Improving Lives. Continuing Success. Accelerating Growth.

UROLOGIX®

2000 ANNUAL REPORT

Urologix®: Who We Are & Who We Help

Urologix, Inc. (Nasdaq: ULGX) was created to serve an important yet unmet need – the need to develop an effective, minimally invasive treatment for benign prostatic hyperplasia (BPH), a non-cancerous enlargement of the prostate affecting over 23 million men worldwide.

Our primary product offering, the Targis™ System, is recognized as a standard of care for the minimally invasive treatment of BPH. Better than medication and safer than surgery, Targis has become the treatment of choice for BPH sufferers around the world.

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Another year of improving lives, continuing success and accelerating growth

TO OUR SHAREHOLDERS:

The past year has been an eventful one for Urologix®. I am pleased to report that the company has continued to make significant progress in achieving its goal of making Targis™ a treatment of choice for BPH sufferers around the world.

As a result of our accomplishments over the past year, Urologix is now better positioned than ever before to offer a marketplace of over 23 million men an alternative treatment option – one that is proven to be better than medication and safer than surgery.

Setting the Stage for Growth

Our mission from the start was to help BPH sufferers improve their quality of life. Today, we can proudly say we have achieved that mission. Targis is fast becoming a standard of care for the treatment of BPH worldwide.

In fiscal year 2000, Urologix made great strides toward solidifying its procedure-based business model and has set a solid foundation from which to further accelerate its growth strategy.

Building a Winning Team

In order to build on our success, we actively sought key additions to our management team and Board of Directors. Of particular note, we hired Kirsten Doerfert, Vice President Marketing, and David Montecalvo, Vice President, Product Development and Operations. In addition, Ron Blasewitz filled the new position of Chief Operating Officer, Christopher Geyen was promoted to Chief Financial Officer, and David Talen was promoted to Vice President, International.

We are also pleased to report that Rick Randall joined our Board of Directors, bringing with him extensive experience in high growth medical products companies. Rick's expertise and insight will be valuable as we look to aggressively expand our sales and marketing teams to accelerate the growth and acceptance of Targis treatment.

With these additions, we have created a team with a wealth of medical device and urological experience from companies such as Medtronic, GE Medical Systems and Circon Corporation. We believe that with this team in place, we will be able to capture the opportunity that our technology and the BPH market offers.

Setting a Standard of Care

During the year we achieved two key milestones that have helped further solidify the reputation of Targis treatment as a standard of care by which all BPH treatments are measured.

The first milestone occurred at the American Urological Association's annual meeting in Atlanta. A leading urologist presented five years of multi-center clinical data showing conclusively that Targis treatment provides durable results and truly superior outcomes.

The second milestone occurred at the Fifth International Consultation on BPH where the World Health Organization strongly endorsed Targis treatment as a safe, effective, minimally invasive alternative to surgery.

By achieving these important milestones, Urologix has established an improved standard of care while successfully positioning the company for continued growth.

Continuing to Enhance Our Technology

During the year we made several enhancements to the Targis System that both increased patient comfort and physician ease of use.

In March, we received FDA approval for Cruise II, a software enhancement to Targis that improves ease of use and gives physicians the ability to perform a fully automated treatment.

Another major development in 2000 was the FDA's approval of the Express Protocol. The Express Protocol shortens Targis treatment time to under 30 minutes in most cases – less than half that of the Standard Protocol.

The Express Protocol delivers results similar to the 60-minute treatment – providing durable relief from BPH symptoms and enabling patients to quickly return to their daily routine.

Our new 30-minute treatment enhances both patient comfort and physician productivity. It also gives Urologix a competitive advantage by enabling us to offer a system that combines a quick, comfortable treatment with industry leading patient satisfaction and outcomes.

These important developments and accomplishments have strengthened Urologix and further solidified Targis in the marketplace as a leading treatment for BPH.

As a result of our efforts, more than 10,000 men are leading happier, more fulfilling lives thanks to a unique technology that we created just for them. Knowing that our technology is making such an important difference in so many people's lives is incredibly rewarding for everyone at Urologix.

Medicare Proposes Office-Based Reimbursement for Targis

In July, the Health Care Financing Administration (HCFA) published proposed payment rates and a schedule for implementing office-based reimbursement beginning January 1, 2001. This is a major step forward not only for Urologix, but for physicians and their patients as well.

With the proposed change in Medicare reimbursement to cover office-based Targis treatment procedures, physicians will be able to determine the most appropriate site of service for patients in their community. It will also provide busy physicians with the ability to treat more patients more efficiently.

The pending approval of office-based reimbursement creates significant opportunity for Urologix to expand patient access and ultimately reduce the system costs for BPH treatments.

Building Lasting Relationships

Our collaborative approach to working with physicians and strategic business partners continued to bear fruit in 2000.

During the year, we continued to focus on providing Targis treatment to physicians on a per procedure basis. This physician-friendly approach eliminates the capital investment barrier. As a result of the success of this program, we have significantly increased acceptance of and access to our technology among physicians.

Our team has also succeeded in providing doctors with the business support and training they need to introduce Targis treatment to their patients and colleagues. It's all part of our ongoing effort to build and maintain the long-term relationships so vital to our company's growth.

"I am pleased to report that the company has continued to make significant progress in achieving its goal of making Targis™ a treatment of choice for BPH sufferers around the world."

Michael M. Selzer Jr.
President and Chief Executive Officer

Building on Our Success

Taken together, our accomplishments this year underscore what our employees and shareholders have known for some time: that Targis is the best minimally invasive BPH treatment available in the world today.

I'm proud to report that the future has never looked brighter for Urologix. Today, the company is uniquely positioned for continued success and accelerated growth. As we move forward, we are focusing our efforts to grow the company through:

- *Continued expansion of our sales force*
- *Increased marketing and physician training programs*
- *Further expanding the availability of Targis treatment*
- *Expanding the company's scope into other treatment areas*

As we continue to grow and prosper, we look forward to sharing our progress with our patients, the medical community and with our shareholders. Thank you for your continued support.

Sincerely,

Michael M. Selzer Jr.
President and Chief Executive Officer

Targis™ sets a new standard for effective, long-lasting results

At Urologix, we set the highest standards for ourselves and our technology. That's because we know that the ultimate beneficiary of our work is the patient – and it's up to us to make sure Targis provides the safest, most effective treatment possible.

Targis Is a New Standard of Care

Surgery and drug therapy have long been considered the standards for treating BPH. But not anymore. At the 5th International Consultation on BPH, the World Health Organization endorsed microwave treatment as a highly desirable alternative – citing the Targis treatment category as a truly minimally invasive treatment that can be delivered in an outpatient setting without anesthesia, which is a benefit for both patients and physicians.

