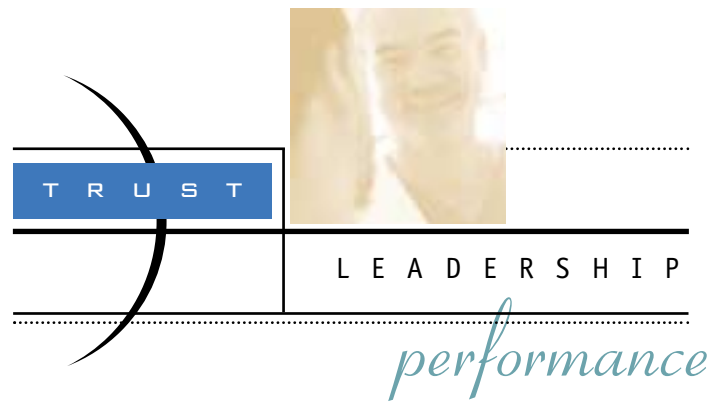


*A N N U A L R E P O R T*

14405 Twenty-First Avenue North  
Minneapolis, Minnesota 55447-4685  
Ph. 763.475.1400 • Fax 763.475.1443



Urologix®

2001 ANNUAL REPORT

## UROLOGIX: THE TRUSTED LEADER

Urologix, Inc. (Nasdaq: ULGX) is the trusted leader in the minimally invasive treatment of benign prostatic hyperplasia (BPH) – a non-cancerous enlargement of the prostate that affects nearly all men at some point in their life.

Our flagship Cooled ThermoTherapy™ technology has helped revolutionize the treatment of BPH. With more than 80,000 patients treated, Cooled ThermoTherapy is being embraced as a new standard of care by physicians and patients around the world.

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**THREE WORDS CAPTURE AN OUTSTANDING YEAR:  
TRUST, LEADERSHIP, PERFORMANCE.**

**To Our Shareholders:**

Fiscal 2001 was the most successful year in Urologix' 10-year history. Two milestones fueled our remarkable growth. First, Medicare's decision to reimburse Cooled ThermoTherapy™ in the urologist's office now enables us to offer our treatment at the optimal site of care, where it was designed to be performed. Second, our acquisition of the Prostatron® product line from EDAP on October 1, 2000, brought us the proprietary technology on which Cooled ThermoTherapy is based. It strengthened our patent portfolio, enabled us to deliver a unified message about the benefits of Cooled ThermoTherapy to the market and created many operational synergies.

These milestones, combined with our expanded customer base; our enhanced relationships with physicians, nurses and practice managers; and a more efficient organization, position us better than ever for future growth.

**Solutions Patients Can Trust**

Every patient with benign prostatic hyperplasia (BPH) wants the treatment he receives to be comfortable, convenient and effective. Our industry-leading clinical studies demonstrate that the great majority of patients will enjoy significant relief from their BPH symptoms seven years after Cooled ThermoTherapy treatment.

From the beginning, this proprietary treatment was designed to be performed in a variety of settings, including the physician's office. Since Medicare began reimbursing for Cooled ThermoTherapy treatment in the office in January 2001, we have seen outstanding growth and acceptance of the procedure.

We believe that most patients who understand all of their BPH treatment options will make Cooled ThermoTherapy their number one choice. We also anticipate that continued physician and patient acceptance, fueled by excellent clinical outcomes and recent favorable changes in reimbursement, will lead to marked treatment growth in fiscal 2002.

### **Market Leadership**

We are committed to making Cooled ThermoTherapy a valuable part of every urologist's practice. Physicians want to know that the treatment they prescribe will provide safe, effective and lasting results, with superior patient satisfaction. They also want to know that the business relationships they form will yield lasting success. That's why more and more urologists are turning to Urologix as the trusted market leader. Our market development efforts focus on providing urologists with the most complete clinical, technical, practice management and reimbursement support available. Our experienced sales force works with the urologists' entire office staff to integrate Cooled ThermoTherapy into their practices quickly.

We offer urologists a choice of unique product options that not only meet their clinical needs but provide cost flexibility, as well. The Prostatron System provides an easy-to-use, fully automatic, effective treatment that minimizes procedure time. The Targis™ system offers similar treatment benefits and features enhanced versatility with customizable treatment parameters. Both Prostatron and Targis have demonstrated industry-leading clinical results, durability and comfort that provide patients with an enhanced quality of life in a single treatment.

With the acquisition of the Prostatron product line and our internal success in expanding the reach of our technology, we now have more than 200 installed units serving more than 500 treatment sites throughout the United States, in addition to units in more than 32 countries. This market penetration has enabled us to treat more than double the number of patients than before the addition of Prostatron, giving us critical mass at an important time in our development.

Our efforts and commitment to bring high quality, industry-leading products to market are yielding results. Since January 1, 2001, we have entered into agreements with more than 80 office-based practices to enable them to offer Cooled ThermoTherapy to patients. We also are rapidly expanding access to urologists through our mobile partners. With the combined strength of our expanded sales force and our mobile distribution partners, we are looking to expand the number of physicians who treat with Cooled ThermoTherapy in the current fiscal year.

### **Record-Breaking Financial Performance**

The growing reach and increased acceptance of our treatment has led to a record-breaking year for Urologix. Fiscal 2001 closed with sales of \$15.3 million, an 88 percent improvement over the previous year. Our "procedure-focused" business model allowed us to expand our physician base significantly, leading to a global volume of nearly 14,000 treatments, 150 percent more than in fiscal 2000.

We have worked hard to create a lean and agile organization with a fast-growing revenue stream. This strategy has enabled us to reduce our net loss by 28 percent from \$7.1 million to \$5.1 million last year while continuing to make significant investments in our sales and marketing efforts.

