

2014 CEO Letter to Shareholders

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

To our Shareholders



It is again my pleasure to write to you about Electromed's progress in fiscal year 2014. While there has been no lack of challenges to overcome, I am very proud of the Electromed team for their hard work, focus and determination to bring the Company back to profitable growth. We made notable progress towards that

objective as revenue growth accelerated in the second half of fiscal 2014 and we reported a profit in the fourth quarter. While much remains to be done, we have made major strides in putting the foundation in place for improved long-term financial performance.

Perhaps the greatest highlight of fiscal 2014 was the launch of the SmartVest® SQL®, the most advanced high frequency chest wall oscillation (HFCWO) product we have ever developed. We designed the SQL to stand apart from the competition with features that our patients and clinicians requested. In addition to being significantly smaller, quieter and lighter than our previous versions, we enhanced programmability and ease of use, setting a new standard for HFCWO device benefits.

In fiscal 2014, net revenue was \$15.5 million, up 2.5% compared to the prior year. We continued to face pressure on both product pricing and reimbursement from payers. This is not a new challenge for us. We believe this was a pivotal year and we are managing these challenges with positive results. We reported a net loss of \$1.3 million or \$0.16 per basic and diluted share. This includes a full valuation allowance against all of our net U.S. federal and state deferred tax assets totaling \$727,000 at June 30, 2014.

We generated over \$2.0 million of cash flow from operations which enabled us to make needed investments for growth while maintaining a strong cash position for flexibility.

Our focus is domestic home care and institutional markets, which represent our greatest opportunity for revenue

growth. On the home care side, we believe improved sales execution, better territory management and a precise focus on high-potential opportunities will improve revenue trends. To ensure our clinical area managers (our salespeople) are maximizing the value of their time and resources, we have initiated a more formalized and rigorous territory review process. Initial response to this effort has been positive and we look forward to more progress in this area as fiscal 2015 progresses. Since the choice of an HFCWO device used at home is often impacted by the device the patient is using while in a hospital, we are strengthening our presence in the institutional market and have added a dedicated institutional sales executive focused on revenue growth.

We face some challenges on the cost side of the SQL as it is currently a more expensive product for us to build than previous products. We expect to make measurable progress to bring those costs in line, although we may incur some incremental expense while optimizing manufacturing processes and raw material components.

A year ago, I described several areas of focus for fiscal 2014:

- Returning to historical profitability through increased sales and expense control.
- Generating revenue growth through product development.
- Growing domestic and international sales by expanding our geographic footprint.
- Treating our customers and patients with integrity and respect.

During fiscal 2014, we made significant progress towards returning to profitability and reached that goal in the fourth quarter. We began generating revenue from SQL, our new, internally developed product. We committed to growing domestic and international sales and we made some, although not enough, progress on that objective. While sales increased, we are focused on growing sales at a higher rate. In the fourth quarter of fiscal 2014, we delivered double-digit revenue growth and continuing that trend is a high priority for the Company. Finally, I believe we have delivered on our fourth objective as our patient and clinician customers tell us we excel at listening to them and treating them with respect and dignity. I am very proud of this Company's performance and legacy in that area.

CEO Letter to Shareholders, continued

As I look ahead, our goals for fiscal 2015 include a few new areas of focus:

- Deliver profitable growth that is sustainable beyond fiscal 2015.
- Reduce manufacturing costs for SQL to bring margins into line with previous products.
- Grow quality referrals and increase the rate of reimbursement on referrals.
- Enhance our superior service model and world-class reimbursement support.
- Maintain the highest standards of integrity, respect and privacy.

We believe the future is bright for airway clearance products as the population ages and chronic health concerns such as COPD impact a growing percentage of adults. On the other side of the equation, health care cost containment will remain in the forefront and will create hurdles for all companies providing solutions to the health care marketplace. We know the emphasis on avoiding retreatment of the same conditions supports the use of the best therapies and we believe HFCWO is one of those therapies. It is up to us to make that case to clinicians and patients on a daily basis. With a very strong product offering and a team committed to improving the lives of those affected by airway clearance issues, we are in an excellent position to succeed in the years ahead.

Fiscal 2014 was a year of significant transition, refocusing and positioning for growth. We began to see positive results including strong revenue growth in the fourth quarter and a return to profitability. Our goal is to make that our standard, not a one-time occurrence. We know it may not be a perfect trend line but I have increased confidence that we have put the Company on the right course for success in fiscal 2015 and beyond.

Sincerely,



Kathleen Skarvan
Chief Executive Officer

Cautionary Statements

Certain statements found in this letter and on the accompanying fact sheet may constitute forward-looking statements as defined in the U.S. Private Securities Litigation Reform Act of 1995. Forward-looking statements reflect the speaker's 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. Forward-looking statements can generally be identified by the words "believe," "expect," "anticipate" or "intend" or similar words. Forward-looking statements made in this letter include the Company's plans and expectations regarding the economic environment in which the Company operates, referral and approval trends, sales growth and sustained profitability, financial and operational performance, cost reductions, the impact of regulatory changes, and the Company's strategic goals and focus for future periods, including our focus on institutional sales and enhancing our service and reimbursement support. Forward-looking statements cannot be guaranteed and actual results may vary materially due to the uncertainties and risks, known and unknown, associated with such statements. Examples of risks and uncertainties for Electromed include, but are not limited to, the impact of emerging and existing competitors, the effectiveness of our sales and marketing initiatives, changes to reimbursement programs, our ability to effectively control costs, and our ability to obtain credit as needed, as well as other factors described from time to time in our reports to the Securities and Exchange Commission (including our Annual Report on Form 10-K). 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.

Corporate Headquarters

500 Sixth Avenue NW
New Prague, MN 56071
Phone: 800-462-1045 or 952-758-9299
Fax: 952-223-6253

www.smartvest.com