Better Than Medication, Safer Than Surgery

Targis treatment has become a treatment of choice for the many BPH patients who find medication ineffective or are concerned about the risks associated with surgery. For these patients, Targis offers a minimally invasive treatment option that is safe and far less costly than a lifetime of medication.

Lasting Results Make All the Difference

Every patient wants the treatment he receives to provide lasting results. Long-term clinical studies show a great majority of patients continue to enjoy significant relief from their BPH symptoms five years following Targis treatment. For men looking to improve their quality of life, lasting results like these make all the difference.

Office Treatment for Added Convenience

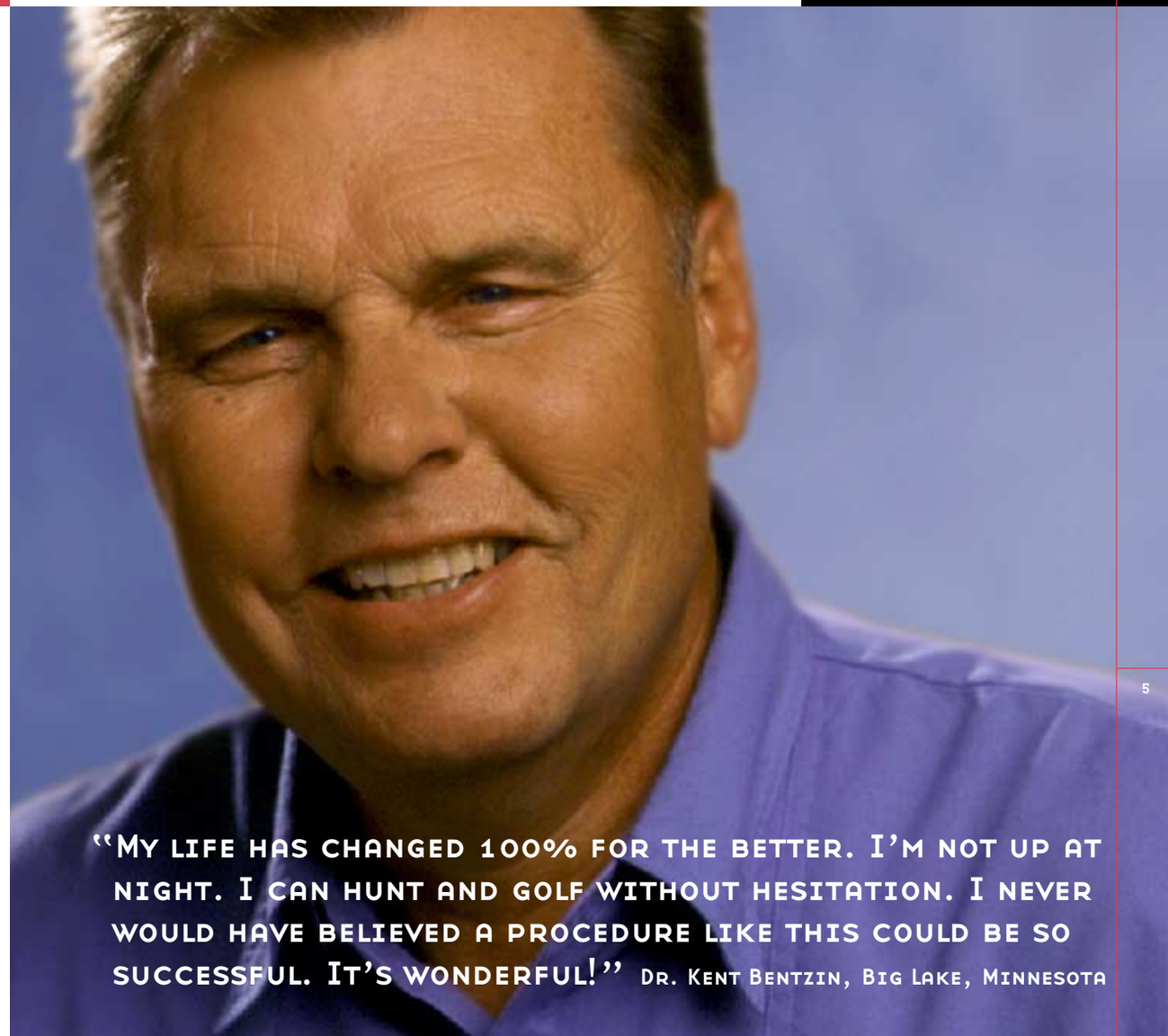
From the beginning, Targis treatment was designed to be easily performed in a variety of settings including the urologist's office. Now that Medicare has proposed to reimburse office-based Targis procedures, we hope patients will be able to enjoy the convenience of making just one visit to the urologist for both diagnosis and treatment.

