Electromed, Inc.
Form 10-K
September 14, 2011

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

FORM 10-K

(Mark One)
x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended June 30, 2011

o 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	**41-1732920**
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

500 Sixth Avenue NW, New Prague, MN 56071
(Address of principal executive offices)

(952) 758-9299
(Registrant s telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Common Stock $0.01 par value	**Nasdaq Capital Market**
(Title of each class)	(Name of each exchange on which registered)

Securities registered pursuant to Section 12(g) of the Exchange Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes o No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.
Yes o No x

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 x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, 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 o No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

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 o	Accelerated filer o
Non-accelerated filer o (Do not check if smaller reporting company)	Smaller reporting company x

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

The aggregate market value of the Common Stock held by non-affiliates of the Registrant as of December 31, 2010 was approximately $18,460,401 based upon the closing price of the Registrant s Common Stock on such date.

There were 8,101,085 shares of the registrant s common stock outstanding as of August 31, 2011.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Definitive Proxy Statement for the registrant s Fiscal 2012 Annual Meeting of Shareholders, to be filed within 120 days of June 30, 2011, are incorporated by reference into Part III of this Form 10-K.

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INFORMATION REGARDING FORWARD LOOKING STATEMENTS

Some of the statements in this report may contain forward-looking statements that reflect our current view on future events, future business, industry and other conditions, our future performance, and our plans and expectations for future operations and actions. In some cases, you can identify forward-looking statements by the following words: anticipate, believe, continue, could, estimate, expect, intend, ma plan, potential, predict, project, should, will, would, or the negative of these terms or other comparable terminology, although not all forward-looking statements contain these words. Our forward-looking statements in this report relate to the following: our business strategy, including our intended level of investment in research and development and marketing activities and our expectations with respect to earnings and sales growth, industry relationships, marketing strategies and international sales; our business strengths and competitive advantages; our expectation that our products will continue to qualify for reimbursement and payment under government and private insurance programs; the expected impact of applicable regulations on our business; our belief that our current facilities are adequate to support our growth plans; our intended use of proceeds from our initial public offering; our intent to enter into a separation agreement and release with our Chief Financial Officer; our expectations with respect to ongoing compliance with the terms of our credit facility; our intent to renew our line of credit; and our anticipated revenues, expenses, and capital requirements. Many of these forward-looking statements are located in this report under Item 1. BUSINESS; Item 2. PROPERTIES and Item 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS, but they may appear in other sections as well. These statements involve known and unknown risks, uncertainties and other factors that may cause our results or our industry s actual results, levels of activity, performance or achievements to be materially different from the information expressed or implied by these forward-looking statements. Forward-looking statements are only predictions and are not guarantees of performance. These statements are based on our management s beliefs and assumptions, which in turn are based on currently available information.

You should read this report thoroughly with the understanding that our actual results may differ materially from those set forth in the forward-looking statements for many reasons, including events beyond our control and assumptions that prove to be inaccurate or unfounded. We cannot provide any assurance with respect to our future performance or results. Our actual results or actions could and likely will differ materially from those anticipated in the forward-looking statements for many reasons, including the reasons described in this report. These factors include, but are not limited to:

the competitive nature of our market;

the risks associated with expansion into international markets;

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;

our ability to protect and expand our intellectual property portfolio; and

general economic and business conditions.

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PART I

Item 1. Business.

Overview

Electromed, Inc. (we, us, Electromed or the Company) was founded by Mr. Robert D. Hansen and Mr. Craig N. Hansen and incorporated in Minnesota in 1992. In August 2010, we completed an initial public offering (IPO) of 1,700,000 shares of our common stock. In September 2010, the underwriter in the IPO acquired an additional 200,000 shares pursuant to the exercise of a portion of its over-allotment option. Our common stock is traded on the NASDAQ Capital Market under the ticker symbol ELMD.

We manufacture, market and sell products that provide airway clearance therapy, including the Electromed SmartVest® Airway Clearance System (Electromed SmartVest System) and related products, to patients with compromised pulmonary function. The Electromed SmartVest System generates High Frequency Chest Wall Oscillation (HFCWO), also known as High Frequency Chest Compression, a technique for airway clearance therapy. HFCWO facilitates airway clearance by loosening and mobilizing respiratory secretions in a patient s lungs. A vest is worn over the torso that repeatedly compresses and releases the chest at frequencies from 5 to 20 cycles per second. Each compression (or oscillation) produces pulsations within the lungs that shear secretions from the surfaces of the airways and propels them toward the mouth where they can be removed by normal coughing. Unlike traditional chest physio-therapy, which must be performed on the patient while he or she is placed in a series of often uncomfortable positions, HFCWO can be performed with the patient sitting upright.

Studies show that HFCWO therapy is as effective an airway clearance method for patients who have cystic fibrosis or other forms of compromised pulmonary function as traditional chest physio-therapy administered by a respiratory therapist. However, HFCWO can be self-administered, relieving a caregiver of participation in the therapy, and eliminating the attendant cost of an in-home care provider. We believe the treatments are cost-effective primarily because they reduce a patient s risk of respiratory infections and other secondary complications that are associated with impaired mucus transport. Secondary complications, such as pneumonia, may be serious or life-threatening and often result in costly hospital visits.

The Electromed SmartVest System is a portable, programmable, and multi-positional airway clearance machine that generates HFCWO and has been approved by the Food and Drug Administration (FDA) to treat the condition of excess lung secretions. Consequently, it may be prescribed to patients suffering from cystic fibrosis, chronic obstructive pulmonary disease, muscular dystrophy, post-surgical airway complications and a variety of other diseases and conditions associated with impaired lung and airway capacity. By clearing airways, patients are able to rid their lungs of retained secretions and are therefore less likely to develop lung infections such as pneumonia.

The Electromed SmartVest System features a programmable electro-mechanical pulse generator and a pneumatic therapy garment, which together provide safe, comfortable, and effective airway clearance therapy. We believe that the lightweight, portable design allows patients greater freedom to travel and enjoy activities of daily living, resulting in enhanced quality of life for patients using the Electromed SmartVest System. A broad range of vest sizes for children and adults allow for tailored fit and function. User-friendly controls allow children to administer their own daily therapy under adult supervision. Our goal has been to make the HFCWO airway clearance treatments as comfortable and convenient as possible so our patients can more easily tolerate their regimen and be able to perform their treatments as readily as possible.

In order to maintain and expand our position in the market for airway clearance therapy products, we have assembled an experienced team of employees with expertise in health care, product development, manufacturing, marketing, sales, and financial management. For example, approximately 28% of our employees are respiratory therapists. In addition, we engage over 300 respiratory therapists and health professionals on a non-exclusive independent contractor basis to educate and train customers on the Electromed SmartVest System. Our team also includes several consultants who advise us on quality assurance, product development, and financing, and who keep us apprised of industry developments and opportunities in Europe.

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Personnel

Our management team has significant business experience and has developed industry relationships, resulting from memberships in various respiratory care professional groups and attendance, sponsorship and participation in numerous medical conferences in the U.S., Europe, and Asia. In June 2011, we appointed Dr. James J. Cassidy to the newly-created position of Chief Operating Officer. Dr. Cassidy has extensive international management experience in the medical device industry.

In addition to relationships developed at the management level, our staff and contractors, who often play a key role in the education of current and potential customers, have developed trusted relationships across the U.S. with physicians and other caregivers over the course of their careers. Approximately 28% of our full-time employees, including our entire Patient Services Department and approximately half of our sales representatives, are respiratory therapists. Many of these individuals have extensive experience in the field of respiratory care, and their relationships and experience are of great worth to us. These individuals maintain a dialogue with clinics, patients, patient families, and respiratory therapist trainers to ensure that our products are being properly operated and are performing effectively. Additionally, our sales representatives participate in various events, such as family days held by the Cystic Fibrosis Foundation for cystic fibrosis patients, at which they have an opportunity to demonstrate the effectiveness of the Electromed SmartVest System and further develop relationships with patients, patient families, physicians and hospitals.

In order to ensure the efficient production of high-quality products, we employ experienced personnel in our Engineering and Manufacturing Departments and work with an established network of vendors who permit us to integrate all assembly and quality assurance on a single campus.

Our Products

Our products are primarily used in the home health care market. We also sell our products for use in hospitals, which we refer to as institutional sales. Accordingly, our points of contact are home health care use, hospitals, clinics, and pulmonary rehabilitation centers, both domestically and internationally. The Electromed SmartVest System is a doctor-prescribed therapy and, depending on the circumstances of the patient, its cost to an individual is generally reimbursable by Medicare, Medicaid, private insurance, or a combination of the three. We have received clearance from the FDA to market our products.

The Electromed SmartVest System

The Electromed SmartVest System consists of a pneumatic therapy garment, an electronic pulse generator for creating and controlling force pulses, and a single hose which extends the force pulses from the generator to the pneumatic vest. The Electromed SmartVest System is a portable airway clearance therapy system that gives the patient direct control over the most difficult and time-consuming aspects of respiratory therapy, and provides caregivers an easier and more reproducible means of administering therapy to disabled or bedridden patients. The Electromed SmartVest System also has other appealing practical features, including improved ease of use and a non-clinical appearance. We believe these attributes particularly appeal to children, teenagers and young adults who represent the majority of the cystic fibrosis patient population. Our system allows the patient to be relatively mobile while therapy is being given, unlike manual chest physical therapy in which the patient must remain in a fixed position.

