

Electromed, Inc.
Form 10-Q
February 12, 2019

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE
ACT OF 1934

For the quarterly period ended December 31, 2018

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)

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Minnesota

(State or other jurisdiction of incorporation or organization)

41-1732920

(I.R.S. Employer Identification No.)

500 Sixth Avenue NW

New Prague, Minnesota

(Address of principal executive offices)

56071

(Zip Code)

(952) 758-9299

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes No

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

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

There were 8,384,184 shares of Electromed, Inc. common stock, par value \$0.01 per share, outstanding as of the close of business on February 8, 2019.

Electromed, Inc.
Index to Quarterly Report on Form 10-Q

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PART I – FINANCIAL INFORMATION

Item 1.

Financial Statements.

Electromed, Inc.**Condensed Balance Sheets**

| | December 31, 2018 | June 30, 2018 |
|--|----------------------|------------------|
| | (Unaudited) | |
| Assets | | |
| Current Assets | | |
| Cash | \$7,211,122 | \$7,455,844 |
| Accounts receivable (net of allowances for doubtful accounts of \$45,000) | 11,937,466 | 11,811,308 |
| Contract assets | 781,806 | 776,338 |
| Inventories | 2,735,934 | 2,486,848 |
| Prepaid expenses and other current assets | 329,327 | 751,541 |
| Income tax receivable | 24,860 | – |
| Total current assets | 23,020,515 | 23,281,879 |
| Property and equipment, net | 2,875,807 | 3,091,242 |
| Finite-life intangible assets, net | 618,034 | 649,103 |
| Other assets | 6,257 | 5,907 |
| Deferred income taxes | 361,000 | 364,000 |
| Total assets | \$26,881,613 | \$27,392,131 |
| Liabilities and Shareholders' Equity | | |
| Current Liabilities | | |
| Current maturities of long-term debt, net of debt issuance costs | \$– | \$1,101,043 |
| Accounts payable | 713,097 | 810,644 |
| Accrued compensation | 1,195,479 | 1,269,849 |
| Income tax payable | – | 397,390 |
| Warranty reserve | 790,000 | 760,000 |
| Other accrued liabilities | 372,494 | 464,357 |
| Total current liabilities | 3,071,070 | 4,803,283 |
| Commitments and Contingencies | | |
| Shareholders' Equity | | |
| Common stock, \$0.01 par value; authorized: 13,000,000 shares; 8,384,184 and 8,288,659 issued and outstanding at December 31, 2018 and June 30, 2018, respectively | 83,842 | 82,887 |

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| | | |
|--|--------------|--------------|
| Additional paid-in capital | 15,641,714 | 14,953,103 |
| Retained earnings | 8,084,987 | 7,552,858 |
| Total shareholders' equity | 23,810,543 | 22,588,848 |
| Total liabilities and shareholders' equity | \$26,881,613 | \$27,392,131 |

See Notes to Condensed Financial Statements (Unaudited).

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

| | Three Months Ended | | Six Months Ended | |
|---|---------------------------|-------------|-------------------------|--------------|
| | December 31, | | December 31, | |
| | 2018 | 2017 | 2018 | 2017 |
| Net revenues | \$8,012,487 | \$6,963,044 | \$15,288,370 | \$13,267,366 |
| Cost of revenues | 1,950,040 | 1,560,427 | 3,683,039 | 3,174,032 |
| Gross profit | 6,062,447 | 5,402,617 | 11,605,331 | 10,093,334 |
| Operating expenses | | | | |
| Selling, general and administrative | 5,152,394 | 4,575,172 | 10,428,148 | 9,096,076 |
| Research and development | 237,838 | 56,794 | 306,028 | 127,458 |
| Total operating expenses | 5,390,232 | 4,631,966 | 10,734,176 | 9,223,534 |
| Operating income | 672,215 | 770,651 | 871,155 | 869,800 |
| Interest income (expense), net | 16,521 | (4,894) | 29,974 | (9,093) |
| Net income before income taxes | 688,736 | 765,757 | 901,129 | 860,707 |
| Income tax expense | 311,000 | 346,000 | 369,000 | 360,000 |
| Net income | \$377,736 | \$419,757 | \$532,129 | \$500,707 |
| Income per share: | | | | |
| Basic | \$0.05 | \$0.05 | \$0.06 | \$0.06 |
| Diluted | \$0.04 | \$0.05 | \$0.06 | \$0.06 |
| Weighted-average common shares outstanding: | | | | |
| Basic | 8,298,961 | 8,200,167 | 8,279,493 | 8,200,167 |
| Diluted | 8,669,739 | 8,648,886 | 8,658,346 | 8,645,987 |

See Notes to Condensed Financial Statements (Unaudited).