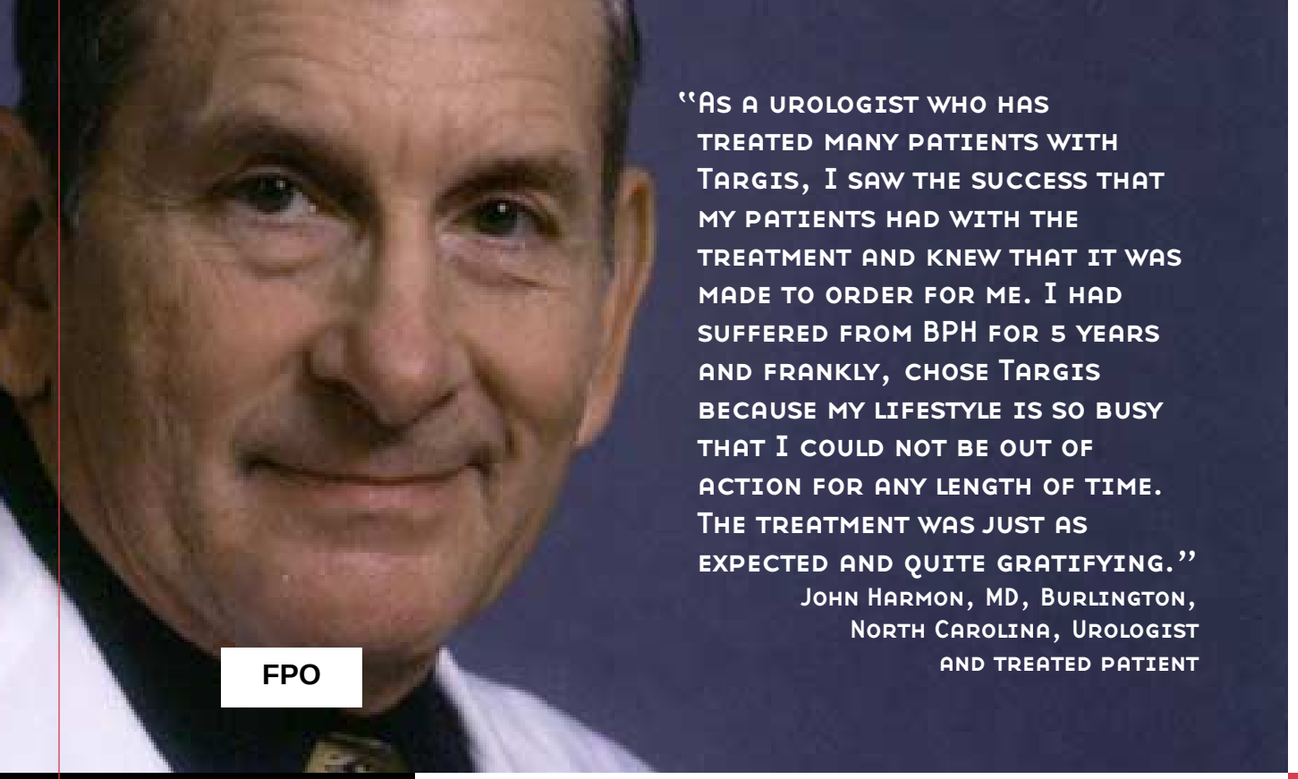
Quicker Recovery, Lasting Relief

We believe patients who consider all of their BPH treatment options will make Targis their number one choice. And, why not? This simple, minimally invasive treatment offers much quicker recovery than surgery and provides lasting relief from BPH symptoms that is better than medication. For most patients, it is simply the best choice.

A Patient's Perspective

For patients worldwide, Targis offers a proven way to achieve long-term relief from the symptoms of BPH – without the risk of surgery or the high cost associated with drug therapy. And now, with the proposed Medicare reimbursement for in-office treatment, Targis offers the most convenient minimally invasive option available.





"As a urologist who has treated many patients with Targis, I saw the success that my patients had with the treatment and knew that it was made to order for me. I had suffered from BPH for 5 years and frankly, chose Targis because my lifestyle is so busy that I could not be out of action for any length of time. The treatment was just as expected and quite gratifying."

John Harmon, MD, Burlington, North Carolina, Urologist and treated patient

A Physician's Perspective

Physicians have found a partner in Urologix. They turn to us for a treatment they know to be safe, effective and durable. They also know that the excellent outcomes our Targis System provides will lead to happy, satisfied patients – which in turn helps their medical practice grow and thrive.

Physicians want to know that the treatment they prescribe will provide effective, lasting results. They also want to know that the business relationships they form will yield lasting success. That's why more and more physicians are turning to Urologix.

Durability Physicians Can Depend On

With five years of multicenter clinical data – more than any other minimally invasive treatment option – Targis has been proven to provide effective, long-lasting relief from BPH symptoms. Urologists know they can depend on Urologix to provide the high level of product durability they expect from a leader in the field.

Physician Acceptance at an All Time High

Over the past two years, the number of urologists trained to perform Targis treatment has grown almost eight-fold. This rapidly accelerating acceptance of Targis treatment is a strong sign that the urology community's confidence in Urologix continues to grow.

Physicians Welcome Faster, Office-Based Treatment

Urologists have welcomed the recent FDA approval of Express Protocol – effectively cutting Targis treatment time in half. Urologists and technicians are also excited about the new Cruise II software enhancement that provides the ability to perform a fully automated Targis treatment.

Express Protocol and Cruise II, combined with Medicare's proposed decision to reimburse office-based Targis treatment, will enable urologists to treat more patients more quickly and easily than ever before.

Here to Help Every Step of the Way

Urologix is dedicated to making Targis treatment a valuable part of every urologist's practice. We do this by providing each of our physician partners with the most complete clinical, technical and reimbursement support available. Urologix also offers the business development and marketing support to help physicians quickly integrate Targis treatment into their practices.

Lasting results help build lasting relationships

Urologix®: A growth opportunity

Urologix has made significant progress over the past year to position the company for continued success and future growth. As we continue to grow and achieve our goals, we remain more committed than ever to creating value for our shareholders.

The Leader in a Rapidly Growing Market

Over the past year the market for minimally invasive treatments for BPH such as Targis has grown rapidly. It is estimated that the U.S. market for minimally invasive treatments for BPH grew more than 65% last year, with further growth expected in years to come. With Targis as a standard of care for BPH, we believe Urologix is uniquely positioned to profit from this rapidly growing market opportunity.

Growing to Meet Rising Demand

Urologix is one of the fastest growing companies in the BPH market. Over the past year, we have doubled the number of Targis treatment locations to more than 200 nationwide and continue to expand our global presence. By expanding the reach of Targis treatment, the company has enjoyed rapid growth in procedure revenue – with domestic procedure kit sales up 80% over fiscal year 1999.

Leaner, Faster and More Nimble Than Ever

At Urologix, we have worked hard to create a lean and agile organization as innovative as our technology. By implementing a unique "procedure focused" business model, we have significantly reduced operating costs for our physician partners while generating a fast-growing stream of revenue for our company.

Office-Based Reimbursement a Plus

In July 2000, Medicare proposed reimbursement for Targis treatment conducted in the urologist's office beginning in January of 2001. Reimbursement for office-based Targis treatment represents a significant opportunity both for physicians and patients. It marks a major step forward in making Targis easily available and more affordable to all BPH sufferers.

An Investment Perspective

Today, there are over 23 million men suffering from BPH. In Urologix, investors see an emerging industry leader with the low cost/high margin business model, proprietary technologies and seasoned management team needed to take full advantage of this sizable market opportunity.

Financial Information

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YEARS ENDED JUNE 30	2000	1999	1998	1997	1996
STATEMENTS OF OPERATIONS DATA		(in thousands, except per share data)			
Sales	**$ 8,163**	$ 6,110	$11,194	$ 5,504	$ 362
Operating loss	**(8,574)**	(15,762)	(13,693)	(10,067)	(7,825)
Net loss	**(7,097)**	(14,016)	(15,013)	(8,234)	(7,593)
Basic and Diluted:					
Net loss per common share	**$ (0.62)**	$ (1.24)	$ (1.44)	$ (0.90)	$ (1.22)
Shares used in computing net loss per share	**11,514**	11,346	10,429	9,173	6,235
BALANCE SHEET DATA					
Working capital	**$23,132**	$28,803	$41,375	$27,013	$39,940
Total assets	**31,956**	38,988	53,489	35,582	42,368
Total liabilities	**3,186**	3,521	4,152	3,185	1,780
Total shareholders' equity	**28,770**	35,467	49,337	32,397	40,588

Forward Looking Statements

Statements included in this Annual Report that are not historical current facts are forward-looking statements that are based on current expectations and beliefs. Forward-looking statements involve risks and uncertainties that could cause actual results to differ materially from those suggested in the forward-looking statements. Some of the factors that could cause actual results to differ include, among others, (i) market acceptance of the Targis System, (ii) availability, timing and amount of third-party reimbursement for the Targis procedure, (iii) the Company's ability to maintain intellectual property protection for its proprietary products and to defend its existing intellectual property rights from challenges by third parties, and the additional factors set forth under "Business—Cautionary Statements Regarding Future Operations" in the Company's Form 10-K for the year ended June 30, 2000, and other documents filed from time to time with the Securities and Exchange Commission. The forward-looking statements included in this Annual Report are made only as of the date hereof, and Urologix undertakes no obligation to publicly revise or update the forward-looking statements to reflect subsequent events or circumstances.

