Zacks Small - Cap Research

September 13, 2011

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Electromed Inc (ELMD-NASDAQ)

ELMD: Q4: Another Top-Line Beat. Management Delivering.

Current Recommendation	**Outperform**
Prior Recommendation	N/A
Date of Last Change	5/12/2011
Current Price (09/13/11)	$3.44
Target Price	**$5.50**

OUTLOOK

By all accounts Electromed is delivering on its relatively simple plan of growing revenue through increasing the size of its sales force. Revenue grew to $19.0 million in fiscal 2011, up 33% from the $14.3 million posted in 2010.

Revenue and profitability should continue to grow as ELMD maintains this strategy and newly hired sales reps become more productive. We look for more revenue to flow to the bottom line in 2012 as EMLD begins to gain more operating leverage.

We continue to be big believers in management and SmartVest. We are maintaining our $5.50 price target and Outperform rating.

SUMMARY DATA

52-Week High	**$3.94**
52-Week Low	**$3.05**
One-Year Return (%)	**-7.24**
Beta	**-0.04**
Average Daily Volume (sh)	**3,557**
Shares Outstanding (mil)	**8**
Market Capitalization ($mil)	**$27**
Short Interest Ratio (days)	**1.34**
Institutional Ownership (%)	**6**
Insider Ownership (%)	**42**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**N/A**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**26.5**
P/E using 2012 Estimate	**19.1**
P/E using 2013 Estimate	**13.2**
Zacks Rank	**N/A**

Risk Level	**N/A,**
Type of Stock	**Small-Blend**
Industry	**Med Instruments**

ZACKS ESTIMATES

Revenue
(in '000 of $)

	Q1 (Sep)	Q2 (Dec)	Q3 (Mar)	Q4 (Jun)	Year (Jun)
2011	4,165 A	4,686 A	5,199 A	4,954 A	19,004 A
2012	5,027 E	5,446 E	6,069 E	5,644 E	22,186 E
2013					25,500 E
2014					28,526 E

Earnings per Share

	Q1 (Sep)	Q2 (Dec)	Q3 (Mar)	Q4 (Jun)	Year (Jun)
2011	$0.02 A	$0.04 A	$0.06 A	$0.02 A	$0.13 A
2012	$0.02 E	$0.05 E	$0.06 E	$0.05 E	$0.18 E
2013					$0.26 E
2014					$0.35 E

Zacks Projected EPS Growth Rate - Next 4 Years % **35**

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Q4 2011 Financial Results

Electromed reported financial results for the fiscal fourth quarter ending June 30, 2011 on September 12th. For the third straight quarter revenue came in ahead of our estimate, with another strong showing from the Homecare segment. While EPS was $0.01 shy of our number, this was a result of an uptick in R&D spend as ELMD prepares for future growth and a jump in the tax rate (the latter, a one-time event). Meanwhile, both gross margin and SG&A (as % of sales) were nearly dead-on with what we were looking for.

By all accounts Electromed is delivering on its relatively simple plan of growing revenue through increasing the size of its sales force. Revenue grew to $19.0 million in fiscal 2011, up 33% from the $14.3 million posted in 2010. As we outlined when we picked up coverage of ELMD in late 2010, incrementally beefing up the sales force, combined with a focus on high quality customer support that is driven by management's genuine interest in improving the quality of life of people that can benefit from HFCWO therapy, could be significant catalysts to growing revenue over the mid-term. The plan appears to be working and we continue to be big believers in both the SmartVest product as well as management's ability to invest for the future and grow revenues, profits, EPS and cash.

Revenue
Q4 revenue of $4.95 million was up 37% y-o-y (-5% sequentially) and consisted of $4.61 million (+36% y-o-y) from the Homecare segment, $107k (+2% y-o-y) from International and $237k (+101% y-o-y) from Government/Institutional.

Growth in the size of the sales force continues to be the catalyst driving Homecare segment sales - while not specifically mentioned by management, anecdotally we believe ELMD has also been successful in taking share gains against competitors. Electromed currently has 23 sales reps, up significantly from a sales force of only 14 late-2009. Many of these additions were made over the last 6 months and, as we also discussed in our initiation report, it can take two to three quarters to get newly hired reps up to speed and fully productive. As these reps climb the learning curve, their efficiency and productivity should improve - we expect this to be another driver of revenues and margins in fiscal 2012.

