

Electromed, Inc.  
Form 10-Q  
February 11, 2014  
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**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, 2013

☐ 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**

(IRS Employer  
Identification No.)

**500 Sixth Avenue NW**

**New Prague, MN 56071**

(Address of principal executive offices, including 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 ☐

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

Large accelerated filer ☐

Accelerated filer ☐

Non-accelerated filer ☐

Smaller Reporting Company ☒

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 8,114,252 shares of Electromed, Inc. common stock, par value \$0.01, outstanding as of the close of business on February 7, 2014.

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Condensed Consolidated Balance Sheets**

	December 31, 2013 (Unaudited)	June 30, 2013
<b>Assets</b>		
Current Assets		
Cash and cash equivalents	\$ 1,236,576	\$ 503,564
Accounts receivable (net of allowances for doubtful accounts of \$45,000)	7,040,935	9,014,043
Inventories	2,266,734	1,379,594
Prepaid expenses and other current assets	298,611	428,843
Income taxes receivable	868,645	538,285
Deferred income taxes	557,000	557,000
<b>Total current assets</b>	12,268,501	12,421,329
Property and equipment, net	3,761,465	3,743,675
Finite-life intangible assets, net	1,019,724	1,080,734
Other assets	348,093	310,089
<b>Total assets</b>	\$ 17,397,783	\$ 17,555,827
<b>Liabilities and Equity</b>		
Current Liabilities		
Current maturities of long-term debt	\$ 45,156	\$ 57,540
Accounts payable	1,301,835	643,681
Accrued compensation	321,072	565,023
Warranty reserve	700,000	680,000
Other accrued liabilities	234,337	247,267
<b>Total current liabilities</b>	2,602,400	2,193,511
Long-term debt, less current maturities	1,274,775	1,332,455
Deferred income taxes	103,000	103,000
<b>Total liabilities</b>	3,980,175	3,628,966
<b>Commitments and Contingencies (Note 7)</b>		
<b>Equity</b>		
Common stock, \$0.01 par value; authorized: 13,000,000; shares issued and outstanding: 8,114,252		
shares	81,143	81,143
Additional paid-in capital	13,200,352	13,134,938
Retained earnings	136,113	710,780
<b>Total equity</b>	13,417,608	13,926,861
<b>Total liabilities and equity</b>	\$ 17,397,783	\$ 17,555,827

See Notes to Condensed Consolidated Financial Statements.

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**Electromed, Inc. and Subsidiary**  
**Condensed Consolidated Statements of Operations (Unaudited)**

	For the Three Months Ended December 31,		For the Six Months Ended December 31,	
	2013	2012	2013	2012
Net revenues	\$ 3,501,075	\$ 3,856,370	\$ 6,919,253	\$ 7,887,656
Cost of revenues	978,029	1,342,002	2,040,375	2,552,455
<b>Gross profit</b>	<b>2,523,046</b>	<b>2,514,368</b>	<b>4,878,878</b>	<b>5,335,201</b>
Operating expenses				
Selling, general and administrative	2,739,104	3,000,532	5,463,032	5,816,544
Research and development	92,735	109,250	301,843	210,440
<b>Total operating expenses</b>	<b>2,831,839</b>	<b>3,109,782</b>	<b>5,764,875</b>	<b>6,026,984</b>
<b>Operating loss</b>	<b>(308,793)</b>	<b>(595,414)</b>	<b>(885,997)</b>	<b>(691,783)</b>
Interest expense, net of interest income of \$3,940, \$10,975, \$11,338, and \$15,322 respectively	19,469	25,777	34,670	62,516
<b>Net loss before income taxes</b>	<b>(328,262)</b>	<b>(621,191)</b>	<b>(920,667)</b>	<b>(754,299)</b>
Income tax benefit (expense)	89,000	210,000	346,000	272,000
<b>Net loss</b>	<b>\$ (239,262)</b>	<b>\$ (411,191)</b>	<b>\$ (574,667)</b>	<b>\$ (482,299)</b>
Loss per share:				
Basic and diluted	\$ (0.03)	\$ (0.05)	\$ (0.07)	\$ (0.06)
Weighted-average common shares outstanding:				
Basic	8,114,252	8,114,252	8,114,252	8,114,252
Diluted	8,114,252	8,114,252	8,114,252	8,114,252

See Notes to Condensed Consolidated Financial Statements.

Table of Contents**Electromed, Inc. and Subsidiary  
Condensed Consolidated Statements of Cash Flows (Unaudited)**

	<b>For the Six Months Ended December 31,</b>	
	<b>2013</b>	<b>2012</b>
<b>Cash Flows From Operating Activities</b>		
Net loss	\$ (574,667)	\$ (482,299)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation	259,074	231,918
Amortization of finite-life intangible assets	63,235	66,234
Amortization of debt issuance costs	8,136	6,377
Share-based compensation expense	65,414	86,382
Loss on disposal of property and equipment	28,178	22,020
Changes in operating assets and liabilities:		
Accounts receivable	1,973,108	1,125,717
Inventories	(887,140)	493,388
Prepaid expenses and other assets	(210,972)	(272,371)
Accounts payable and accrued liabilities	407,275	(74,972)
<b>Net cash provided by operating activities</b>	<b>1,131,641</b>	<b>1,202,394</b>
<b>Cash Flows From Investing Activities</b>		
Expenditures for property and equipment	(291,044)	(482,122)
Expenditures for finite-life intangible assets	(2,225)	(28,092)
<b>Net cash used in investing activities</b>	<b>(293,269)</b>	<b>(510,214)</b>
<b>Cash Flows From Financing Activities</b>		
Net payments on revolving line of credit		(1,168,128)
Principal payments on long-term debt including capital lease obligations	(70,064)	(220,871)
Payments of deferred financing fees	(35,296)	
<b>Net cash used in financing activities</b>	<b>(105,360)</b>	<b>(1,388,999)</b>
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>733,012</b>	<b>(696,819)</b>
Cash and cash equivalents		
Beginning of period	503,564	1,702,435
End of period	\$ 1,236,576	\$ 1,005,616