Overview

Urologix® develops, manufactures, and markets a minimally invasive medical device for the treatment of benign prostatic hyperplasia ("BPH"), commonly known as "enlarged prostate". BPH dramatically affects the quality of life of millions of men by causing adverse changes in urinary voiding patterns. Urologix' Targis™ System has been approved for marketing in the United States, the 15 European Union countries, Japan and Canada.

The Targis procedure is a non-surgical, catheter-based treatment that uses a proprietary microwave technology to precisely heat diseased areas of the prostate, while simultaneously cooling and protecting the pain-sensitive urethral tissue. Because the urethra is protected from heat and is not punctured or penetrated, Targis treatment can be performed without anesthesia or intravenous sedation. Accordingly, Targis treatment is uniquely positioned to be performed in a physician's office or an outpatient clinic. The Company believes Targis treatment provides an efficacious, safe and cost-effective solution for BPH that provides results superior to medication without the complications and side effects inherent in surgical procedures, and, as such, is well positioned to address the needs of physicians, patients and payors.

The Company markets the Targis System in the United States through a direct sales force. The Company intends to continue to expand the direct sales force and enhance its direct sales capabilities. The Company's strategy is to focus marketing and sales efforts on generating physician access to and awareness of the Targis System while creating patient demand by providing education on the benefits of Targis treatment versus other treatment options.

Outside the United States, the Company has a distribution agreement with Nihon Kohden Corporation, a major Japanese developer, manufacturer and marketer of medical devices, for the market development and sales of the Targis System in Japan. The Company also has a distribution agreement with Boston Scientific Corporation ("Boston Scientific") covering the majority of the European countries. Under the agreement, Urologix has responsibility for market development of the Targis System and works with Boston Scientific to sell Targis Systems from Boston Scientific's inventory through Urologix' direct sales force and other distributors in Europe. Boston Scientific compensates Urologix for Urologix' market development services.

Results of Operations

FISCAL YEARS ENDED JUNE 30, 2000 AND 1999

Sales increased to $8.2 million in fiscal 2000 from $6.1 million in fiscal 1999, due primarily to increased sales of Targis System procedure kits in the United States. U.S. sales grew to $7.9 million in fiscal 2000 from $5.6 million in 1999, while international sales decreased to $300,000 in fiscal 2000 from $500,000 in 1999. The increase in U.S. procedure kits sales is primarily the result of the "per procedure" sales and marketing business model that was implemented in March of 1999. Under the per procedure fee program, customers pay a fee for the use of a Targis System control unit and treatment catheter, reducing the need for an upfront capital equipment purchase. The Company will continue to offer this program in fiscal 2001. As expected, international sales decreased in fiscal 2000 due to existing inventories of the Company's products held by the Company's international distributors.

Cost of goods sold includes raw materials, labor, overhead, and royalties incurred in connection with the production of the Targis System control units and disposable procedure kits. Cost of goods sold decreased to $4.4 million in fiscal 2000 compared to $5.9 million in fiscal 1999. Cost of goods sold was adversely affected by two events in fiscal 1999. First, as a result of a downward revision to forecasted sales, the Company established a reserve of $1.3 million for excess inventory. Second, the Company operated under a reduced production schedule, as production was transitioned to a new catheter design, resulting in the allocation of overhead over a lower production volume. Gross profit as a percentage of sales increased to 47% in fiscal 2000 from 3% in the prior fiscal year due primarily to improved manufacturing efficiency, decreased product cost, and the impact of the two events noted above.

Research and development expenses include expenditures for product development, regulatory compliance, and clinical studies. Clinical study costs consist largely of payments to clinical sites and investigators, product for clinical studies, and costs associated with monitoring clinical studies. Research and development expenses decreased to $3.6 million in fiscal 2000 from $5.1 million in fiscal 1999, due primarily to reductions in staffing, lower clinical study expenses, and lower product development expenses. Research and development expenses are expected to remain at approximately the same levels in fiscal 2001 as the Company focuses on improving the function and features of the Targis System, reducing the production cost of the Targis System components, and investigating other applications for its technology.

Sales and marketing expenses decreased slightly in fiscal 2000 to $6.7 million, from $6.8 million in fiscal 1999. The decrease was primarily the result of reductions in international sales and marketing expenses which were offset by increased investment in U.S. sales and marketing efforts. The Company expects sales and marketing expenses to increase as the Company hires additional direct sales representatives and intensifies its efforts to generate awareness and acceptance of the Targis treatment.

General and administrative expenses decreased to $2.1 million in fiscal 2000 from $4.0 million in fiscal 1999. General and administrative expenses for fiscal 1999 include a $1.6 million charge incurred in connection with the operational realignment. Excluding the impact of a $1.6 million charge, general and administrative expenses decreased due to reductions in staffing and other administrative expenses.

Interest income decreased to $1.5 million for fiscal 2000 from $1.7 million in fiscal 1999. Interest income decreased due primarily to lower cash and investment balances.

FISCAL YEARS ENDED JUNE 30, 1999 AND 1998

Sales decreased to $6.1 million in fiscal 1999 from $11.2 million in fiscal 1998 due to a decrease in international sales. Sales in the United States represented approximately 92% of revenue in fiscal 1999, compared to 27% of revenue in fiscal 1998, representing growth in United States sales of 87% from fiscal 1998 to fiscal 1999.

Cost of goods sold decreased to $5.9 million in fiscal 1999 compared to $9.2 million in fiscal 1998. The decrease in cost of goods sold was attributable primarily to decreases in sales volume. Cost of goods sold in fiscal 1999 included a $1.3 million reserve for excess inventory, while fiscal 1998 cost of goods sold included a $700,000 inventory write down related to a bad component. Gross profit as a percentage of sales decreased to 3% in fiscal 1999 from 18% in 1998, primarily as a result of the excess inventory write-down and allocation of overhead over lower production volume.

Research and development expenses decreased to $5.1 million in fiscal 1999 from $6.7 million in fiscal 1998, due primarily to the conclusion of several clinical studies and lower regulatory expenses.