	Q4 2010	Actual Q4 2011	Y-o-Y Change	Zacks Est Q4 2011	Actual +/- Zacks est.
Homecare	$3,401.0	$4,609.0	35.5%	$4,256.0	8.3%
International	$105.0	$107.0	1.9%	$170.0	-37.1%
Gov't / Instit.	$118.0	$237.0	100.8%	$215.0	10.2%
	$3,624.0	**$4,953.0**	**36.7%**	**$4,641.0**	**6.7%**

Total revenue came in 7% better than our estimate, almost entirely as a result of the beat in the Homecare segment, which accounts for over 90% of ELMD's total revenue.

Gross Margin
GM came in at 72.7% compared to our 72.4% estimate. For the full fiscal year, GM was 72.9%, down from 74.1% in fiscal 2010. We have modeled only very modest improvement in GM in 2012 (to 73.2%), which actually could prove to be somewhat conservative as ELMD could see greater margin benefits as a result of increased sales volumes.

Operating Expenses
SG&A came in at $2.85 million, or 57.5% of sales, compared to our 57.3% ($2.66 million) estimate. We think ELMD could start to see a much more significant improvement in SG&A as a percentage of sales going into 2012 as they begin to realize greater operating leverage from growth in revenue.

R&D expense was $344k in Q4, which was materially higher than our $241k estimate. Management indicated on the call that they have begun to make further investments in product development as they look to the future and implied that the Q4 level of R&D spend may continue throughout 2012. We have made adjustments to our model to account for this.

Net Income / EPS
Net income and EPS were $165k and $0.02, compared to our $253k and $0.03 estimates. The difference, a result of the higher than modeled R&D figure and tax rate of 55% (vs our 40% estimate). Management noted on the call that the relatively high effective tax rate is due to revaluation of investment tax credits - this should not be an ongoing event - we model the tax rate to hover in the 37.5 - 38% range going forward.

Cash
Electromed exited the fiscal year (6/30/11) with $4.09 million in cash and equivalents, compared to $3.95 million at 3/31/11. Cash used in operating activities was $140k in the most recent quarter, but stripping out the increase in working capital (including $361k increase in A/R), operating cash flow was positive $221k. We continue to see no concern with the increase in A/R as long collection times are very typical of the industry and can cause intermittent spikes in A/R (this will especially be the case for a company growing as rapidly as ELMD is). Cash position remains strong and, along with cash from operations and piecemeal draws on the revolver, should provide sufficient flexibility to weather any quarterly variability in working capital needs.

Valuation and Recommendation
We continue to value Electromed using Hill-Rom's (HRC) long-term PE/G ratio as a comparable. Hill-Rom's long-term PE/G currently sits at 0.85 (down from 1.64 since our last update as HRC stock price is down about 38% since then). Now that ELMD's fiscal 2011 is complete, we are also now using our 2012 EPS estimate for ELMD (previously using 2011 estimate) for comparative valuation purposes. We also now model out to 2014, instead of just through 2013. We model ELMD to post EPS of $0.43 in 2014, implying four-year CAGR of 35%. Backing this growth rate into the 0.85 PE/G results in a near-term P/E multiple of 30x. We look for ELMD to earn $0.18/share in fiscal 2012 which values the company at approximately $5.50 per share - which leaves our price target unchanged. ELMD currently trades at $3.44/share, implying significant upside in the shares. We are also maintaining our Outperform rating.