The Electromed SmartVest System therapy garment offers the following features:

Design: We have pioneered a vest design that provides consistent and controlled pulse pressure that is distributed throughout the vest and treats the entire front and back thoracic (chest) cavity. The Electromed vest is low profile, featuring a soft, breathable fabric. Some competitive models have reduced weight and size of their vests by reducing coverage area of the chest and applying pressure to the chest only. We do not endorse or employ a partial coverage vest, and all of our products offer 360-degree coverage. Our vest uses a flow-through system design, which improves patient comfort by providing a continuous accommodation grid of air release holes in the vest air bladder, allowing air releases to automatically adjust. This can prevent lags in pulse pressure accommodation as compared to a closed-loop system, in which electronic signal generators must continuously send changes in air fill instruction to the air pump. We believe heightened patient comfort is realized because of our flow-through design.

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Size and Ease of Use: The Electromed SmartVest System is available in eight sizes to accommodate children and adults. The simple design of the Velcro and overlap closure system creates a broad size adjustment range to insure a properly tailored fit. It also makes the Electromed vest easier to clean and disinfect than some competitors products, which often use straps and buckles. The patented design includes a removable bladder, permitting the therapy garment to be easily washed and dried. This feature also helps improve infection control efforts.

Material: An attractive washable nylon shell with quick fit Velcro provides an appealing non-clinical look and feel, which we believe enhances self-esteem and patient compliance.

Modular Assembly: The Electromed vest s modular assembly allows the custom modification of the manifold to enhance pulsation and avoid local areas of sensitivity such as incisions and catheters.

The Electromed SmartVest System s electronic pulse generator features the following important aspects:

Portable Design: The pulse generator for the Electromed SmartVest System is streamlined and fits into a roller bag for easy transport. Our product s vest and hose are carried in a small companion bag. The unit is relatively lightweight and can be readily carried or rolled by an individual. The system complies with airline carry-on size limits and can be carried onto an airplane or stowed in the trunk of a car, allowing patients greater freedom to travel.

Single-Hose System: When the Electromed SmartVest System is in use, a single hose delivers the pulsation to the vest, which we believe provides therapy in a more comfortable and unobtrusive manner than a two-hose system. In addition to facilitating patient comfort, the single-hose system provides effective treatment by simplifying delivery of the air pulse energy to the lungs. The pulse is delivered evenly from the base of the SmartVest therapy garment, extending the force pulses upward and inward in strong but smooth cycles of 360-degree latitudes, which delivers simultaneous treatment to the patient s chest and back and all lobes of the lungs.

Programmable Pulse Generation: The Electromed SmartVest System uses a pulse generator with an internal programmable memory feature to generate a pneumatic pulse electronically. The pulse frequency can be adjusted from 5 to 20 cycles per second, which accommodates the required therapeutic range. The range can be preset with programmable controls, in order to assure patient safety and specific treatment requirements. For example, the unit can be programmed to deliver a varying pulse frequency during the course of a treatment session without requiring manually directed changes. We believe this feature adds convenience and enhances patient compliance with treatment protocol choices.

Power Supply: The Electromed SmartVest System also includes a power supply suitable for use in international markets, such that voltage and amperage are accommodated automatically.

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Other Products

We market the Electromed Single Patient Use Vest (SPUV) and Electromed SmartVest Wrap® to health care providers, particularly those working in intensive care units. Hospitals issue the SPUV or Electromed SmartVest Wrap to one patient for the duration of his or her stay. Both products facilitate continuity of care because they introduce the patient to our product line and may encourage use of the Electromed SmartVest System for home care, which can be provided to the chronic condition patient upon discharge. Both products provide full coverage pulsation. The SPUV is a full-sized vest that is often used for patients undergoing institutional treatment who are already accustomed to using an Electromed SmartVest System. The SPUV is intended for short-term, in-patient use and allows the patient to avoid contaminating his or her home-use vest while continuing treatment in a hospital or other facility.

The Electromed SmartVest Wrap, which we introduced in 2007, is lightweight, convenient, and well-suited for patients recovering from surgery and short-term illnesses. We believe that the design of the Electromed SmartVest Wrap, which lacks a vest outer shell, makes it easy for the health care professional to operate because it does not need to go over the patient s head, minimizing the need to move post-surgical patients and avoiding interference with other apparatuses the patient may be using. In addition, the wrap is reversible, which allows the air pulse generator to be aligned on either side of a hospital bed. We believe that our ability to provide a relatively more comfortable therapy alternative to patients results in a higher likelihood of patient cooperation and consistent use.

We have designed and patented a mobile pedestal, which we manufacture and provide with sales of our institutional models of the Electromed SmartVest System. The mobile pedestal allows for easy transport within the medical facility. This unit includes a pneumatic feature, permitting ease of movement in raising and lowering the vertical position of the generator.

Our Markets

We market our HFCWO products to a broad patient population. For patients with a chronic pulmonary condition, many hours per day may be dedicated to a variety of treatments. The Electromed SmartVest System provides effective airway clearance therapy in a comfortable and portable design which allows patients greater independence and speed of treatment. Building from a foundation of product quality, as well as our dedication to customer service, our goal is to be a consistent innovator in providing airway clearance therapy to patients with compromised pulmonary function.

Because sale of the Electromed SmartVest System is by physician s prescription only, we market to health care professionals, such as doctors, nurses, respiratory therapists, and clinic coordinators. However, with respect to both our in-home and institutional products, the health care professionals decisions may be based on preferences expressed by patients. Therefore, we believe that it is also important to market our products to patients and caregivers. In addition, because the availability of reimbursement is an important consideration for health care professionals and patients, we must also prove the effectiveness of our product to public and private insurance providers.

The Electromed SmartVest System is currently prescribed to patients who suffer from cystic fibrosis (CF), chronic obstructive pulmonary disease (COPD), bronchiectasis, neuro-muscular disorders or post-surgical complications and patients who are ventilator dependent or have other conditions involving excess secretion and impaired mucus transport. When we entered the market in 2000, we focused on providing our product to CF patients because we felt those individuals could greatly benefit from treatment from our HFCWO system and it was the indication most likely to qualify for reimbursement at that time. Over time, we have expanded our focus to include post-surgical and intensive care patients at risk of developing pneumonia, patients with end-stage neuromuscular disease, and ventilator-dependent patients.

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The essential requirements that make a patient a candidate for airway clearance therapy are compromised respiratory function with a need to:

- secure airway clearance therapy on a cost-effective long-term basis, confidently and with relative ease;
- maintain and/or improve pulmonary status;
- mobilize secretions several times per day; and
- carry out activities of daily living.

The Electromed SmartVest System is designed to meet the individual patient s needs by providing a therapy that is efficient, is easy to administer, and can be performed independently. Electromed s established marketing and product support services provide education, training, and follow-up with the patient population to insure the product is integrated into their daily treatment regimen. We believe advantages of the Electromed SmartVest System to the independent patient include:

- usually can be reimbursed by private insurance, by federal or state government programs or combinations of the foregoing;
- consistent treatments at home;
- independence from a dedicated caregiver;
- portability;
- improved comfort during therapy; and
- improved self-image.

Marketing, Sales and Distribution

During our 2011 fiscal year, we worked to expand and reposition our domestic sales force. We believe these efforts contributed to our revenue growth in fiscal 2011. We expect to achieve future earnings and sales growth through focusing on continuing educational opportunities and industry relationships, building distributor relationships in Europe and Asia, and maintaining leadership in product innovation.

We participate in medical conferences and maintain industry contacts in order to increase the visibility of our products and acceptance by physicians and health care professionals, as well as patients. In addition , we have a designated marketing department and place advertisements in leading medical magazines and journals in the U.S. and Europe. We also believe that the Internet has provided us with a marketing benefit in recent years, as several overseas distributors have contacted us after visiting our website.

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North American Marketing

Approximately half of our domestic sales representatives are respiratory therapists. Each sales representative, or Clinical Area Manager (CAM), is responsible for introducing our products, principally the Electromed SmartVest System, to clinics and hospitals within a specific geographical area, and are also able to provide training and continued support to customers. As of June 30, 2011, we had 28 total sales representatives, including a national sales manager, 3 regional sales managers, and 24 CAM s. Collectively, our sales force covers the entire United States and portions of Canada, which we have divided into West, Midwest, and East regions. Each clinical area manager is assigned to a particular territory within one of the three regions. We have also developed a network of over 300 respiratory therapists and health care professionals to assist with training patients across the U.S. on a non-exclusive independent contractor basis. We believe that the professional knowledge of the CAM s and trainers demonstrates our commitment to customer service and facilitates sales.

International Marketing

In fiscal 2011, our international sales comprised approximately 3.2% of net revenue. Internationally, we have made sales in fifteen different countries. In addition to sales made in Canada, the principal countries in which we have made sales internationally, and the countries in which our principal distributors are located, are Italy, Japan and Taiwan. We are actively identifying distributors and other international sales opportunities.

