscal 2019 we entered into agreements with two HME distributors to distribute and sell the SmartVest System in targeted geographies in the United States homecare market. While we intend to continue our direct sales channel as our primary homecare revenue source, engaging select HME distributors supports the need to broaden the SmartVest brand, particularly in geographies where we have low market share.
- > New Board members - Subsequent to the end of fiscal 2019, our Board of Directors elected John Erb and Gregory Fluet to serve as additional Electromed directors. These two highly accomplished executives possess a wealth of medical device industry knowledge and experience that complements the credentials of our other Board members and will be invaluable to Electromed as we execute on our growth strategy.
- > Building expansion project - This year we commenced a building expansion project, completed in September, that will save us over \$130,000 in annual lease expense, while providing us with sufficient infrastructure to support our long-term growth.

The Bronchiectasis Opportunity

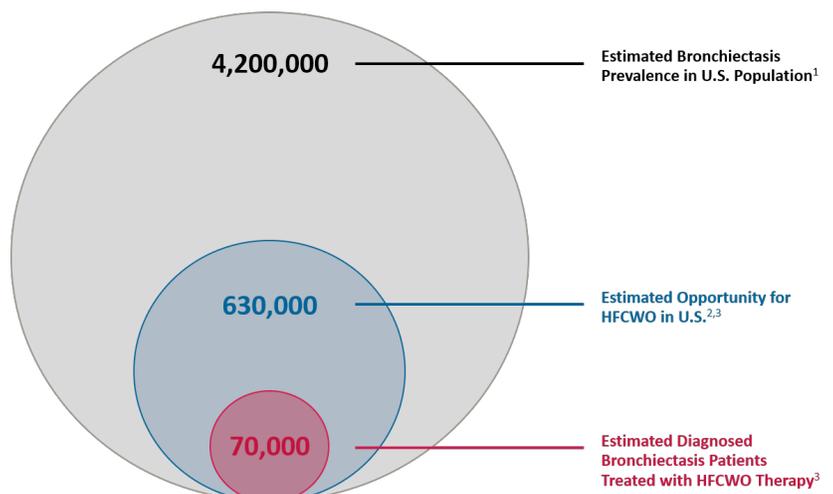
Underpinning our enthusiasm for long-term profitable growth is the largest opportunity for our airway clearance system: patients with non-cystic fibrosis bronchiectasis ("bronchiectasis"). Bronchiectasis is a chronic, progressive disease resulting in failure to clear sputum, leading to inflammation that progressively destroys the normal lung architecture—in particular, the elastic fibers of bronchi. Bronchiectasis patient prevalence is growing at approximately 9% 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. At right is just one of the many compelling patient testimonials we received this year.

"I have been suffering with shortness of breath for approximately three years. I was not able to stand and talk at the same time. I became unable to continue my work as a church pastor because I couldn't get enough breath to preach. There was an instant change with the first treatment. Before the illness attacked my lungs, I was walking from five to seven miles a day. Of course, with my declining breathing ability, I had to stop my daily walks. After a week of using the SmartVest, I have resumed walking. Most days, I only walk about three miles, due to the heat; when the weather cools off, I will set a daily goal of six miles. I feel like I have a second chance at life. By the way, I turned 77 today. I am also working again. Thank you SmartVest."

– Ted, SmartVest System user diagnosed with bronchiectasis

Estimated HFCWO Market Opportunity — Bronchiectasis Patients (U.S.)

It is estimated that the prevalence of bronchiectasis in the United States in 2017 was approximately 4.2 million adults, of which approximately 630,000 individuals, like Ted, could benefit from HFCWO therapy with the SmartVest System. This compares to an estimate of only 70,000 patients treated with HFCWO therapy to date.



1. Weycker D, Hansen G, Seifer F. Prevalence and incidence of non-cystic fibrosis bronchiectasis among US adults in 2013. *Chronic Respiratory Disease*. 2017; 14(4):377-384.

2. Estimate for 2016, extrapolated from "Trends in Bronchiectasis-Among Medicare Beneficiaries in the United States, 2000 to 2007" (Amy E. Seitz, MPH, et al. 2012).

3. Aksamit T.R., et al. Bronchiectasis Research Registry C. Adult Patients With Bronchiectasis: A First Look at the US Bronchiectasis Research Registry. *Chest*. 2017;151:982-92.

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While the market is underpenetrated, bronchiectasis is experiencing a surge in clinical interest and awareness, including the relationship to chronic obstructive pulmonary disease ("COPD"), commonly referred to as bronchiectasis COPD overlap syndrome. In addition to improving quality of life for patients, HFCWO therapy with the SmartVest System reduces the comprehensive cost of care for our healthcare system by keeping patients out of the hospital. We believe the average cost per hospitalization for pneumonia or COPD readmission is approximately \$10,000.

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

- increase referrals in largest, fastest growing segment, adult pulmonology and more specifically, bronchiectasis;
- improve sales productivity through deeper clinic penetration and market share growth;
- enhance patient and provider support to provide best-in-class customer care;
- expand and share the body of clinical evidence to increase utilization of the SmartVest System for patients with bronchiectasis;
- develop innovative device features that appeal to patients; and
- grow institutional market share to support home care growth.

We believe our organic growth strategy will support our goal of low double-digit revenue growth over the next few years. Moreover, combined with our ongoing emphasis on cost-containment, we also expect operating margin improvement in the coming fiscal year.

In conclusion, we made notable progress this past year and I believe Electromed is positioned for a successful fiscal 2020, supported by an outstanding team, world-class customer care and a best-in-class product that helps people breathe easier and live better. We are optimistic about our prospects for not only gaining market share, but also further developing the market in the adult pulmonology niche. I would like to thank our employees and clinicians for once again enabling us to improve quality of life and outcomes for a greater number of patients with compromised pulmonary function. Finally, I thank you, my fellow Electromed shareholders, for your continued support as we execute our strategic plan.

Sincerely,



Kathleen S. Skarvan
President and CEO

Cautionary Statement Regarding 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, projected cost savings and goals for fiscal 2020 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 our 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 state and federal 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; our ability to develop new sales channels for our product such as the homecare distributor channel; 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. 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. Such 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.

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