FINANCIAL STATEMENTS

INCOME STATEMENT **Electromed Inc.**

	2011 A	Q1E	Q2E	Q3E	Q4E	2012 E	2013 E	2014 E	2015 E
Home Care Revenue	$17,347.0	$4,664.0	$4,945.0	$5,538.0	$5,181.0	$20,328.0	$23,295.0	$26,005.0	$28,555.0
% of total revenue	*91.3%*	*92.8%*	*90.8%*	*91.3%*	*91.8%*	*91.6%*	*91.4%*	*91.2%*	*89.4%*
y-o-y growth	*32.3%*	*22.6%*	*16.5%*	*18.1%*	*12.4%*	*17.2%*	*14.6%*	*11.6%*	*9.8%*
International Revenue	$608.0	$141.0	$212.0	$191.0	$204.0	$748.0	$980.0	$1,201.0	$1,888.0
% of total revenue	*3.2%*	*2.8%*	*3.9%*	*3.1%*	*3.6%*	*3.4%*	*3.8%*	*4.2%*	*5.9%*
y-o-y growth	*-6.0%*	*-11.3%*	*6.5%*	*33.6%*	*90.7%*	*23.0%*	*31.0%*	*22.6%*	*57.2%*
Gov't / Institutional Revenue	$1,048.0	$222.0	$289.0	$340.0	$259.0	$1,110.0	$1,225.0	$1,320.0	$1,490.0
% of total revenue	*5.5%*	*4.4%*	*5.3%*	*5.6%*	*4.6%*	*5.0%*	*4.8%*	*4.6%*	*4.7%*
y-o-y growth	*91.2%*	*9.4%*	*19.9%*	*-7.4%*	*9.3%*	*5.9%*	*10.4%*	*7.8%*	*12.9%*
Net Sales	$19,003.7	$5,027.0	$5,446.0	$6,069.0	$5,644.0	$22,186.0	$25,500.0	$28,526.0	$31,933.0
YOY Growth	*32.9%*	*20.7%*	*16.2%*	*16.7%*	*13.9%*	*16.7%*	*14.9%*	*11.9%*	*11.9%*
Cost of product sales	$5,156.3	$1,387.5	$1,328.8	$1,699.3	$1,523.9	$5,939.5	$6,680.0	$7,250.0	$7,988.0
Gross Income	$13,847.3	$3,639.5	$4,117.2	$4,369.7	$4,120.1	$16,246.5	$18,820.0	$21,276.0	$23,945.0
Gross Margin	*72.9%*	*72.4%*	*75.6%*	*72.0%*	*73.0%*	*73.2%*	*73.8%*	*74.6%*	*75.0%*
SG&A	$10,942.7	$2,991.1	$3,115.1	$3,277.3	$3,160.6	$12,544.1	$13,974.0	$15,347.0	$16,956.4
% SG&A	*57.6%*	*59.5%*	*57.2%*	*54.0%*	*56.0%*	*56.5%*	*54.8%*	*53.8%*	*53.1%*
R&D	$1,033.7	$291.6	$294.1	$315.6	$293.5	$1,194.7	$1,326.0	$1,483.4	$1,532.8
% R&D	*5.4%*	*5.8%*	*5.4%*	*5.2%*	*5.2%*	*5.4%*	*5.2%*	*5.2%*	*4.8%*
Operating Income	$1,870.9	$356.9	$708.0	$776.8	$666.0	$2,507.7	$3,520.0	$4,445.7	$5,455.8
Operating Margin	*9.8%*	*7.1%*	*13.0%*	*12.8%*	*11.8%*	*11.3%*	*13.8%*	*15.6%*	*17.1%*
Interest income, net	($191.4)	($40.0)	($40.0)	($40.0)	($40.0)	($160.0)	($50.0)	$95.0	$120.0
Pre-Tax Income	$1,679.6	$316.9	$668.0	$736.8	$626.0	$2,347.7	$3,470.0	$4,540.7	$5,575.8
Taxes (benefit)	$623.0	$118.8	$250.5	$276.3	$234.7	$880.4	$1,318.6	$1,725.5	$2,118.8
Tax Rate	*37.1%*	*37.5%*	*37.5%*	*37.5%*	*37.5%*	*37.5%*	*38.0%*	*38.0%*	*38.0%*
Income before non-control interest	$1,056.6	$198.1	$417.5	$460.5	$391.2	$1,467.3	$2,151.4	$2,815.2	$3,457.0
Margin	*5.6%*	*3.9%*	*7.7%*	*7.6%*	*6.9%*	*6.6%*	*8.4%*	*9.9%*	*10.8%*
Income to non-controlling interest	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0
% of total	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*
Net Income	$1,056.6	$198.1	$417.5	$460.5	$391.2	$1,467.3	$2,151.4	$2,815.2	$3,457.0
Net Margin	*5.6%*	*3.9%*	*7.7%*	*7.6%*	*6.9%*	*6.6%*	*8.4%*	*9.9%*	*10.8%*
EPS	$0.13	$0.02	$0.05	$0.06	$0.05	$0.18	$0.26	$0.35	$0.43
YOY Growth	*-10.0%*	*52.4%*	*42.9%*	*-5.6%*	*136.6%*	*34.0%*	*46.1%*	*30.9%*	*23.6%*
Diluted Shares O/S	7,837	8,120	8,122	8,122	8,124	8,122	8,150	8,150	8,100