Our historical practice and continued intent includes developing long-term relationships with distributors who have knowledge and experience in serving respiratory physicians and patients in the host country. Units are sold at a consistent price with payment made directly from the distributor, rather than allowing payments consistent with reimbursement procedures as is the case for domestic sales. For all international sales, our Quality Assurance Department and Chief Financial Officer monitor pricing, payments and conforming regulatory practice. Our Chief Executive Officer and Marketing Director oversee the growth and performance of international sales.

Competition

HFCWO was first developed for CF patients at the University of Minnesota. The purpose of HFCWO is to provide more effective mucus clearance in a form that could be performed independently of a caregiver. The original technology was licensed to American Biosystems, Inc. (now Advanced Respiratory, Inc. (ARI), part of Hill-Rom Holdings, Inc., a publicly traded company) which, until the introduction of our original MedPulse Respiratory Vest System® in 2000, was the only manufacturer of this technology. All of ARI s products use a two-hose, closed-loop system, in contrast to the single-hose, flow-through system that we designed, which we believe provides greater ease of use and patient comfort. In 2005, Respiratory Technologies, Inc., a privately held company doing business as RespirTech, received FDA clearance to market their inCourage system (the inCourage System), which includes a HFWCO vest. Like the Electromed SmartVest System, ARI s The Vest and RespirTech s inCourage System are cleared for market by the FDA.

From a clinical performance perspective, all HFCWO products meet a common standard of substantial equivalence. As a result, features and benefits such as number of hoses required to deliver the therapy (one hose versus two hoses), construction quality, appearance of the generator, reputation for patient services, and sales effectiveness of field personnel have become key variables. We believe that the product features of the Electromed SmartVest System enable us to compete effectively, particularly when health care professionals, patients, and caregivers are provided with demonstrations of product choices prior to committing to a specific product. We often provide demonstration units to encourage such comparisons. Unlike our competitors products, the Electromed SmartVest System has a single-hose, flow-through system design and an adjustable vest made from soft, breathable and washable fabric. We use Velcro in our patented vest to provide a tailored fit, as opposed to an inflatable fit model. In addition to product features, our focus on providing exemplary customer training and service, along with our commitment to engage and retain highly motivated employees and contractors, many of whom are medical professionals, provides a valuable competitive advantage.

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Alternative products for administering pulmonary therapy include:

- Positive Expiratory Pressure (PEP) mask, which provides backpressure into the lungs on expiration to keep respiratory tracts open longer to drain;
- The Flutter® (Scandipharm), a tube which vibrates on expiration;
- Acapella® Vibratory PEP Therapy System (Smiths Medical), a handheld device that combines PEP with oscillations;
- Intrapulmonary Percussive Ventilation Device, generally comprised of a ventilator that combines positive air pressure with nebulisation as appropriate; and
- Traditional Chest Physical Therapy (CPT), which is usually performed one to four times per day.

Physicians may prescribe some or all of these devices and techniques, depending upon each patient s health status, severity of disease, compliance, or personal preference. We believe our primary competitive advantage over alternative treatments is patient comfort, ease of use, and the effectiveness of HFCWO treatment as compared to CPT and other alternative treatments. Because HFCWO is not technique dependent, as compared to most other pulmonary therapy products, therapy begins automatically once power is provided and remains consistent and controlled for the duration of the session. We strive to make the Electromed SmartVest System an increasingly attractive and comfortable form of HFCWO therapy. We believe that HFCWO therapy generally, and the Electromed SmartVest System in particular, produces less interference with daily activities, which increases the likelihood of regular use. We believe these advantages encourage physicians to prescribe and patients to request the Electromed SmartVest System for pulmonary therapy. Reimbursement for the diverse patient populations for each of these pulmonary therapies varies greatly because a patient s medical care costs are typically addressed by a combination of private insurance and government benefit schedules, as well as state health care policies and programs.

Research and Development

In addition to the 21 U.S. patents and 7 foreign patents that we currently hold, we have a number of pending patent applications domestically and internationally.

As of June 30, 2011, our research and development staff consisted of three full-time employee engineers. We also receive engineering support from several consultants, including Mr. Craig N. Hansen, pursuant to an agreement with Hansen Engine Corporation. See Part III, Item 13, Certain Relationships and Related Transactions, and Director Independence. Our team, the majority of whom have experience in respiratory therapy and medical device development, has a demonstrated record of developing new products which receive the appropriate product approvals and regulatory clearances, with our products having been approved or cleared in the U.S., Canada, and the member countries of the European Economic Area.

During the fiscal years ended June 30, 2011 and 2010 we incurred research and development expenses of $1,034,000 and $601,000, respectively. As a result of our expected investments in enhancing the Electromed SmartVest System, we intend to spend at least 5% of net revenue on research and development activities for the foreseeable future.

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Intellectual Property

As of June 30, 2011, we held 21 issued U.S. patents and 7 foreign patents covering the Electromed SmartVest System and its underlying technology, and had 32 pending U.S. and foreign patent applications. These patents and patent applications offer coverage in the field of air pressure pulse delivery to a human in support of airway clearance. Our first U.S. patent expires in 2013 and in Canada in 2016.

We generally pursue patent protection for patentable subject matter in our proprietary devices in foreign countries in which we make regular sales. We have been granted patent protection in Canada, New Zealand and South Africa. We have additional patent applications pending in Canada, Japan, and South Korea and with the European Patent Organization, whose member states include Spain, Croatia, Greece, Italy, Portugal, and Romania.

We have also received the following U.S. trademark and service mark registrations: MEDPULSE, MEDPULSE RESPIRATORY VEST SYSTEM, SMARTVEST, SMARTVEST WRAP, SMARTWRAP, FACT, SOFT START, TRIMLINE, and CREATING SUPERIOR CARE THROUGH INNOVATION.

Manufacturing

Our headquarters in New Prague, Minnesota include a dedicated manufacturing and engineering facility of more than 10,000 square feet. Our site has been regularly audited by the FDA, in accordance with FDA practices, and we maintain our operations in a manner consistent with FDA requirements for a medical device manufacturer. Our manufacturing processes emphasize simplicity, cost-effectiveness, and a capacity to realize increases in production volume with escalation in demand. All employees are responsible for maintaining specific manufacturing and quality standards, which are monitored by our quality assurance manager under an extensive system designed to satisfy FDA and International Organization for Standardization (ISO) standards.

Our staff is responsible for manufacturing each Electromed SmartVest System. While components are outsourced based upon detailed specifications, each Electromed SmartVest System is assembled, tested, and approved for final shipment at our manufacturing site in New Prague, Minnesota, under careful control consistent with FDA, Underwriters Laboratory (UL), and ISO standards. While all third-party vendors present some degree of risk of supply or impairment issues, many of our vendors are located within 100 miles of our headquarters, which enables us to closely monitor the supply chain. We maintain at least a two-month supply of all of our critical components, and the materials used in the Electromed SmartVest System are generally available from a number of suppliers.

A rigorous quality standard is applied to components received from vendors. Any adverse findings result in the quarantine of any out of specification components. Before an Electromed SmartVest System is shipped to a patient, rigorous testing is again applied to match the performance of the air pulse generator with the particular vest size stipulated for the patient.

Seasonality

Our business is not materially affected by seasonality.

Product Warranties

We provide a warranty on the Electromed SmartVest System that covers the cost of replacement parts and labor, or a new Electromed SmartVest System in the event we determine a full replacement is necessary. For Electromed SmartVest Systems initially purchased and currently located in the United States and Canada, we provide a lifetime warranty to the individual patient for whom the system is prescribed. For products sold to patients in Greece, we provide a five-year warranty. For sales to institutions within the United States and Canada, and for all other sales to individuals and institutions made outside of the United States, Canada and Greece, we provide a three-year warranty. Our warranties provide that if a newer model of our systems has been developed and sold between the time of purchase of the original system and we determine the need for replacement, we may replace the system with a newer model at our discretion.

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Third-Party Reimbursement

In the U.S., individuals who use the Electromed SmartVest System will generally rely on third-party payers, including private payers and governmental payers such as Medicare and Medicaid, to cover and reimburse all or part of the cost of using the Electromed SmartVest System. Reimbursement for HFCWO therapy and the Electromed SmartVest System varies among public and private insurance providers.

Most patients are able to qualify for reimbursement and payment from Medicare, Medicaid, private insurance or combinations of the foregoing. We expect that subsequent generations of HFCWO products will also qualify for reimbursement under Medicare Plan B and most major health plans. However, some third-party payers must also approve coverage for new or innovative devices or therapies before they will reimburse health care providers who use the medical devices or therapies. In addition, we face the risk that new or modified products could have a lower reimbursement rate, or that the levels of reimbursement currently available for our existing products could decrease, which would hamper our ability to market and sell that product. Consequently, our sales will continue to depend in part on the availability of coverage and reimbursement from third-party payers, even though our devices may have been cleared for commercial distribution by the FDA. The manner in which reimbursement is sought and obtained varies based upon the type of payer involved and the setting in which the procedure is furnished. The nature of any future legislation is uncertain, making it difficult for us to predict the impact of cost-containment trends on operating results.