Electromed, Inc.**Condensed Statements of Cash Flows (Unaudited)**

| | Six Months Ended December 31, | |
|---|----------------------------------|-------------|
| | 2018 | 2017 |
| Cash Flows From Operating Activities | | |
| Net income | \$532,129 | \$500,707 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation | 329,947 | 329,719 |
| Amortization of finite-life intangible assets | 59,863 | 56,610 |
| Amortization of debt issuance costs | 1,958 | 4,394 |
| Share-based compensation expense | 500,745 | 386,248 |
| Deferred income taxes | 3,000 | (50,000) |
| Loss of disposal of property and equipment | 1,198 | - |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (126,158) | 347,190 |
| Contract assets | (5,468) | 7,356 |
| Inventories | (242,459) | 169,723 |
| Prepaid expenses and other assets | 421,864 | 4,074 |
| Income tax receivable | (24,860) | - |
| Income tax payable | (397,390) | (72,414) |
| Accounts payable and accrued liabilities | (233,780) | (153,824) |
| Net cash provided by operating activities | 820,589 | 1,529,783 |
| Cash Flows From Investing Activities | | |
| Expenditures for property and equipment | (122,337) | (228,176) |
| Expenditures for finite-life intangible assets | (28,794) | (10,038) |
| Net cash used in investing activities | (151,131) | (238,214) |
| Cash Flows From Financing Activities | | |
| Principal payments on long-term debt including capital lease obligations | (1,103,001) | (25,041) |
| Issuance of common stock upon exercise of options | 188,821 | - |
| Net cash used in financing activities | (914,180) | (25,041) |
| Net (decrease) increase in cash | (244,722) | 1,266,528 |
| Cash | | |
| Beginning of period | 7,455,844 | 5,573,709 |
| End of period | \$7,211,122 | \$6,840,237 |

See Notes to Condensed Financial Statements (Unaudited).

Electromed, Inc.
Notes to Condensed Financial Statements
(Unaudited)

Note 1. Interim Financial Reporting

Basis of presentation: Electromed, Inc. (the “Company”) develops, manufactures and markets innovative airway clearance products that apply High Frequency Chest Wall Oscillation (“HFCWO”) therapy in pulmonary care for patients of all ages. The Company markets its products in the U.S. to the home health care and institutional markets for use by patients in personal residences, hospitals and clinics. The Company also sells internationally both directly and through distributors. International sales were approximately \$414,000 and \$267,000 for the six months ended December 31, 2018 and 2017, respectively. Since its inception, the Company has operated in a single industry segment: developing, manufacturing and marketing medical equipment.

The accompanying unaudited condensed financial statements of the Company have been prepared in accordance with U.S. generally accepted accounting principles (“U.S. GAAP”) for interim financial statements and pursuant to the rules and regulations of the U.S. Securities and Exchange Commission. In the opinion of management, the accompanying unaudited condensed financial statements reflect all adjustments consisting of normal recurring adjustments necessary for a fair presentation of the Company’s financial position and results of operations as required by Regulation S-X. Interim results of operations are not necessarily indicative of the results that may be achieved for the full year. The financial statements and related notes do not include all information and footnotes required by U.S. GAAP for annual reports. This interim report should be read in conjunction with the audited financial statements included in the Company’s Annual Report on Form 10-K for the fiscal year ended June 30, 2018 (“fiscal 2018”).

A summary of the Company’s significant accounting policies follows:

Use of estimates: Management uses estimates and assumptions in preparing the condensed financial statements in accordance with U.S. GAAP. Those estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and the reported revenues and expenses. Actual results could vary from the estimates that were used. The Company believes the critical accounting policies that require the most significant assumptions and judgments in the preparation of its condensed financial statements include revenue recognition and the related estimation of variable consideration, allowance for doubtful accounts, the valuation of intangible and long-lived assets, inventory obsolescence, share-based compensation, income taxes and the warranty reserve.

Net income per common share: Net income is presented on a per share basis for both basic and diluted common shares. Basic net income per common share is computed using the weighted average number of common shares outstanding during the period, excluding any restricted stock awards which have not vested. The diluted net income per common share calculation includes outstanding restricted stock grants and assumes that all stock options were exercised and converted into shares of common stock at the beginning of the period unless their effect would be anti-dilutive. Common stock equivalents excluded from the calculation of diluted earnings per share because their impact was anti-dilutive was 356,084 and 177,750 for the three and six months ended December 31, 2018 and 2017, respectively.

New accounting pronouncements: In May 2014, the Financial Accounting Standards Board (“FASB”) issued guidance creating Accounting Standards Codification (“ASC”) 606, “Revenue from Contracts with Customers.” The new section replaces ASC 605, “Revenue Recognition,” and replaces all revenue guidance for specialized transactions and industries. The new section is intended to conform revenue accounting principles to concurrently issued International Financial Reporting Standards with previously differing treatment between U.S. practice and that of much of the rest of the world, as well as to enhance disclosures related to disaggregated revenue information.

The Company adopted the new standard effective July 1, 2018, utilizing the full retrospective method, which required the Company to recast each prior reporting period presented and included adjustments with the cumulative impact of increasing retained earnings by \$0.8 million as of July 1, 2017. The Company has updated its control framework for new internal controls and made changes to existing controls related to the new revenue recognition standard.