Source: Zacks Investment Research *Brian Marckx, CFA*

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BALANCE SHEET **Electromed Inc.**

	June 30, 2011	March 31, 2011
ASSETS		
Current assets:		
Cash and cash equivalents	$ 4,091,739	$ 3,952,032
Accounts Receivable	9,593,105	9,232,544
Inventories	1,855,957	1,664,965
Prepaid expenses and other current assets	371,257	324,519
Deferred income taxes	722,000	514,000
Total current assets	16,634,058	15,688,060
Property and equipment, net	2,807,082	2,770,695
Finite-life intangible assets	1,235,828	1,255,235
Deferred common stock offering costs	-	-
Other assets	191,964	191,895
Total assets	$ 20,868,932	$ 19,905,885
LIABILITIES		
Current liabilities:		
Revolving line of credit	$ 1,768,128	$ 1,268,128
Current maturities of long term debt	438,267	435,793
Accounts payable	733,621	603,483
Accrued compensation	868,229	814,579
Warranty reserve	444,096	427,764
Other accrued liabilities	161,166	37,162
Income tax payable	-	-
Total current liabilities	4,413,507	3,586,909
Long term debt, less current	1,582,102	1,693,431
Deferred income taxes	167,000	145,000
Total liabilites	6,162,609	5,425,340
Commitments and contingencies		
STOCKHOLDERS' EQUITY		
Common stock	81,005	80,999
Additional paid-in capital	12,794,368	12,765,802
Retained earnings	1,853,450	1,689,244
Common stock subscription receivable for shares o/s of 48,500	(22,500)	(55,500)
Total stockholders' equity	14,706,323	14,480,545
Total liabilities and stockholders' equity	$ 20,868,932	$ 19,905,885