A key element in our customer support strategy has been achieved by establishing an effective reimbursement department to seek insurance authorization and process claims on behalf of the patient. The skill and knowledge gained and offered by our reimbursement department is an important factor in building our revenue and serving patients financial interests. Our payment terms allow patients to acquire the Electromed SmartVest System over a period of 1 to 15 months, which is consistent with reimbursement procedures followed by Medicare and other third parties. The amount we receive for any single unit is based on reimbursement schedules and may vary based on a number of factors, including Medicare and third-party reimbursement processes and policies. The patient maintains the risk of reimbursement to the Company in the event of non-payment by third-party payers.

Payments for overseas sales are made directly by the distributors, and we are not involved in the reimbursement process. Overseas sales were approximately 3.2% of our net revenue in fiscal 2011.

Governmental Regulation

Medicare and Medicaid

Recent government and private sector initiatives in the U.S. and foreign countries are aimed to limit the growth of health care costs, including price regulation, competitive pricing, coverage and payment policies, comparative effectiveness of therapies, technology assessments, and managed-care arrangements, and are causing the marketplace to put increased emphasis on the delivery of more cost-effective medical devices. Government programs, including Medicare and Medicaid, have attempted to control costs by limiting the amount of reimbursement they will pay for particular procedures or treatments, restricting coverage for certain products or services, and implementing other mechanisms designed to constrain utilization and contain costs. In addition, many private insurance programs look to Medicare as a guideline in setting their coverage policies and payment amounts. This has created an increasing level of price sensitivity among customers.

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Product Regulations

Our medical devices are subject to regulation by numerous government agencies, including the FDA and comparable foreign agencies. To varying degrees, each of these agencies requires us to comply with laws and regulations governing the development, testing, manufacturing, labeling, marketing, and distribution of our medical devices. Since inception, management has retained the necessary clinical, medical and legal expertise to support required clearances and approvals to market our products. A full-time quality assurance manager as well as a consulting regulatory and clinical expert provide detailed oversight of their respective areas of responsibility. The Company s Chief Operating Officer provides oversight with respect to the manufacturing, quality assurance, research and development, and product development activities of the company.

We have received clearance from the FDA to market our products, including the Electromed SmartVest System, as a powered percussor. On April 7, 2004, our Model 2000ez SMARTVEST was cleared to market by the FDA pursuant to a 510(k) submission.

We obtained ISO 9001 Certification in January 2005, which demonstrates to our international distributors and customers that our products conform to uniform standards for manufacturing quality and that our business meets certain professional standards. In addition, we obtained clearance to use the European Union CE Mark on our products in April 2005. The CE Mark is required for medical device sales in countries within the European Economic Area, which includes the twenty-seven member countries of the European Union as well as Iceland, Liechtenstein, Norway, Switzerland, Turkey, and other European countries that may adopt EU standards voluntarily. Renewal of the CE Mark is required every five years, and our notified body performs an annual audit to ensure that we are in compliance with all applicable regulations. We have maintained our CE Mark in good standing since originally receiving it and most recently renewed it in January 2010. We also require all of our distributors to comply with their home country regulations.

FDA Approval Requirements

If we develop new medical devices or modifications to existing products that would affect the product s safety or effectiveness, we may be required to obtain FDA clearance before marketing the new or modified product in the U.S., either through the 510(k) clearance process or the more complex Premarket Approval Application process. The application process may be time consuming and expensive, particularly if clinical trials are required. Failure to obtain such clearances or approvals could adversely affect our ability to grow our business. Delays in receipt or failure to receive clearances or approvals, the loss of previously received clearances or approvals, or the failure to comply with existing or future regulatory requirements could have a material adverse effect on our business.

Continuing Product Regulation

In addition to its approval processes for new products, the FDA may require testing and surveillance programs to monitor the effects of previously approved products that have been commercialized, and may prevent or limit further marketing of products based on the results of these post-marketing programs. At any time after approval of a product, the FDA may conduct periodic inspections to determine compliance with both the FDA s Quality System Regulation (QSR) requirements and/or current medical device reporting regulations. Product approvals by the FDA can be withdrawn due to failure to comply with regulatory standards or the occurrence of unforeseen problems following initial approval. The failure to comply with regulatory standards or the discovery of previously unknown problems with a product or manufacturer could result in fines, delays or suspensions of regulatory clearances, seizures or recalls of products (with the attendant expenses), the banning of a particular device, an order to replace or refund the cost of any device previously manufactured or distributed, operating restrictions and criminal prosecution, as well as decreased sales as a result of negative publicity and product liability claims.

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We are required to register with the FDA as a device manufacturer and, as a result, we are subject to periodic inspection by the FDA for compliance with the FDA s QSR requirements, which require manufacturers of medical devices to adhere to certain regulations, including testing, quality control and documentation procedures. In addition, the federal Medical Device Reporting regulations require us to provide information to the FDA whenever there is evidence that reasonably suggests that a device may have caused or contributed to a death or serious injury or, if a malfunction were to occur, could cause or contribute to a death or serious injury. Compliance with applicable regulatory requirements is subject to continual review and is rigorously monitored through periodic inspections by the FDA. We are also required to maintain certain certifications in order to sell products internationally, and we undergo periodic inspections by notified bodies to obtain and maintain these certifications.

Advertising and promotion of medical devices, in addition to being regulated by the FDA, are also regulated by the Federal Trade Commission and by state regulatory and enforcement authorities. Recently, promotional activities for FDA-regulated products of other companies have been the subject of enforcement action brought under health care reimbursement laws and consumer protection statutes. Competitors and others can also initiate litigation relating to advertising claims. If the FDA determines that our promotional materials or training constitutes promotion of an unapproved or uncleared use, it could request that we modify our training or promotional materials or subject us to regulatory or enforcement actions, including the issuance of an untitled letter, a warning letter, injunction, seizure, civil fine or criminal penalties. It is also possible that other federal, state or foreign enforcement authorities might take action if they consider our promotional or training materials to constitute promotion of an unapproved use, which could result in significant fines or penalties under other statutory authorities, such as laws prohibiting false claims for reimbursement.

Fraud and Abuse Laws

Federal health care laws apply when we or customers submit claims for items or services that are reimbursed under Medicare, Medicaid or other federally-funded health care programs. The principal federal laws include: the False Claims Act which prohibits the submission of false or otherwise improper claims for payment to a federally-funded health care program; the Anti-Kickback Statute which prohibits offers to pay or receive remuneration of any kind for the purpose of inducing or rewarding referrals of items or services reimbursable by a federal health care program; and health care fraud statutes that prohibit false statements and improper claims with any third-party payer. There are often similar state false claims, anti-kickback, and anti-self referral and insurance laws that apply to state-funded Medicaid and other health care programs and private third-party payers. In addition, the U.S. Foreign Corrupt Practices Act can be used to prosecute companies in the U.S. for arrangements with physicians, or other parties outside the U.S. if the physician or party is a government official of another country and the arrangement violates the law of that country. Enforcement of all of these regulations has become increasingly stringent, particularly due to more prevalent use of the whistleblower provisions under the False Claims Act, which allow a private individual to bring actions on behalf of the federal government alleging that the defendant has submitted a false claim to the federal government and to share in any monetary recovery. If a governmental authority were to conclude that we are not in compliance with applicable laws and regulations, we and our officers and employees could be subject to severe criminal and civil penalties including substantial penalties, fines and damages, and exclusion from participation as a supplier of product to beneficiaries covered by Medicare or Medicaid.

HIPAA and Other Fraud and Privacy Regulations

Federal and state laws protect the confidentiality of certain patient health information, including patient records, and restrict the use and disclosure of such information. In particular, the U.S. Department of Health and Human Services has issued patient privacy and security standards for electronic health information under the Health Insurance Portability and Accountability Act of 1996 and its implementing regulations (HIPAA).

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The HIPAA privacy and security standards govern the use and disclosure of protected health information by covered entities, which are healthcare providers that submit electronic claims, health plans and healthcare clearinghouses. Because we provide our products directly to patients and bill third-party payers such as Medicare, Medicaid, and insurance companies, we are a covered entity and must comply with these standards. The government intended this legislation to reduce administrative expenses and burdens for the health care industry; however, our compliance with certain provisions of these standards entails significant costs for us. Failure to comply with HIPAA or any state or foreign laws regarding personal data protection may result in significant fines or penalties and/or negative publicity. In addition to federal regulations issued under HIPAA, some states have enacted privacy and security statutes or regulations that, in some cases, are more stringent than those issued under HIPAA. In those cases, it may be necessary to modify our planned operations and procedures to comply with the more stringent state laws. If we fail to comply with applicable state laws and regulations, we could be subject to additional sanctions.

The HIPAA health care fraud and false statement statutes also prohibit, among other things, knowingly and willfully executing, or attempting to execute, a scheme to defraud any health care benefit program, including private payers, and knowingly and willfully falsifying, concealing or covering up a material fact or making any materially false, fictitious or fraudulent statement or representation in connection with the delivery of or payment for health care benefits, items or services.