Sales and marketing expenses for fiscal 1999 were $6.8 million, which was consistent with fiscal 1998. Additional sales and marketing costs incurred in 1999, including fees paid to Boston Scientific in connection with the domestic co-marketing agreement, were offset by payments received from Boston Scientific for international market development services provided by Urologix. These payments were recorded as a reduction to sales and marketing expense. Sales and marketing expenses were primarily related to sales and marketing personnel, recruitment of field sales representatives, advertising and promotion, and efforts related to obtaining third-party reimbursement for the Targis System.

General and administrative expenses increased to $4.0 million in fiscal 1999 compared to $2.3 million in fiscal 1998. General and administrative expenses for fiscal 1999 reflect a non-recurring charge of $1.6 million incurred in connection with a reduction in workforce in October 1998 that resulted from the downward revision of the Company's sales forecast. The charge included severance costs paid to employees, future lease costs related to facilities no longer occupied and the impairment of assets no longer used as a result of the reduction in work force.

Interest income decreased to $1.7 million for fiscal 1999 from $2.1 million in fiscal 1998. Interest income decreased due primarily to lower cash and investment balances.

Liquidity and Capital Resources

The Company has financed its operations since inception through sales of equity securities and, to a lesser extent, sales of the Targis System. As of June 30, 2000, the Company had total cash, cash equivalents and available-for-sale securities of $23.6 million and working capital of $23.1 million.

During fiscal 2000, the Company used $4.3 million in operating activities, primarily as a result of the Company's net loss of $7.1 million, which was partially offset by depreciation and amortization of $1.5 million and a decrease in inventories of $1.0 million. The Company generated $3.7 million in investing activities, primarily reflecting the net sale of $4.2 million in investment securities less purchases of $500,000 of property and equipment. The Company completed a secondary offering in November 1997 that raised net proceeds of $31.5 million.

In January of 2000, the Company amended the International Distribution Agreement with Boston Scientific Corporation. Under the amended agreement, Boston Scientific will compensate the Company for market development services by shipping and transferring title of a defined number of Targis System control units held in Boston Scientific's inventory to the Company. The Company intends to use these control units as part of its per procedure rental program.

At June 30, 2000, the Company did not have any significant purchase commitments.

The Company expects to continue to incur additional losses and will use its working capital as it incurs substantial expenses related to the Targis System marketing and research and development activities. In addition, the Company has commenced a program to rent Targis System control units to customers on a per procedure basis. Depending on the growth of this program, the Company may use substantial capital to finance the units rented by customers.

Although the Company believes that existing cash, cash equivalents and available-for-sale securities will be sufficient to fund its operations for at least the next 24 months, there can be no assurance that the Company will not require additional financing in the future or that any additional financing will be available to the Company on satisfactory terms, if at all.

Interest Rate Risk

The fair value of the Company's investment portfolio at June 30, 2000 approximated carrying value. Increases and decreases in prevailing interest rates generally translate into decreases and increases in the fair value of these instruments. Also, fair values of interest rate sensitive instruments may be affected by the credit worthiness of the issuer, prepayment options, relative values of alternative instruments, the liquidity of the instrument and other general market conditions.

Market risk was estimated as the potential decrease in fair value resulting from a hypothetical 10% increase in interest rates for the issues contained in the investment portfolio and was not materially different from the year-end carrying value.

Year 2000 Issue

The Company's computer systems and equipment successfully transitioned to the year 2000 with no significant issues. As of this date, the Company is not aware of any problems resulting from Year 2000 issues, either with its products, internal systems, or the products and services of third parties, that would have a material impact on the future operations or financial results of the Company. The Company will continue to monitor its critical computer applications and those of its customers, suppliers and vendors throughout the year 2000 to ensure that any latent Year 2000 matters that may arise are addressed promptly. The Company did not incur any material expenditures in connection with its Year 2000 testing and remediation.

BALANCE SHEETS

AS OF JUNE 30	2000	1999
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	**$ 458,707**	$ 657,596
Available-for-sale securities	**23,138,875**	27,378,692
Accounts receivable, net of allowance of $285,000 and $171,000	**1,027,494**	1,260,810
Inventories	**1,454,000**	2,436,418
Prepaids and other current assets	**237,978**	588,355
Total current assets	**26,317,054**	32,321,871
PROPERTY AND EQUIPMENT:		
Leasehold improvements	**742,923**	742,923
Machinery, equipment and furniture	**4,516,460**	4,029,743
Less- Accumulated depreciation and amortization	**(3,580,850)**	(2,521,479)
Property and equipment, net	**1,678,533**	2,251,187
OTHER ASSETS	**3,960,266**	4,414,974
	$31,955,853	$38,988,032
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Current maturities of capitalized lease obligations	**$ -**	$ 8,924
Accounts payable	**1,083,697**	836,999
Accrued liabilities	**2,101,783**	2,672,743
Total current liabilities	**3,185,480**	3,518,666
CAPITALIZED LEASE OBLIGATIONS, *less current maturities*	**-**	2,723
Total liabilities	**3,185,480**	3,521,389
COMMITMENTS AND CONTINGENCIES *(Note 6)*		
SHAREHOLDERS' EQUITY:		
Undesignated stock, 4,750,000 shares authorized; none issued or outstanding	**-**	-
Series A Junior Participating Preferred Stock, 250,000 shares authorized; none issued or outstanding	**-**	-
Common stock, $.01 par value, 25,000,000 shares authorized; 11,607,624 and 11,428,937 shares issued and outstanding	**116,076**	114,289
Additional paid-in capital	**91,582,753**	91,149,858
Accumulated deficit	**(62,893,684)**	(55,796,123)
Accumulated other comprehensive loss	**(34,772)**	(1,381)
Total shareholders' equity	**28,770,373**	35,466,643
	$31,955,853	$38,988,032

The accompanying notes to financial statements are an integral part of these balance sheets.

STATEMENTS OF OPERATIONS

FOR THE YEARS ENDED JUNE 30	2000	1999	1998
SALES	**$ 8,163,249**	$ 6,109,890	$ 11,194,212
COST OF GOODS SOLD	**4,356,563**	5,909,826	9,161,708
Gross profit	**3,806,686**	200,064	2,032,504
COSTS AND EXPENSES:			
Research and development	**3,614,199**	5,106,379	6,676,716
Sales and marketing	**6,659,296**	6,837,544	6,764,832
General and administrative	**2,107,950**	4,018,339	2,283,817
Total costs and expenses	**12,381,445**	15,962,262	15,725,365
OPERATING LOSS	**(8,574,759)**	(15,762,198)	(13,692,861)
INTEREST INCOME, NET	**1,477,198**	1,746,428	2,056,014
LITIGATION SETTLEMENT EXPENSE *(Note 6)*	**-**	-	(3,376,144)
NET LOSS	**$(7,097,561)**	$(14,015,770)	$(15,012,991)
BASIC AND DILUTED NET LOSS PER COMMON SHARE	**$ (0.62)**	$ (1.24)	$ (1.44)
BASIC AND DILUTED WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING *(Note 2)*	**11,513,878**	11,346,148	10,428,520

The accompanying notes to financial statements are an integral part of these statements.