See Notes to Condensed Consolidated Financial Statements.

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**Electromed, Inc. and Subsidiary**  
**Notes to Condensed Consolidated Financial Statements**  
**(Unaudited)**

**Note 1. Interim Financial Reporting**

**Basis of presentation:** Electromed, Inc. (the Company) develops, manufactures and markets innovative airway clearance products which apply High Frequency Chest Wall Oscillation (HFCWO) therapy in pulmonary care for patients of all ages. The Company markets its products in the United States 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 \$296,000 and \$337,000 for the six months ended December 31, 2013 and 2012, respectively. Since its inception, the Company has operated in a single industry segment: developing, manufacturing and marketing medical equipment.

The accompanying unaudited condensed consolidated financial statements of the Company have been prepared in accordance with U.S. generally accepted accounting principles for interim financial statements and pursuant to the rules and regulations of the Securities and Exchange Commission. In the opinion of management, the accompanying unaudited condensed consolidated 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, Rule 10-01. 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. generally accepted accounting principles for annual reports. This interim report should be read in conjunction with the consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended June 30, 2013.

**Principles of consolidation:** The accompanying condensed consolidated financial statements include the accounts of Electromed, Inc. and its subsidiary, Electromed Financial, LLC. Operating activities and net assets in Electromed Financial, LLC were insignificant as of and for the three and six months ended December 31, 2013 and the year ended June 30, 2013.

**Liquidity:** For the three months ended December 31, 2013, the Company incurred a net loss of approximately \$239,000, primarily as a result of a decrease in domestic home care revenues. Cash provided by operating activities was approximately \$390,000 for the three months ended December 31, 2013. The principal sources of liquidity in the future are expected to be cash flows from operations and availability on our line of credit. In order to operate profitably in the future, the Company must increase its revenue.

The Company's ability to generate sufficient cash flows over the next year could be negatively impacted by the business challenges in reimbursement from third party payers. There continues to be downward pressure on pricing and added administrative procedures implemented by third party payers in the insurance claims process which has lengthened the approval process compared with the prior year. In fiscal 2013, one of the largest domestic third party payers decentralized its contracting process. As a result, the decentralization has required significantly more administrative efforts on the part of the Company to complete the necessary contracts to maintain our national coverage with that payer. Certain contracts were resolved during fiscal 2013, although the final completion of this process has extended into fiscal year 2014. The challenges the Company currently faces could result in future noncompliance with the covenants contained within the Company's credit facility. 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 the Company's indebtedness or preventing access to additional funds under the credit facility, or requiring prepayment of outstanding indebtedness under the credit facility. If the maturity of the indebtedness is accelerated, or the Company is unable to renew the line of credit, sufficient cash resources to satisfy the debt obligations may not be available and the Company may not be able to continue operations as planned. The indebtedness under the credit agreement is secured by a security interest in substantially all tangible and intangible assets of the Company. If the Company is unable to repay such indebtedness, the bank could foreclose on these assets.

Table of Contents**A summary of the Company's significant accounting policies follows:**

**Use of estimates:** Management uses estimates and assumptions in preparing the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America. 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 consolidated 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 (loss) per common share:** Net loss is presented on a per share basis for both basic and diluted common shares. Basic net loss per common share is computed using the weighted average number of common shares outstanding during the period. The diluted net loss per common share calculation assumes that all stock warrants were exercised and converted into common stock at the beginning of the period, unless their effect would be anti-dilutive. Common stock equivalents of 614,900 and 599,900 were excluded from the calculation of diluted earnings per share for the six months ended December 31, 2013 and 2012, respectively, as their impact was antidilutive.

**Note 2. Inventories**

The components of inventory were approximately as follows:

	December 31, 2013	June 30, 2013
Parts inventory	\$ 1,604,000	951,000
Work in process	214,000	196,000
Finished goods	479,000	263,000
Less: Reserve for obsolescence	(30,000)	(30,000)
Total	\$ 2,267,000	1,380,000

**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. Accumulated amortization was approximately \$542,000 and \$479,000 at December 31, 2013 and June 30, 2013, respectively.

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

	Six Months Ended December 31, 2013	Year Ended June 30, 2013
Balance, beginning	\$ 1,081,000	1,174,000
Additions	2,000	37,000
Amortization expense	(63,000)	(130,000)
Balance, ending	\$ 1,020,000	1,081,000



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**Note 4.      Warranty Liability**

The Company provides a lifetime warranty on its products to the prescribed patient for sales within the United States and a three-year warranty for all institutional sales and sales to individuals outside the United States. 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, 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,  
2013**