Environmental Laws

We are also subject to various environmental laws and regulations both within and outside the U.S. Like other medical device companies, our operations involve the use of substances regulated under environmental laws, primarily manufacturing and sterilization processes. To the best of our knowledge at this time, we do not expect that compliance with environmental protection laws will have a material impact on our consolidated results of operations, financial position, or cash flows.

Employees

As of June 30, 2011, we employed 92 total employees, 85 of which are full-time employees. Of our 92 employees, approximately 28% are respiratory therapists who are licensed by appropriate state professional organizations, including all of the employees in our Patient Services Department and approximately half of our sales representatives. In addition, we retain as independent contractors several expert consultants, who assist with quality assurance, product development, marketing, and international opportunities. We also retain over 300 respiratory therapists and health care professionals on a non-exclusive independent contractor basis to provide training to our customers in the U.S. Approximately 85% of these independent contractors are credentialed by the National Board for Respiratory Care as either Certified Respiratory Therapists or Registered Respiratory Therapists. The remainder of these health care professionals are licensed in fields such as respiratory care, nursing or physical therapy. We believe that providing our customers with the opportunity to obtain support and training from health care professionals underscores our commitment to professional service and high quality.

None of our employees are covered by a collective bargaining agreement. We believe our relations with our employees are good.

Executive Officers of the Registrant

Set forth below are the names, titles, periods of service, and business experience of our executive officers.

Name	Age	Title
Robert D. Hansen	71	Chairman and Chief Executive Officer
Terry M. Belford	60	Chief Financial Officer
Dr. James J. Cassidy	52	Chief Operating Officer

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Robert D. Hansen Chairman and Chief Executive Officer

Mr. Hansen co-founded Electromed in 1992 and is responsible for the strategic direction and development of the Company. Mr. Hansen is also a co-founder and is President and Chief Executive Officer of Hansen Engine Corporation, a research and development company that provides research and development services to Electromed. Mr. Hansen joined Hansen Engine Corporation in January 1983 and has over forty years of business leadership and investment industry experience. Mr. Hansen devotes approximately 5% of his time attending to matters related to Hansen Engine Corporation where he is primarily responsible for corporate governance matters through his service as a member of Hansen Engine Corporation s board of directors. He was also the founder and CEO of LockerMate Corporation until January 1995. Mr. Hansen received a BA Degree from Dana College (1964), Masters of Arts Degree from the University of Cincinnati in U.S. History (1966), and a Masters of Divinity Degree (1976) from Luther Theological Seminary. He completed additional graduate studies in U.S. economic history and foreign policy at the University of Cincinnati. In 1996, Mr. Hansen was awarded a Mini-MBA in Managing Growing Companies from the University of St. Thomas. Among other attributes, skills, experiences and qualifications, our Board believes that Mr. Hansen s history with Electromed and management and investment industry experience allow him to make a valuable contribution as a director. Mr. Hansen is the brother of Craig N. Hansen, one of our directors.

Terry M. Belford, CPA, CMA Chief Financial Officer

Mr. Belford joined Electromed in January 2004 as its Chief Financial Officer. Before joining Electromed, Mr. Belford worked for seventeen years as an independent accountant and consultant, serving clients in the distributing, importing, and manufacturing industries. Prior to that he served for several years as a controller and chief financial officer for both established and start-up companies in the above mentioned industries. Mr. Belford earned a Bachelor of Science degree from the University of Missouri and also holds both CPA and CMA designations. He is a member of the American Institute of Certified Public Accountants, the Minnesota Society of Certified Public Accountants and the Institute of Certified Management Accountants. On August 19, 2011, we entered into a Transition Agreement with Mr. Belford, pursuant to which he will retire effective on the earlier of October 31, 2011 or the date on which our new Chief Financial Officer commences employment.

Dr. James J. Cassidy Chief Operating Officer

Dr. Cassidy was appointed by Electromed in June 2011 to the newly created position of Chief Operating Officer. Dr. Cassidy has extensive international management experience in the medical device industry. From March 2010 to May 2011, Dr. Cassidy offered business development and technology consulting services to the medical device industry through TransAtlantic Medical Device Consulting, LLC, an entity which he founded. Prior to that, Dr. Cassidy was the Chief Operating Officer of Vertebral Technologies, Inc. from June 2009 to February 2010 and the Vice President of Development for ApaTech, Ltd. from September 2004 to February 2009. Dr. Cassidy has also served as the Chief Executive Officer of successful start-up companies in the US (CERAbio) and Europe (Cartificial). In addition, Dr. Cassidy serves as a general partner of Epic BioVentures, LLC, a company that invests in and advises medical technology businesses. Dr. Cassidy has a doctorate in Biomedical Engineering from Case Western Reserve University and an MBA from the University of Memphis.

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Item 1A. Risk Factors.

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

Item 1B. Unresolved Staff Comments.

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

Item 2. Properties.

We own our principal headquarters and manufacturing facilities, consisting of approximately 24,000 total square feet, which are located on an approximately 2.3 acre parcel at 500 Sixth Avenue NW, New Prague, Minnesota 56071 and 502 Sixth Avenue NW, New Prague, Minnesota 56071. Effective July 1, 2011, we also began leasing approximately 20,000 square feet of warehouse space in a building adjacent to the manufacturing facilities. We are in the process of converting approximately 10,000 square feet of the newly leased building to office space. Management considers the current facilities to be satisfactory for our growth plans. In addition, we believe there is sufficient space within the lot in New Prague for additions to the most recently constructed building.

Item 3. 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 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 4. (Removed and Reserved).

PART II

Item 5. Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

Market Information

Our common stock began trading on the NASDAQ Capital Market on August 13, 2010 under the symbol ELMD in connection with our initial public offering. The following table sets forth the high and low sales prices of our common stock by quarter during the 2011 fiscal year. Our stock was not publicly traded during fiscal 2010.

	2011 Fiscal Year	
Quarter Ended	**High**	**Low**
September 30	$ 4.35	$ 3.25
December 31	$ 3.79	$ 3.25
March 31	$ 3.84	$ 2.94
June 30	$ 3.94	$ 3.11

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Holders

As of August 31, 2011, there were 163 registered holders of our common stock.

Dividends

We have never paid cash dividends on any of our securities. We currently intend to retain any earnings for use in operations and do not anticipate paying cash dividends in the foreseeable future. Currently, the agreement governing our credit facility restricts our ability to pay cash dividends.

Recent Sales of Unregistered Equity Securities

In May 2011, we issued 600 shares of common stock to an existing shareholder pursuant to a warrant exercise, for aggregate cash consideration of $1,800. The transaction did not involve an underwriter. We believe the transaction was exempt from the registration requirements of the Securities Act of 1933, as amended, by virtue of Section 4(2) thereof, because the issuance did not involve a public offering, the recipient acquired the shares for investment and not resale, and we have taken appropriate measures to restrict transfer.

Purchase of Equity Securities by the Company

None.

Use of Proceeds

We completed our initial public offering of shares of common stock, $0.01 par value (the IPO) during the first quarter of our 2011 fiscal year. The effective date of our registration statement relating to the IPO, filed on Form S-1 under the Securities Act of 1933 (File No. 333-166470), was August 12, 2010. Net proceeds from the IPO totaled approximately $5,946,000. We have used and intend to use the remainder of the net proceeds from the IPO to make payments on our existing indebtedness; add employees to our Reimbursement, Patient Services and Administrative Departments; add members to our sales force and further develop our focus on institutional sales; continue our research and development efforts; and for general corporate purposes, including to finance equipment purchases and other capital expenditures in the ordinary course of business and to satisfy working capital needs.

During the 2011 fiscal year, we used an estimated $3,097,000 from the net proceeds. We made net payments of approximately $436,000 on our line of credit and term debt with U.S. Bank, National Association. In addition, we used approximately $314,000 to fund the addition of employees to our Reimbursement, Patient Service, and Administrative Departments; approximately $380,000 to add members to our sales force; and approximately $335,000 for expenses associated with being a public company, such as legal, accounting, and other professional fees. Due to the increase in sales during our 2011 fiscal year, we estimate approximately $1,200,000 of the net proceeds were also used to finance the growth in accounts receivable. Finally, we used approximately $432,000 of the net proceeds from the IPO to fund our research and development efforts. A portion of this amount was paid to Hansen Engine Corporation, a research and development company that provides us with engineering services pursuant to a Letter Agreement dated February 16, 2010. Robert D. Hansen, Craig N. Hansen, and Thomas M. Hagedorn are shareholders and directors of Hansen Engine Corporation, and Robert D. Hansen serves as President and Chief Executive Officer of that entity. See Part III, Item 13, Certain Relationships and Related Transactions, and Director Independence.

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Item 6. Selected Financial Data.

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

Item 7. 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 financial statements and the accompanying notes included elsewhere in this Report. The forward-looking statements include statements that reflect management s beliefs, plans, objectives, goals, expectations, anticipations and intentions with respect to our future development plans, capital resources and requirements, results of operations, and future business performance. Our actual results could differ materially from those anticipated in the forward-looking statements included in this discussion as a result of certain factors, including, but not limited to, those discussed in the section entitled Information Regarding Forward-Looking Statements immediately preceding Part I of this Report.