STATEMENTS OF SHAREHOLDERS' EQUITY AND COMPREHENSIVE INCOME (LOSS)

	Accumulated Additional Common Stock Shares	Other Paid-In Amounts	Total Accumulated Capital	Comprehensive Deficit	Total Shareholders' Income (Loss)	Equity
BALANCE, June 30, 1997	9,256,594	$ 92,566	$ 59,131,097	$ (26,767,362)	$ (59,258)	$ 32,397,043
Change in unrealized losses on investment	-	-	-	-	47,750	47,750
Net loss	-	-	-	(15,012,991)	-	(15,012,991)
Comprehensive loss	-	-	-	-	-	(14,965,241)
Stock options exercised	240,562	2,406	198,142	-	-	200,548
Shares issued through public offering, net	1,725,000	17,250	31,509,851	-	-	31,527,101
Shares issued pursuant to employee stock purchase plan	17,736	177	177,276	-	-	177,453
BALANCE, June 30, 1998	11,239,892	$ 112,399	$ 91,016,366	$ (41,780,353)	$ (11,508)	$ 49,336,904
Change in unrealized losses on investment	-	-	-	-	10,127	10,127
Net loss	-	-	-	(14,015,770)	-	(14,015,770)
Comprehensive loss	-	-	-	-	-	(14,005,643)
Stock options exercised	159,224	1,592	68,986	-	-	70,578
Stock awards net of related amortization	29,821	298	64,506	-	-	64,804
BALANCE, June 30, 1999	**11,428,937**	**$114,289**	**$91,149,858**	**$(55,796,123)**	**$ (1,381)**	**$35,466,643**
Change in unrealized losses on investment	**-**	**-**	**-**	**-**	**(33,391)**	**(33,391)**
Net loss	**-**	**-**	**-**	**(7,097,561)**	**-**	**(7,097,561)**
Comprehensive loss	**-**	**-**	**-**	**-**	**-**	**(7,130,952)**
Stock options exercised	**146,784**	**1,468**	**312,423**	**-**	**-**	**313,891**
Stock awards net of related amortization	**31,903**	**319**	**120,472**	**-**	**-**	**120,791**
BALANCE, June 30, 2000	**11,607,624**	**$116,076**	**$91,582,753**	**$(62,893,684)**	**$(34,772)**	**$28,770,373**

The accompanying notes to financial statements are an integral part of these statements.

STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED JUNE 30	**2000**	1999	1998
OPERATING ACTIVITIES:			
Net loss	**$ (7,097,561)**	$ (14,015,770)	$ (15,012,991)
Adjustments to reconcile net loss to net cash used for operating activities-			
Depreciation and amortization	**1,514,079**	1,469,355	1,619,940
Loss on disposal of assets	**-**	773,191	-
Change in operating items:			
Accounts Receivable	**233,316**	2,752,723	(2,194,522)
Inventories	**982,418**	1,877,477	(2,740,539)
Prepaids and other assets	**350,377**	155,609	29,278
Accounts payable and accrued liabilities	**(324,262)**	(605,104)	987,058
Net cash used for operating activities	**(4,341,633)**	(7,592,519)	(17,311,776)
INVESTING ACTIVITIES:			
Purchases of property and equipment	**(486,717)**	(990,867)	(2,222,112)
Purchase of securities	**(55,619,682)**	(37,535,450)	(57,164,738)
Proceeds from sale of securities	**59,826,108**	45,783,611	47,421,001
Purchase of intangible assets, net	**-**	-	(2,000,000)
Net cash provided by (used for) investing activities	**3,719,709**	7,257,294	(13,965,849)
FINANCING ACTIVITIES:			
Proceeds from issuance of common stock, net	**434,682**	135,382	31,905,102
Payments made on capital lease obligations	**(11,647)**	(25,362)	(20,247)
Net cash provided by financing activities	**423,035**	110,020	31,884,855
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	**(198,889)**	(225,205)	607,230
CASH AND CASH EQUIVALENTS:			
Beginning of year	**$ 657,596**	$ 882,801	$ 275,571
End of year	**$ 458,707**	$ 657,596	$ 882,801
SUPPLEMENTAL CASH FLOW DISCLOSURES:			
Cash paid for interest:	**$ 856**	$ 3,346	$ 5,863

The accompanying notes to financial statements are an integral part of these statements.

1. NATURE OF BUSINESS

Description of Operating Activities

Urologix, Inc. (Urologix or the Company) was organized to research, develop, manufacture and market innovative devices for the treatment of benign prostatic hyperplasia (BPH) and other urological disorders. Prior to fiscal 1997, the Company was a development stage enterprise, having devoted substantially all of its efforts to proprietary product development and selling the Targis System to international distributors. These efforts also included raising capital, performing clinical trials and developing commercial markets. The Company received regulatory approvals necessary to market the Targis System in the European Union Countries, Japan and Canada in fiscal 1997, and in August 1997, received United States Food and Drug Administration approval to market the Targis System in the United States.

Although the Company began actively selling its products in 1997 and no longer considers itself to be in the development stage, it has not operated profitably to date and there are no assurances that it will operate profitably in the future.

2. SIGNIFICANT ACCOUNTING POLICIES

Cash and Cash Equivalents

The Company classifies highly liquid investments with original maturities of 90 days or less as cash equivalents. Cash equivalents are stated at cost, which approximates market value.

Available-for-Sale Securities

The Company invests in money market funds and U.S. government and investment-grade corporate securities with original maturities ranging from 91 days to two years. These investments are considered to be available-for-sale and are stated at market value, with the resulting unrealized gains or losses reported as a component of comprehensive loss in the statement of shareholders' equity.

Revenue Recognition

Revenue from product sales is recognized at the time of shipment, net of estimated returns; which are also provided for at the time of shipment. Deferred revenue for warranty service contracts are recognized over the contract period. Revenue from equipment rental through the Company's per procedure fee program is recognized at the time of equipment use.

Inventories

Inventories are stated at the lower of first-in, first-out cost of market and consist of:

June 30	**2000**	1999
Raw materials	**$ 443,500**	$ 783,091
Work-in-process	**210,006**	1,180,443
Finished goods	**800,494**	472,884
	$ 1,454,000	$ 2,436,418

Recently Issued Accounting Standards

In June 1998, the Financial Accounting Standards Board (FASB) issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS No. 133 establishes accounting and reporting standards requiring that every derivative instrument (including certain derivative instruments embedded in other contracts) be recorded in the balance sheet as either an asset or liability measured at its fair value. SFAS No. 133 requires that changes in the derivative's fair value be recognized currently in earnings unless specific hedge accounting criteria are met. Special accounting for qualifying hedges allows a derivative's gains and losses to offset the related results on the hedged item in the income statement, and requires that a company must formally document, designate and assess the effectiveness of transactions that receive hedge accounting treatment.