Primary changes resulting from the adoption of ASC 606:

The Company's adoption of ASC 606 resulted in a change to the timing of revenue recognition, primarily driven by the following:

Some of the SmartVest[®] Airway Clearance Systems ("SmartVest Systems") are sold to customers (patients) who have coverage with certain third-party insurance providers from which the Company receives reimbursements on a monthly installment basis over a specific term. The ultimate amount of consideration received can be significantly less than expected if the applicable third-party insurance provider discontinues payments due to changes in the patient's status, including insurance coverage, hospitalization, death, or otherwise becoming unable to use the system. As the transaction price was not deemed to be fixed and determinable, the Company previously deferred revenue recognition at the time of sale and recognized revenue as each installment became billable and other criteria were met. Under ASC 606, the Company estimates variable consideration in the transaction price at contract inception and through the duration of the contract based on historical experience and other relevant factors and recognizes revenue when control of the SmartVest System is transferred to the patient, which occurs at the time of shipment. This results in an acceleration of the timing of revenue recognition relative to prior accounting treatment.

The Company sells the SmartVest Systems to patients under circumstances where it believes the criteria for reimbursement under government or commercial payer contracts has been met; however, coverage is unconfirmed or payments are under appeal, leading to uncertainty as to the amount of the transaction price that will be collected. Additionally, amounts due directly from patients for deductibles, coinsurance and copays may be subject to implicit price concessions if the patient becomes unable to pay due to hospitalization or death. Previously, the Company fully deferred revenue at the time of sale until the transaction price for these contracts was deemed to be fixed and determinable (i.e., when the appeal was settled, or payment was received). Under ASC 606, the Company estimates variable consideration in the transaction price at contract inception and reassess throughout the contract period based on historical experience and other relevant factors and recognizes revenue when control of the SmartVest System is transferred to the patient, which occurs at the time of shipment or delivery.

Impact on Previously Reported Results:

The following tables present a recast of selected unaudited statement of operations line items after giving effect to the adoption of ASC 606:

| For the three months ended December 31, 2017 | | |
|---|-----------------------|----------------|
| As Previously Reported | Effect of Adoption | As Adjusted |

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| | | | |
|-------------------------------------|-------------|-------------|-------------|
| Net revenues | \$6,984,626 | \$(21,582) | \$6,963,044 |
| Cost of revenues | 1,398,001 | 162,426 | 1,560,427 |
| Gross profit | 5,586,625 | (184,008) | 5,402,617 |
| Operating expenses | | | |
| Selling, general and administrative | 4,759,652 | (184,480) | 4,575,172 |
| Research and development | 56,794 | – | 56,794 |
| Total operating expenses | 4,816,446 | (184,480) | 4,631,966 |
| Operating income | 770,179 | 472 | 770,651 |
| Interest income (expense), net | (4,894) | – | (4,894) |
| Net income before income taxes | 765,285 | 472 | 765,757 |
| Income tax expense | 416,000 | (70,000) | 346,000 |
| Net income | \$349,285 | \$70,472 | \$419,757 |
| Income per share: | | | |
| Basic | \$0.04 | \$0.01 | \$0.05 |
| Diluted | \$0.04 | \$0.01 | \$0.05 |

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| | For the six months ended December 31, 2017 | | |
|-------------------------------------|---|-----------------------|---------------|
| | As Previously Reported | Effect of Adoption | As Adjusted |
| Net revenues | \$ 13,366,405 | \$(99,039) | \$ 13,267,366 |
| Cost of revenues | 2,843,286 | 330,746 | 3,174,032 |
| Gross profit | 10,523,119 | (429,785) | 10,093,334 |
| Operating expenses | | | |
| Selling, general and administrative | 9,463,163 | (367,087) | 9,096,076 |
| Research and development | 127,458 | – | 127,458 |
| Total operating expenses | 9,590,621 | (367,087) | 9,223,534 |
| Operating income | 932,498 | (62,698) | 869,800 |
| Interest income (expense), net | (9,093) | – | (9,093) |
| Net income before income taxes | 923,405 | (62,698) | 860,707 |
| Income tax expense | 453,000 | (93,000) | 360,000 |
| Net income | \$470,405 | \$30,302 | \$500,707 |
| Income per share: | | | |
| Basic | \$0.06 | \$0.00 | \$0.06 |
| Diluted | \$0.05 | \$0.01 | \$0.06 |

The following table presents a recast of selected unaudited balance sheet line items after giving effect to the adoption of ASC 606:

| | June 30, 2018 | | |
|--|------------------------------|-----------------------|----------------|
| | As Previously Reported | Effect of Adoption | As Adjusted |
| Assets | | | |
| Current Assets | | | |
| Accounts receivable, net of allowances for doubtful accounts | \$11,563,208 | | |