Overview

Electromed, Inc. (we, us, Electromed or the Company) was incorporated in 1992. We are engaged in the business of providing 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 (Electromed SmartVest System) and related products, to patients with compromised pulmonary function. Our products are sold for both the home health care market and the institutional market for use by patients in hospitals, which we refer to as institutional sales. For approximately eleven years, we have marketed the Electromed SmartVest System and its predecessor products to patients suffering from cystic fibrosis, chronic obstructive pulmonary disease (COPD), bronchiectasis and repeated episodes of pneumonia. Additionally, we offer our products to a patient population that includes post-surgical and intensive care patients at risk of developing pneumonia, patients with end-stage neuromuscular disease, and ventilator-dependent patients.

Because sale of the Electromed SmartVest System is by a physician s prescription only, we market to physicians and health care providers as well as directly to patients. In addition to distributors overseas, we have established our own domestic sales force, which we believe is able to provide superior support and training to our customers. In addition, we have non-exclusive independent contractor arrangements with over 300 respiratory therapists and health care professionals who also provide education and training to our customers. Further, although the reimbursement process is subject to many contingencies, the Electromed SmartVest System is often eligible for reimbursement from major private insurance providers, 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 Electromed SmartVest System may be reimbursed under the Medicare-assigned billing code for High Frequency Chest Wall Oscillation 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 neuro-muscular 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.

We have been generating revenue from the sale of the Electromed SmartVest System or its predecessor products since 2000 and have generated net income since the fiscal year ended June 30, 2006. For the fiscal year ended June 30, 2011, we generated revenue of approximately $19,004,000 and net income of approximately $1,056,000. Our sales growth rate was 32.9% for the 2011 fiscal year compared to the 2010 fiscal year and was 10.0% for the 2010 fiscal year compared to the 2009 fiscal year. Net income as a percentage of sales was 5.6% in 2011 compared to 6.4% in 2010. Management believes the increase in net income in dollars was primarily the result of the increased sales resulting from expansion of our sales force. The decrease in net income as a percentage of sales was the result of higher expenses from expansion of the sales force and higher direct sales and sales support expenses, along with increased expenses relating to being a public company.

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Critical Accounting Policies and Estimates

During the preparation of our consolidated financial statements, we are required to make estimates, assumptions and judgments that affect reported amounts. Those estimates and assumptions affect our reported amounts of assets and liabilities, our disclosure of contingent assets and liabilities, and our reported revenues and expenses. We update these estimates, assumptions and judgments as appropriate, which in most cases is at least quarterly. We use our technical accounting knowledge, cumulative business experience, judgment and other factors in the selection and application of our accounting policies. While we believe the estimates, assumptions and judgments we use in preparing our consolidated financial statements are appropriate, they are subject to factors and uncertainties regarding their outcome and therefore, actual results may materially differ from these estimates. The following is a summary of our primary critical accounting policies and estimates. Please also refer to Note 1 to the Consolidated Financial Statements, included in Part II, Item 8 of this Report.

Revenue Recognition and Allowance for Doubtful Accounts

Revenues from direct patient sales are recorded at the amount to be received from patients under their arrangements with third-party payers, including private insurers, prepaid health plans, Medicare and Medicaid. In addition, we record an estimate for selling price adjustments which often arise from changes in a patient s insurance coverage, changes in a patient s state of domicile, insurance company coverage limitations or patient death. We periodically review originally billed amounts and our collection history and make changes to the estimation process by considering any changes in recent collection or sales allowance experience, but have not made material adjustments to previously recorded revenues and receivables.

Other than the installment sales as discussed below, we expect to receive payment on the vast majority of accounts receivable within one year and therefore classify all receivables as current assets. However, in some instances, payment for direct patient sales can be delayed or interrupted resulting in a small portion of collections occurring later than one year. In the event receivables are expected to be paid over longer intervals than one year, we recognize revenue under the installment method.

Certain third-party reimbursement agencies pay us on a monthly installment basis, which can span from 18 to 60 months in the cases of Wisconsin, New York and Texas Medicaid, which constitute the majority of our installment method sales. Due to the length of time over which reimbursement is received, we believe that the inherent uncertainty of collection due to external factors noted above precludes us from making a reasonable estimate of revenue at the time the product is shipped. In certain circumstances, the patient must periodically attest that the unit continues to be utilized as a prerequisite to continued reimbursement coverage. Therefore, we believe the installment method is appropriate for these sales. If the third party reimbursement agency discontinues payment and we determine no further payments will be made from the patient, the carrying value of the account receivable is written off as a period adjustment against the previously recognized sales. Under the installment method, we do not record accounts receivable or revenue at the time of product shipment. We defer the revenue associated with the sale and, as each installment is received, that amount is recognized as revenue. Deferred costs associated with the sale are amortized to cost of revenue ratably over the estimated period in which collections are scheduled to occur.

Accounts receivable are also net of an allowance for doubtful accounts, which are accounts from which payment is not expected to be received although product was provided and revenue was earned. Management determines the allowance for doubtful accounts by regularly evaluating individual customer receivables and considering a customer s financial condition and credit history. Receivables are written off when deemed uncollectible. Recoveries of receivables previously written off are recorded when received.

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We request that customers return to us previously-sold units that are no longer in use, in order to limit the possibility that such units would be resold by unauthorized parties or used by individuals without a prescription. The customer is under no obligation to return the product; however, we do reclaim the majority of previously sold units upon the discontinuance of patient usage. We have not obtained certification to recondition and resell returned units. Returned units are primarily used for warranty replacement parts and demonstration equipment. Returned products do not have significant value to us as the costs of becoming certified to resell, reclamation and reconditioning typically exceed the costs of producing a new unit.

Valuation of Long-lived and Intangible Assets

Long-lived assets, primarily property and equipment and finite-life intangible assets are evaluated for impairment whenever events or changes in circumstances indicate the carrying value of an asset may not be recoverable. In evaluating recoverability, the following factors, among others, are considered: a significant change in the circumstances used to determine the amortization period, an adverse change in legal factors or in the business climate, a transition to a new product or service strategy, a significant change in customer base, and a realization of failed marketing efforts. The recoverability of an asset is measured by a comparison of the unamortized balance of the asset to future undiscounted cash flows. If we believe the unamortized balance is unrecoverable, we would recognize an impairment charge necessary to reduce the unamortized balance to the estimated fair value of the asset. The amount of such impairment would be charged to operations at the time of determination.

Property and equipment are stated at cost less accumulated depreciation. We use the straight-line method for depreciating property and equipment over their estimated useful lives, which range from 3 to 39 years. Our finite-life intangibles consist of patents and trademarks and their carrying costs include 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, using the straight-line method. During the years ended June 30, 2011 and 2010, we incurred legal defense costs associated with a trademark infringement lawsuit filed against us (see Note 9 to the Consolidated Financial Statements included in Part II, Item 8 of this Report). Such legal defense costs are being capitalized and amortized over the remaining useful life of the trademark. We expect future amortization expense to increase as we incur additional costs associated with our patents and trademarks.

Allowance for Excess and Slow-moving Inventory

An allowance for potentially slow-moving or excess inventories is made based on our analysis of inventory levels on hand and comparing it to expected future production requirements, sales forecasts and current estimated market values.

Income Taxes

We recognize deferred tax assets and liabilities based on the differences between the financial statement carrying amounts and the tax basis of assets and liabilities. We provide a valuation allowance for deferred tax assets if we determine, based on the weight of available evidence, that it is more likely than not that some or all of the deferred tax assets will not be realized.

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Warranty Reserve

We provide a lifetime warranty on products sold to patients in the United States and Canada, a three-year warranty for institutional sales within the United States and Canada, a five-year warranty on products sold to patients in Greece, and a three-year warranty on all other sales to individuals and institutions outside of the United States, Canada and Greece. We estimate, based upon a review of historical warranty claim experience, the costs that may be incurred under our warranty policies and record a liability in the amount of such estimate at the time a product is sold. The warranty cost is based upon future product performance and durability, and is estimated largely based upon historical experience. We estimate the average useful life of our products to be approximately five years. Factors that affect our warranty liability include the number of units sold, historical and anticipated rates of warranty claims, the product useful life, and cost per claim. At our discretion, based upon the cost to either repair or replace a product, we have occasionally replaced such products covered under warranty with a new model. We periodically assess the adequacy of our recorded warranty liability and make adjustments to the accrual as claim data and historical experience warrant.

Share-Based Compensation

Share-based payment awards consist of warrants issued to employees for services, and to nonemployees in lieu of cash payment for products or services. Expense is estimated using the Black-Scholes pricing model at the date of grant and the portion of the award that is ultimately expected to vest is recognized on a straight-line basis over the requisite service or vesting period of the award. In determining the fair value of our share-based payment awards, we make various assumptions when using the Black-Scholes pricing model including expected risk free interest rate, stock price volatility, life and forfeitures.

Results of Operations

Fiscal Year Ended June 30, 2011 Compared to Fiscal Year Ended June 30, 2010

Revenues

Revenue results for the twelve month periods are summarized in the table below (dollar amounts in thousands).