In June 1999, the FASB issued SFAS No. 137, "Accounting for Derivative Instruments and Hedging Activities—Deferral of the Effective Date of FASB Statement No. 133," which delayed the effective date of SFAS No. 133 to fiscal years beginning after June 15, 2000. There will be no effect of initial adoption of SFAS No. 133 on the Company's financial position or results of operations.

Property and Equipment

Property and equipment are stated at cost. Improvements that extend the useful lives of property and equipment are capitalized at cost and depreciated over the remaining useful lives. Repairs and maintenance are charged to expense as incurred. Depreciation is provided using the straight-line method based upon estimated useful lives of three to seven years for machinery, equipment, furniture and leasehold improvements.

Other Assets

Other assets consist primarily of license fees and prepaid royalties resulting from patent licensing agreements. The agreements require the Company to pay a royalty on sales of equipment. The license fees and amounts prepaid by the Company have been charged to expense as sales are recognized.

Research and Development Costs

Research and development costs are charged to expense as incurred.

Net Loss Per Common Share

Basic and diluted net loss per common share is computed by dividing net loss by the weighted average number of shares of common stock outstanding during each period. The impact of common stock equivalents has been excluded from the computation of weighted average common shares outstanding, as the effect would be antidilutive.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Ultimate results could differ from those estimates.

Financial Instruments

The carrying amount of the Company's financial instruments, including cash, available-for-sale securities, accounts payable and accruals, approximates fair value as the majority of these instruments are short-term in nature.

3. INCOME TAXES

A reconciliation of the Company's statutory tax rate to the effective rate for the years ended June 30 is as follows:

	2000	1999	1998
Federal statutory rate	**34%**	34%	34%
State taxes, net of federal tax benefit	**6**	6	6
Valuation allowance	**(40)**	(40)	(40)
	-%	-%	-%

As of June 30, 2000, the Company had net operating loss carryforwards of approximately $63,000,000 for federal income tax purposes that are available to offset future taxable income through the year 2015. Certain restrictions caused by the change in ownership resulting from sales of stock will limit annual utilization of the net operating loss carryforwards.

The components of the Company's deferred tax assets for the years ended June 30 is as follows:

	2000	1999	1998
Net operating loss carryforwards	**$25,204,000**	$22,082,000	$16,762,000
Temporary deductible differences	**715,000**	720,000	228,000
Valuation allowance	**(25,919,000)**	(22,802,000)	(16,990,000)
	$ -	$ -	$ -

4. OPERATIONAL REALIGNMENT AND OTHER CHARGES

As a result of a downward revision to the Company's sales forecast in the first quarter of fiscal 1999, the Company consolidated facilities and reduced the workforce in an effort to decrease operating expenses. As a result of this operational realignment, the Company

recorded a charge to general and administrative expenses for $1.6 million, reflecting severance costs paid to employees, future lease costs related to facilities no longer occupied and the impairment of assets no longer used. Additionally, the Company established a $1.3 million reserve for excess inventories as a result of the downward revision to the sales forecast. The impact of the operational realignment produced reductions to operating expense beginning in the second quarter of fiscal 1999.

The charges described above were recorded in the quarter ended September 30, 1998. The elements of the total charge as of June 30, 2000 were as follows:

	Total Charges	Asset Write-down	Change in Estimate	Cash Outlays	
				Completed	Future
Inventories	$ 1,300,000	$ 1,300,000	$ -	$ -	$ -
Fixed assets	722,000	722,000	-	-	-
Facility shut down	548,000	-	(130,000)	341,000	77,000
Employee severance	309,000	-	-	309,000	-
	$ 2,879,000	$ 2,022,000	$ (130,000)	$ 650,000	$ 77,000

5. SHAREHOLDERS' EQUITY

Stock Options

The Company has a stock option plan (the 1991 Stock Option Plan) which provides for the granting of incentive stock options to employees and nonqualified stock options to employees, directors and consultants. As of June 30, 2000, the Company has reserved 2,450,910 shares of common stock under this plan. As of June 30, 2000, 382,756 shares were available for future grants under this plan. Options expire seven to ten years from the date of grant and are subject to varying vesting schedules. Under the current terms of the Company's 1991 Stock Option Plan, persons serving as non-employee directors at the date of the annual shareholder meeting automatically receive a grant to purchase 5,000 shares of Common Stock at a price equal to fair market value on the date of grant. The options are immediately exercisable on the date of grant and expire 10 years from the date of grant, subject to earlier termination one year after the person ceases to be a director of the Company. In May 1998 and October 1998, the Company repriced certain stock options previously granted to $8.81 and then to $3.65, the fair market value on the date of repricing.

	Stock Options	Weighted Average Exercise Price
Balance at June 30, 1997	973,737	$ 5.47
Options granted	447,234	10.51
Options canceled	(159,635)	8.27
Options exercised	(240,562)	1.19
Balance at June 30, 1998	1,020,774	8.23
Options granted	1,359,421	3.69
Options canceled	(939,585)	8.64
Options exercised	(159,224)	.44
Balance at June 30, 1999	1,281,386	3.81
Options granted	891,826	3.31
Options canceled	(452,784)	3.69
Options exercised	(146,784)	2.14
Balance at June 30, 2000	1,573,644	$ 3.72
Options exercisable at June 30, 2000	443,001	$ 3.84

The Company accounts for stock options under the provisions of Accounting Principles Board Opinion No. 25, under which no compensation cost has been recognized. Had compensation cost for these options been determined consistent with SFAS No. 123, "Accounting for Stock-Based Compensation," the net loss and loss per share would have been increased to the following pro forma amounts:

	2000	1999	1998
Net loss as reported	**$ (7,097,561)**	$ (14,015,770)	$ (15,012,991)
Pro forma	**(9,321,107)**	(15,850,908)	(16,942,225)
Net loss per share as reported	**$(0.62)**	$(1.24)	$(1.44)
Pro forma	**(0.81)**	(1.40)	(1.63)

For purposes of calculating the above required disclosure, the fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions used for grants in 2000, 1999 and 1998, respectively: risk-free interest rates of 6.30%, 6.16% and 5.52%, no expected dividend yield, expected volatility of 69.27% in 2000, 70.83% in 1999, and 54.25% in 1998, and expected lives of seven years.