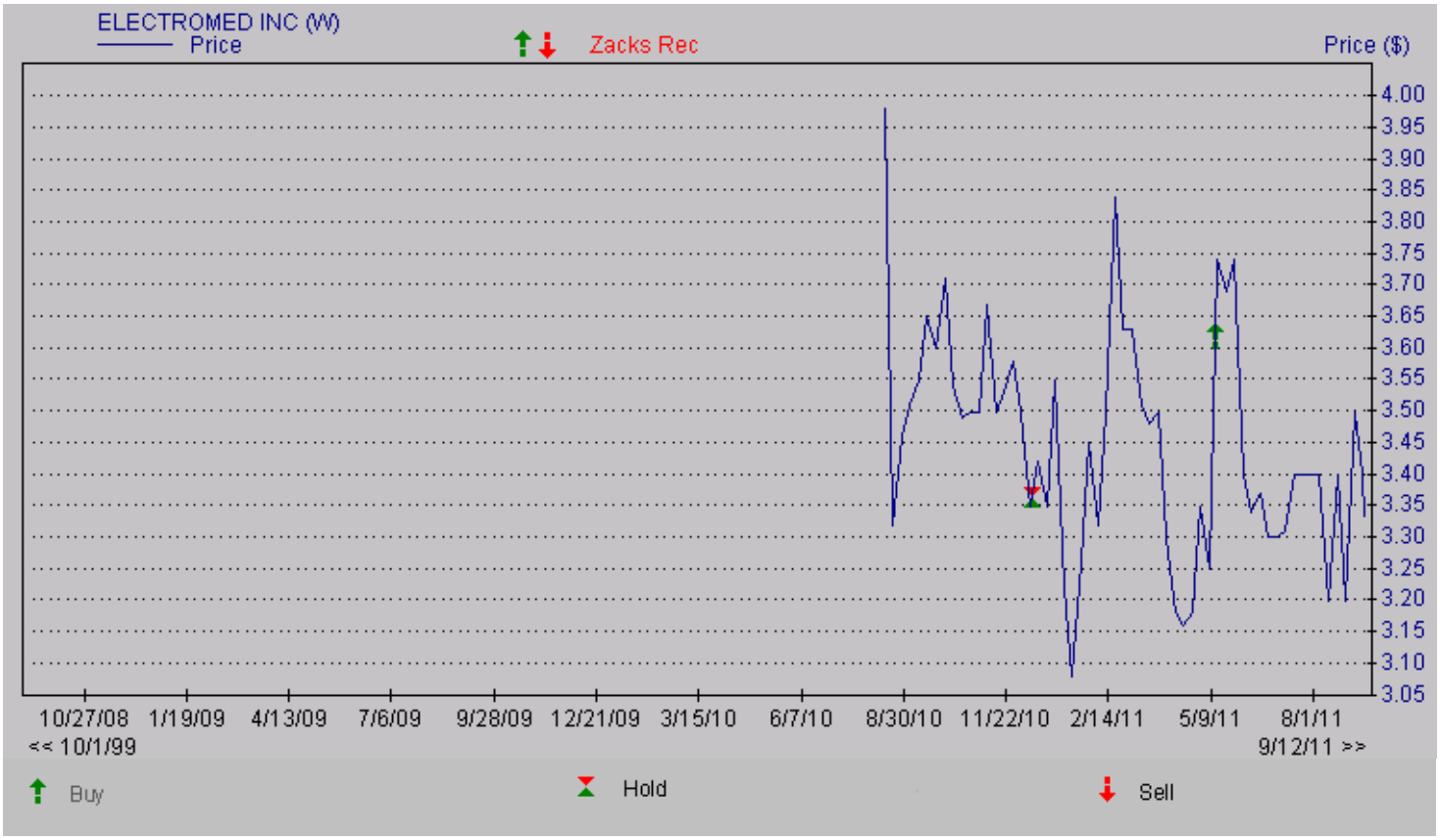
Electromed, Inc

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	Fiscal Year Ending June 30, 2011	2010
Cash flows from operating activities:		
Net income	1,055,577	933,536
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	335,620	298,928
Amortization of finite-life intangible assets	113,850	52,820
Amortization of debt issuance costs	31,463	53,404
Share based compensation expense	156,169	168,895
Deferred income taxes	(186,000)	(149,000)
Loss on disposal of P&E	26,225	4,258
Issuance of common stock for services	-	22,500
Changes in operating assets and liabilities:		
Accounts receivable	(3,016,103)	(228,856)
Inventory	(385,182)	(292,086)
Prepaid expenses and other assets	(193,342)	(111,345)
Accounts payable and accrued liabilites	646,619	(145,117)
Net cash provided by operating activities	(1,415,104)	607,937
Cash flows from investing activities:		
Expenditures for P&E, net	(451,503)	(269,616)
Purchase of nonctonrolling interest in Electromed Financial, LLC	-	(125,000)
Expenditures for finite-life intangible assets	(659,210)	(514,505)
Net cash used in investing activities	(1,110,713)	(909,121)
Cash flows from financing activities:		
Payments on revolving line of credit	-	1,768,128
Proceeds from LT debt	-	2,520,000
Noncontrolling interest distributions paid	-	(18,417)
Principal pymnts on LT debt inc. capital lease obligations	(435,968)	(3,648,744)
Payments of deferred financing fees	(6,716)	(75,780)
Proceeds from stock issuance	6,363,713	-
Payments of deferred offering costs	-	(417,550)
Proceeds of warrant exercises	25,800	390,832
Expenditures of IPO	-	-
Income tax benefit related to exercise of stock warrants	-	22,526
Repurchase of common stock	-	-
Proceeds from subscription notes receivable	60,000	9,000
Net cash provided by (used in) financing activities	6,006,829	549,995
Net increase (decrease) in cash and cash equivalents	3,481,012	248,811
Cash and cash equivalents, beginning of period	610,727	361,916
Cash and cash equivalents, end of period	4,091,739	610,727

Electromed, Inc

HISTORICAL ZACKS RECOMMENDATIONS



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