	Twelve Months Ended June 30,		Increase (Decrease)	
	2011	2010		
Total Revenue	$ 19,004	$ 14,304	$ 4,700	32.9%
Home Care Revenue	$ 17,348	$ 13,109	$ 4,239	32.3%
International Revenue	$ 608	$ 647	($ 39)	(6.0%)
Government/Institutional Revenue	$ 1,048	$ 548	$ 500	91.2%

Home Care Revenue. Our home care revenue increased by 32.3% or approximately $4,239,000 in fiscal 2011 compared to fiscal 2010. This resulted from a 29.1% increase in referrals, from 2,076 in 2010 to 2,680 in 2011, and a 14.1% increase in approvals from third party payers, from 1,323 in 2010 to 1,510 in 2011. We attribute this increase primarily to an increase in productivity by our existing sales staff as they continued to expand and strengthen their relationships with customers. In addition, we employed 26 full time equivalents in sales in fiscal 2011 compared to 18 in fiscal 2010, an increase of 44.4%.

International Revenue. International revenue decreased by 6.0% in fiscal 2011, or $39,000. Revenue from sales in Asia and the Middle East in fiscal 2011 increased by approximately $98,000 and $12,000 respectively over fiscal 2010, while sales in Europe and Central/South America decreased by approximately $85,000 and $64,000 respectively over fiscal 2010. Sales to Europe continued to be negatively affected by the debt crises and austerity programs in many European countries.

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Government/Institutional Revenue. Revenue from sales to government and private institutions increased by approximately $500,000 in fiscal 2011 compared to fiscal 2010. Revenue from sales to the U.S. Department of Veteran Affairs (VA) and other government institutions rose by approximately $114,000 or 91.9% from approximately $124,000 in fiscal 2010 to approximately $238,000 in fiscal 2011. Revenue from sales to private institutions increased by approximately $386,000 or 91.0% from approximately $424,000 in fiscal 2010 to approximately $810,000 in fiscal 2011. The above increases were driven both by increased number of institutions as customers and a higher average total yearly sales amount per institution.

Gross Profit

Gross profit increased to $13,778,000, or 72.5% of net revenues, for the fiscal year ended June 30, 2011, from approximately $10,378,000, or 72.6% of net revenues, for the fiscal year ended June 30, 2010. The increase in gross profit dollars resulted from the increase in sales volume.

Operating expenses

Selling, general and administrative expenses. Selling, general and administrative expenses for the fiscal year ended June 30, 2011 were approximately $10,874,000, compared to approximately $7,981,000 for the same period in the prior year, an increase of approximately $2,893,000 or 36.2%. SG&A payroll and compensation related expenses increased by approximately $1,391,000 or 36.7% to approximately $5,181,000. SG&A payroll expenses constituted 27.3% of sales in fiscal 2011 compared to approximately $3,790,000 or 26.5% of sales in fiscal 2010. The increase was primarily driven by the increase in size of the sales force and supporting staff as well as higher incentive compensation paid to our sales staff due to higher net revenues. In addition, due to the increase in number of total employees and reporting requirements related to being a public company, we added management personnel. Travel, meals and entertainment, and trade show expenses increased by approximately $467,000 to approximately $1,619,000, or 8.5% of sales, in fiscal 2011 compared to approximately $1,152,000, or 8.1% of sales, in fiscal 2010. This increase was primarily due to the increased size of the sales force.

Legal and professional fees increased by approximately $378,000 to approximately $690,000, or 3.6% of sales, compared to approximately $312,000, or 2.2% of sales, in 2010, due to the need for additional accounting and legal services associated with the reporting and compliance requirements of being a public company in 2011 as compared to being a private company in 2010. Advertising and marketing expenses increased by approximately $275,000 to approximately $823,000, or 4.3% of sales, in fiscal 2011 compared to approximately $548,000, or 3.8% of sales, in fiscal 2010. Management expects to spend approximately 5% of sales on advertising and marketing expenses during fiscal 2012 . Patient training expenses increased by approximately $121,000 to approximately $476,000, or 2.5% of sales, in fiscal 2011 compared to approximately $355,000, or 2.5% of sales, in 2010. The increase in patient training expenses was primarily driven by the increase in number of referrals. Insurance expenses increased by approximately $108,000 to approximately $701,000, or 3.7% of sales, in fiscal 2011 compared to approximately $593,000, or 4.1% of sales, in 2010. General liability insurance expenses are driven by sales volume and workers compensation expenses are driven by payroll levels, both of which increased in fiscal 2011. In addition we had an increase of approximately $59,000 in directors & officers liability expenses due to becoming a public company.

Research and development expenses. Research and development (R&D) expenses were approximately $1,034,000 or 5.4% of sales and $601,000 or 4.2% for the fiscal years ended June 30, 2011 and 2010, respectively, a planned increase of approximately $433,000. As a percentage of sales, management expects to spend at least 5.0% of sales on R&D expenses for the foreseeable future.

Interest expense

Interest expense decreased to approximately $191,000 in fiscal 2011, compared to $263,000 in fiscal 2010, a decrease of approximately $72,000. The decrease was due to a combination of a decrease in average debt outstanding due to payments on term loans and lower average interest rates on outstanding debt.

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Income tax expense

Income tax expense was $623,000 in fiscal 2011, compared to $599,000 in the 2010 fiscal year. The effective income tax rate in 2011 was approximately 37.1% compared to approximately 39.5% in 2010. The decrease in the effective rate is due to discrete items recorded in fiscal 2011, which related to higher than originally estimated tax credits and differences between our actual income tax obligation for 2010 as compared to the amount originally estimated.

Net income

Net income for the twelve months ended June 30, 2011 was approximately $1,056,000, or 5.6% of revenues, compared to approximately $916,000, or 6.4% of revenues, in the same period in fiscal 2010. The dollar increase in net income was the result of higher sales and gross profit, which was partially offset by increases in expenses. The decrease in net income as a percentage of sales was the result of higher expenses from expansion of our sales force, R&D efforts, and increased reporting and compliance requirements of being a public company.

Liquidity and Capital Resources

Cash Flows and Sources of Liquidity

Cash Flows from Operating Activities

For the fiscal year ended June 30, 2011, our net cash used in operating activities was approximately $1,415,000. Our net income of approximately $1,056,000 was adjusted for non-cash expenses of approximately $477,000 and a decrease in current liabilities of approximately $646,000. Net income was also offset by approximately $3,016,000, $385,000 and $193,000 increases in accounts receivable, inventories, prepaid expenses and other current assets, respectively.

For the fiscal year ended June 30, 2010, our net cash provided by operating activities was approximately $608,000. Cash flows provided by operations primarily consisted of net income of $934,000, adjusted for non-cash expenses of approximately $452,000, offset by approximately $229,000, $292,000 and $111,000 increases in accounts receivable, inventories, prepaid expenses and other current assets, respectively and a decrease in current liabilities of approximately $145,000.

Cash Flows from Investing Activities

For the fiscal year ended June 30, 2011, cash used in investing activities was approximately $1,111,000. Cash used in investing activities primarily consisted of approximately $452,000 in net expenditures for property and equipment and $659,000 in payments for patent and trademark costs, the majority of which related to the defense of our SmartVest trademark.

For the fiscal year ended June 30, 2010, cash used in investing activities was approximately $909,000. During the fiscal year ended June 30, 2010, we paid approximately $514,000 in costs related to defending our SmartVest trademark, $270,000 for purchases of property and equipment, and $125,000 for the purchase of the minority interest in Electromed Financial, LLC.

Cash Flows From Financing Activities

For the fiscal year ended June 30, 2011, cash provided by financing activities was approximately $6,007,000, consisting of approximately $6,364,000 net proceeds from the issuance of common stock in our initial public offering, $26,000 from exercise of warrants, and $60,000 in proceeds from subscription notes receivable. This was offset by principal payments on long-term debt of approximately $436,000.

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For the fiscal year ended June 30, 2010, cash provided by financing activities was approximately $550,000. Short- and long-term borrowings during the period, which included borrowings under our U.S. Bank credit facility, were approximately $4,288,000. The proceeds from the U.S. Bank credit facility were primarily used to pay off the principal balance of existing debt. Proceeds from the issuance of common stock were approximately $391,000. Offsetting the cash provided by financing activities were principal payments on long-term debt of approximately $3,649,000 and payments of $418,000 of deferred costs associated with our initial public offering.

Adequacy of Capital Resources

We currently have a credit facility with U.S. Bank, National Association (U.S. Bank) that provides for a $3,500,000 revolving line of credit, which is renewable annually at November 30 of each year, and $2,520,000 in term debt. A $1,520,000 Term Loan bears interest at 5.79% (Term Loan A). The remaining $1,000,000 term loan bears interest at 4.28% (Term Loan B). Interest on the operating line of credit accrues at LIBOR plus 2.75% (3.00% at June 30, 2011) and is payable monthly. The amount eligible for borrowing on the line of credit is limited to 60% of eligible accounts receivable less the outstanding balance on our Term Loan B. The line of credit is scheduled to expire on November 30, 2011, if not renewed. Term Loan A requires monthly payments of principal and interest of approximately $10,700 and has a maturity date of December 9, 2014. Term Loan B requires monthly payments of principal and interest of approximately $29,600 and has a maturity date of December 9, 2012. As of June 30, 2011, we had approximately $1,768,000 outstanding on the operating line of credit and approximately $1,940,000 outstanding on the term loan debt for a total outstanding under the U.S. Bank credit facility of $3,708,000. As of June 30, 2011, we had net unused availability of $1,732,000 under the line of credit. We are required to pay a fee of 0.125% per annum on unused portions of the revolving line of credit.