The weighted average fair value of options granted during 2000, 1999 and 1998 was $2.40, $2.62 and $10.51, respectively. Options outstanding at June 30, 2000, have an exercise price between $0.40 and $14.00, a weighted average exercise price of $3.72 and a weighted average remaining contractual life of 8.0 years.

1996 Employee Stock Purchase Plan

In 1996, the Company adopted the 1996 Employee Stock Purchase Plan (the Plan) and reserved 100,000 common shares for issuance under the Plan. Under the terms of the Plan, employees may purchase common shares at prices to be determined by the Company's board of directors, ranging from 85% to 100% of the shares' fair market value. Eligible employees elect to participate through payroll deductions at the maximum level established by the board of directors, but not to exceed 10% of the participant's base pay, as defined. As of June 30, 2000, 54,460 shares had been purchased under the Plan for gross proceeds of $253,497.

6. COMMITMENTS AND CONTINGENCIES

Sales Commitments

The Company has signed agreements granting Boston Scientific Corporation and Nihon Kohden Corporation exclusive distribution rights for the Targis System in Japan and the majority of the European countries. Nihon Kohden Corporation has exclusive distribution rights for Japan, while Boston Scientific Corporation has a distribution agreement that covers the majority of the European countries. Under the agreement with Boston Scientific Corporation, Urologix has a commitment to provide market development services for the Targis System for which Urologix is compensated for these services by Boston Scientific.

Litigation

In May 1998, the Company entered into a settlement agreement resolving litigation with BSD Medical Corporation (BSD) and TherMatrx, Inc. (TherMatrx) regarding a dispute about a previous settlement agreement. Pursuant to the settlement agreement, the Company paid $5 million to BSD and TherMatrx and will maintain its non-exclusive license to certain patents owned by BSD and TherMatrx pertaining to transurethral insertable applicators and systems for the treatment of BPH and other urological conditions. Of the $5 million settlement amount, $2 million was included in other assets and is amortized against future sales, and the remaining $3 million plus related legal expenses were recorded as litigation settlement expense for the year ended June 30, 1998.

401(k) Plan

The Company provides a 401(k) savings plan to which eligible employees may make pretax payroll contributions of up to 15% of their compensation. Company matching contributions are discretionary, and none have been made to date.

Leases

The Company leases its facility and certain equipment under noncancelable operating leases which expire at various dates through fiscal 2003. Rent expense related to operating leases was approximately $280,400, $195,500, and $139,700 for the years ended June 30, 2000, 1999 and 1998, respectively. Future minimum lease commitments under noncancelable operating leases with initial remaining terms of one year or more are as follows as of June 30, 1999:

	OPERATING LEASES
Fiscal year:	
2001	$ 280,409
2002	296,763
2003	205,632
	$ 782,804

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To Urologix®, Inc.:

We have audited the accompanying balance sheets of Urologix, Inc. (a Minnesota corporation) as of June 30, 2000 and 1999, and the related statements of operations, shareholders' equity and comprehensive income (loss) and cash flows for each of the three fiscal years in the period ended June 30, 2000. 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 auditing standards generally accepted in the 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. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes 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 financial statements referred to above present fairly, in all material respects, the financial position of Urologix, Inc. as of June 30, 2000 and 1999, and the results of its operations and its cash flows for each of the three fiscal years in the period ended June 30, 2000, in conformity with accounting principles generally accepted in the United States.

ARTHUR ANDERSEN LLP
Minneapolis, Minnesota
August 7, 2000

Corporate Information

Directors

Michael M. Selzer Jr.
President and Chief Executive Officer, Urologix, Inc.

Mitchell Dann
Chairman of the Board
Urologix, Inc.
Principal
Sapient Capital

Susan Bartlett Foote
Division Head
Division of Health Services Research and Policy
School of Public Health
University of Minnesota

Bobby I. Griffin
Former Executive Vice President of Medtronic, Inc. and President of Medtronic Pacing Business

Paul A. LaViolette
Senior Vice President
Boston Scientific Corporation and President, Boston Scientific International

Richard D. Randall
Former President and Chief Executive Officer of Innovasive Devices, Inc.

David C. Utz, M.D.
Professor, Mayo Medical School
Consultant Emeritus,
Mayo Clinic, Rochester, MN

Senior Management

Michael M. Selzer Jr.
President and Chief Executive Officer

Ron A. Blasewitz
Senior Vice President and Chief Operating Officer

Christopher R. Geyen
Vice President and Chief Financial Officer

Kirsten Doerfert
Vice President, Marketing

David A. Montecalvo
Vice President, Product Development and Operations

David J. Talen
Vice President, International

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Independent Public Accountants

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Legal Counsel

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55402-2223

Investor Relations Counsel

GCI Group
777 Third Avenue
New York, New York
10017-1344

Stock Transfer Agent and Registrar

Wells Fargo
P.O. Box 64854
Saint Paul, Minnesota
55164-0854
(800) 468-9716

Securities Information

The Company's shares are publicly traded on the Nasdaq Stock Market under the symbol ULGX. On September 8, 2000, the Company had 274 shareholders of record. The Company has never paid cash dividends on its Common Stock. The Board of Directors of the Company currently intends to retain any and all income for use in the Company's business and does not anticipate paying any cash dividends in the foreseeable future. Following are the quarterly high and low closing prices of the Company's common stock as reported on the Nasdaq Stock Market.

Fiscal Quarter	First	Second	Third	Fourth
2000:				
High	$4.00	$6.13	$10.44	$6.88
Low	2.32	2.88	4.00	3.81
1999:				
High	8.94	6.00	5.00	3.69
Low	4.50	3.50	3.00	2.25

Form 10-K Availability

Copies of the Company's Form 10-K for the 2000 fiscal year, filed with the Securities and Exchange Commission, are available to any shareholder at no charge upon written request from:

Secretary
Urologix, Inc.
14405 Twenty-First Avenue North
Minneapolis, Minnesota
55447-4685

UROLOGIX®

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MC1193

We appreciate your interest in Urologix®.

To request additional investor information or for information about Targis™ treatment, please visit our web site at **www.urologix.com** or fill out and return the attached postcard.

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COMPANY

ADDRESS

CITY/STATE/ZIP

COUNTRY

PHONE

FAX

E MAIL

I am a(n) — check all that apply:

- ❑ Private investor
- ❑ Institutional investor
- ❑ Broker
- ❑ Physician
- ❑ Investment analyst
- ❑ Patient

I wish to receive the following information:

- ❑ Investment Packet
- ❑ 10-K
- ❑ Proxy Statement
- ❑ 10-Q
- ❑ Patient Information

Please add my name to the Urologix list for receiving financial news releases. I wish to receive news releases via (check one):

- ❑ E mail
- ❑ Mail
- ❑ Fax

❑ **Please send me patient information about Targis™ treatment for BPH.**