The agreement governing the credit facility contains certain covenants that restrict our ability to, among other things, pay cash dividends, incur indebtedness or liens, change Chief Executive Officer or Chief Financial Officer, merge or consolidate with any person, or sell, lease, assign, transfer or otherwise dispose of any assets other than in the ordinary course of business. The agreement also contains financial covenants that require maintenance of certain fixed charge and cash flow leverage ratios. We were in compliance with all requirements under the credit facility as of June 30, 2011. Subsequent to fiscal year end, we reached an agreement with our Chief Financial Officer pursuant to which he will retire effective on the earlier of October 31, 2011 or the date on which our new Chief Financial Officer commences employment. We expect to obtain consent from U.S. Bank with respect to this event.

On August 13, 2010, we completed the sale of 1,700,000 shares of common stock, par value $0.01 per share, in an IPO, at an offering price of $4.00 per share. On September 28, 2010, Feltl and Company, Inc., the underwriter of the IPO, acquired 200,000 shares of our common stock at a price of $4.00 per share, pursuant to exercise of its over-allotment option. Gross proceeds from the issuance of common stock in connection with the IPO, including the overallotment option, were approximately $7,600,000. After deducting the payment of underwriters discounts and commissions and offering expenses, our net proceeds from the sale of shares in the IPO, including the overallotment option, were approximately $5,946,000.

For fiscal 2011 and 2010, we spent approximately $466,000 and $270,000 on property and equipment, respectively. We currently expect to finance equipment purchases with borrowings under our credit facility and cash flows from operations. 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.

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In connection with the employment agreements we entered into with our Chief Executive Officer and Chief Financial Officer on January 1, 2010, we may be required to make cash payments to these officers if they resign following a change in control or are terminated at any time without cause. With respect to a resignation upon a change in control, the amount of the severance payment would be equal to two times the annual base salary then in effect. With respect to a termination without cause, the amount of the severance payment would be equal to the base salary of the executive then in effect. In each instance, the executive would also be entitled to a pro rata portion of any earned but unpaid incentive compensation at the time of termination, the severance would be payable in a lump sum within 60 days of the separation event, and the executive would, in order to receive the severance and continued benefits, be required to sign a release of claims against us, return all property owned by Electromed and agree not to disparage us.

On August 19, 2011, we entered into a Transition Agreement with our Chief Financial Officer, pursuant to which he will retire effective on the earlier of October 31, 2011 or the date on which our new Chief Financial Officer commences employment. We expect to enter into a Separation Agreement and Release on the effective date of Mr. Belford s retirement, which will supersede Mr. Belford s January 1, 2010 employment agreement. The Separation Agreement and Release will provide that Mr. Belford will receive approximately $27,600 as payment for accrued but unused vacation time and a payment in the amount of approximately $147,000 representing six months of separation pay and a pro rata portion of the calendar year 2011 bonus payment, which amount will be paid in a lump sum on the first day of the seventh month following the effective date of Mr. Belford s retirement. In exchange, Mr. Belford will execute a general release of claims, will continue to be bound by the terms of his Non-Competition, Non-Solicitation and Confidentiality Agreement dated January 1, 2010, and will provide consulting and transition services as reasonably requested by the Company through December 31, 2011.

Based on our current operational performance, we believe our cash and available borrowings under the existing credit facility will adequately provide our liquidity needs for, at a minimum, the next twelve months. We intend to renew our line of credit with U.S. Bank, National Association upon its maturity date on November 30, 2011. However, we cannot guarantee that we will be able to renew our line of credit or procure additional financing upon favorable terms, if at all.

Certain Information Concerning Off-Balance Sheet Arrangements

We have no off-balance sheet arrangements.

New Accounting Pronouncements

For recently issued accounting pronouncements, see Note 1 to the Consolidated Financial Statements, included in Part II, Item 8 of this Report.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk.

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

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Item 8. Financial Statements and Supplementary Data.

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Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders
Electromed, Inc. and Subsidiary

We have audited the accompanying consolidated balance sheets of Electromed, Inc. and Subsidiary as of June 30, 2011 and 2010, and the related consolidated statements of income, equity, and cash flows for the years then ended. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Electromed, Inc. and Subsidiary as of June 30, 2011 and 2010, and the results of their operations and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

/s/ McGladrey & Pullen, LLP

Minneapolis, Minnesota
September 14, 2011

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Electromed, Inc. and Subsidiary
Consolidated Balance Sheets
June 30, 2011 and 2010

	June 30	
	2011	**2010**
Assets		
Current Assets		
Cash and cash equivalents	$ 4,091,739	$ 610,727
Accounts receivable (net of allowances for doubtful accounts of $45,000)	9,593,105	6,577,002
Inventories	1,855,957	1,470,775
Prepaid expenses and other current assets	371,257	269,193
Deferred income taxes	722,000	514,000
Total current assets	16,634,058	9,441,697
Property and equipment, net	2,807,082	2,688,941
Finite-life intangible assets, net	1,235,828	1,055,776
Deferred common stock offering costs	-	828,034
Other assets	191,964	128,789
Total assets	$ 20,868,932	$ 14,143,237
Liabilities and Equity		
Current Liabilities		
Revolving line of credit	$ 1,768,128	$ 1,768,128
Current maturities of long-term debt	438,267	397,886
Accounts payable	733,621	1,239,827
Accrued compensation	868,229	665,083
Warranty reserve	444,096	363,277
Other accrued liabilities	161,166	68,097
Total current liabilities	4,413,507	4,502,298
Long-term debt, less current maturities	1,582,102	2,033,325
Deferred income taxes	167,000	145,000
Total liabilities	6,162,609	6,680,623
Commitments and Contingencies (Note 9)		
Equity		
Electromed, Inc. equity:		
Common stock, $0.01 par value; authorized: 13,000,000 shares; issued and outstanding: 8,100,485 and 6,187,885 shares, respectively	81,005	61,879
Additional paid-in capital	12,794,368	6,685,362
Retained earnings	1,853,450	797,873
Common stock subscriptions receivable for shares outstanding of 15,000 and 48,500, respectively	(22,500)	(82,500)
Total equity	14,706,323	7,462,614
Total liabilities and equity	$ 20,868,932	$ 14,143,237

See Notes to Consolidated Financial Statements.

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Electromed, Inc. and Subsidiary
Consolidated Statements of Income
Years Ended June 30, 2011 and 2010

	Years Ended June 30	
	2011	**2010**
Net revenues	$ 19,003,507	$ 14,303,848
Cost of revenues	5,226,001	3,925,557
Gross profit	13,777,506	10,378,291
Operating expenses		
Selling, general and administrative	10,873,904	7,981,338
Research and development	1,033,693	600,986
Total operating expenses	11,907,597	8,582,324
Operating income	1,869,909	1,795,967
Interest expense, net of interest income of $10,923 and $6,417 respectively	191,332	263,431
Net income before income taxes	1,678,577	1,532,536
Income tax expense	(623,000)	(599,000)
Net income	1,055,577	933,536
Less: Net income attributable to noncontrolling interest	-	(17,198)
Net income attributable to Electromed, Inc.	$ 1,055,577	$ 916,338
Earnings per share attributable to Electromed, Inc. common shareholders:		
Basic	$ 0.14	$ 0.15
Diluted	0.13	0.15
Weighted-average Electromed, Inc. common shares outstanding:		
Basic	7,816,367	6,081,030
Diluted	7,841,006	6,114,919

See Notes to Consolidated Financial Statements.

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Electromed, Inc. and Subsidiary
Consolidated Statements of Equity
Years Ended June 30, 2011 and 2010

	Electromed, Inc.						
	Common Stock		Additional Paid-in Capital	Retained Earnings (Deficit)	Common Stock Subscriptions Receivable	Noncontrolling Interest	Total Equity
	Shares	Amount					
Balance at June 30, 2009	6,047,152	$ 60,472	$ 6,201,636	$ (118,465)	$ (91,500)	$ 6,599	$ 6,058,742
Net income	-	-	-	916,338	-	17,198	933,536
Issuance of common stock upon exercise of warrants	135,733	1,357	389,475	-	-	-	390,832
Issuance of common stock for payment of services	5,000	50	22,450	-	-	-	22,500
Proceeds from subscription notes receivable	-	-	-	-	9,000	-	9,000
Distributions paid to holders of non-controlling interest	-	-	-	-	-	(18,417)	(18,417)
Share-based compensation expense	-	-	168,895	-	-	-	168,895
Income tax benefit related to exercise of stock warrants	-	-	22,526	-	-	-	22,526