The positive financial effect of the Prostatron acquisition was clearly visible in our gross margins. With the elimination of a royalty payment and additional product volume as a result of the acquisition, we improved gross margins as a percent of sales from 47 percent in fiscal 2000 to 62 percent in fiscal 2001.

During fiscal 2001, we set and attained aggressive goals for our team and delivered outstanding financial performance. This success created substantial value for our shareholders and helped position us for continued success and future growth.

## Looking Forward

Our future has never looked brighter. With a strong management team and a fundamentally solid business model, we have positioned our company and our products to leverage new opportunities to bring our treatment to physicians in the most convenient treatment site in their community. Last year we expanded our U.S. sales force to 23 members, continued our relationship with an outstanding group of mobile distribution partners and employed local distributors who now provide Cooled ThermoTherapy to most of the developed world.

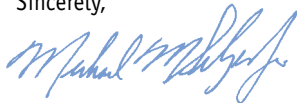
We will continue to increase awareness of and access to our industry-leading technology. With the increasing number of new physicians offering office-based Cooled ThermoTherapy, a significant focus in fiscal 2002 will be on training and creating patient demand to solidify our BPH franchise. We also will continue our aggressive investment in new enhancements for Cooled ThermoTherapy, led by Cooled ThermoCath™, our new proprietary treatment platform currently in clinical trial. We believe this next generation of products will further enhance the convenience and comfort of office-based Cooled ThermoTherapy treatment.

Finally, as we continue to strengthen our market leadership, we are looking for ways to expand further in the urology field. Initially, we will focus on other prostate disorders, such as prostatitis, a debilitating inflammation of the prostate gland that as of yet has no cure. Next, we will continue to evaluate our technology for use in other areas of urology, such as cancer. We also will review external opportunities to expand into a full-line urology company that will leverage our considerable strength in marketing and distribution. These strategies will help us achieve our vision to provide simple solutions that improve the lives of urology patients.

For the past 10 years, we have known that Cooled ThermoTherapy is a great technology, but our initial treatment took too long, and the path to reimbursement was unclear. I'm pleased to say these barriers have been removed, and we are on the road to future success for our customers, our shareholders, our employees and, most importantly, the patient. We owe this success to the efforts and contributions of each and every Urologix employee, and I thank them for helping create a company of which we can be very proud.

It's an exciting time for Urologix. We're pleased to be considered a trusted leader in BPH treatment, and we take our commitment to the field of urology very seriously. We believe we're on the threshold of exciting growth opportunities and look forward to serving urology patients in the years ahead.

Sincerely,

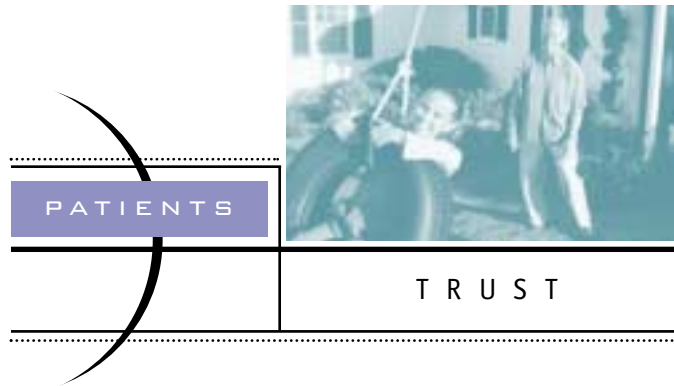


Michael M. Selzer Jr.

President and Chief Executive Officer



As the U.S. Olympic Committee athlete development manager, Wayne Faris, 59, shown here with his dog, Rusty, leads an active lifestyle. He provides elite coaching and training in six very vigorous sports: women's hockey, biathlon, cross-country skiing, weightlifting, snowboarding and curling. Three years ago, however, his benign prostatic hyperplasia (BPH) symptoms prevented him from traveling with much confidence and threatened to curtail his activities. Together with his physician, Faris decided that Cooled ThermoTherapy treatment was right for him. Today, he says, "I don't even think about those symptoms any more. I can do anything I want."



**PATIENTS TRUST US TO ENHANCE  
THEIR QUALITY OF LIFE.**

Men from all walks of life put their trust in Urologix to provide a safe, effective solution for BPH, enabling them to return to a full, active lifestyle.

BPH is essentially an enlarged prostate – a condition characterized most frequently by symptoms involving changes in urinary flow and urinary function, such as frequency or urgency of urination. If left untreated, BPH can result in urinary retention, kidney damage or urinary tract infections.

Urologix provides two minimally invasive products for patients with BPH, the Prostatron and Targis Systems. Both use a patented technology called Cooled ThermoTherapy to deliver microwave energy directly to the prostate, destroying excess tissue, while cooling and preserving the surrounding tissue to maintain patient comfort and increase durability.

**Better than medication; less invasive than surgery**

Not long ago, medication and surgery were the only available methods of treating an enlarged prostate and relieving the symptoms of BPH. Although there are several medications on the market to treat BPH, many men with this condition find that medication alone is not completely effective. Medication also can cause a number of intolerable side effects, including fatigue, headache, changes in blood pressure and even impotence. It is estimated that up to 40 percent of men discontinue their medication within the first year.

Likewise, there can be potential setbacks with surgery. Surgery comes with a lengthy recovery time, the possibility of severe complications and the risks associated with anesthesia. In addition, pre-existing conditions can make surgery a poor option for many patients. Today, Cooled ThermoTherapy from Urologix is the least invasive procedure available to treat BPH effectively. It is better than medication and less invasive than surgery. With Cooled ThermoTherapy there are few risks or complications, and because Cooled ThermoTherapy is a non-surgical procedure, patients do not require anesthesia, only mild analgesia.

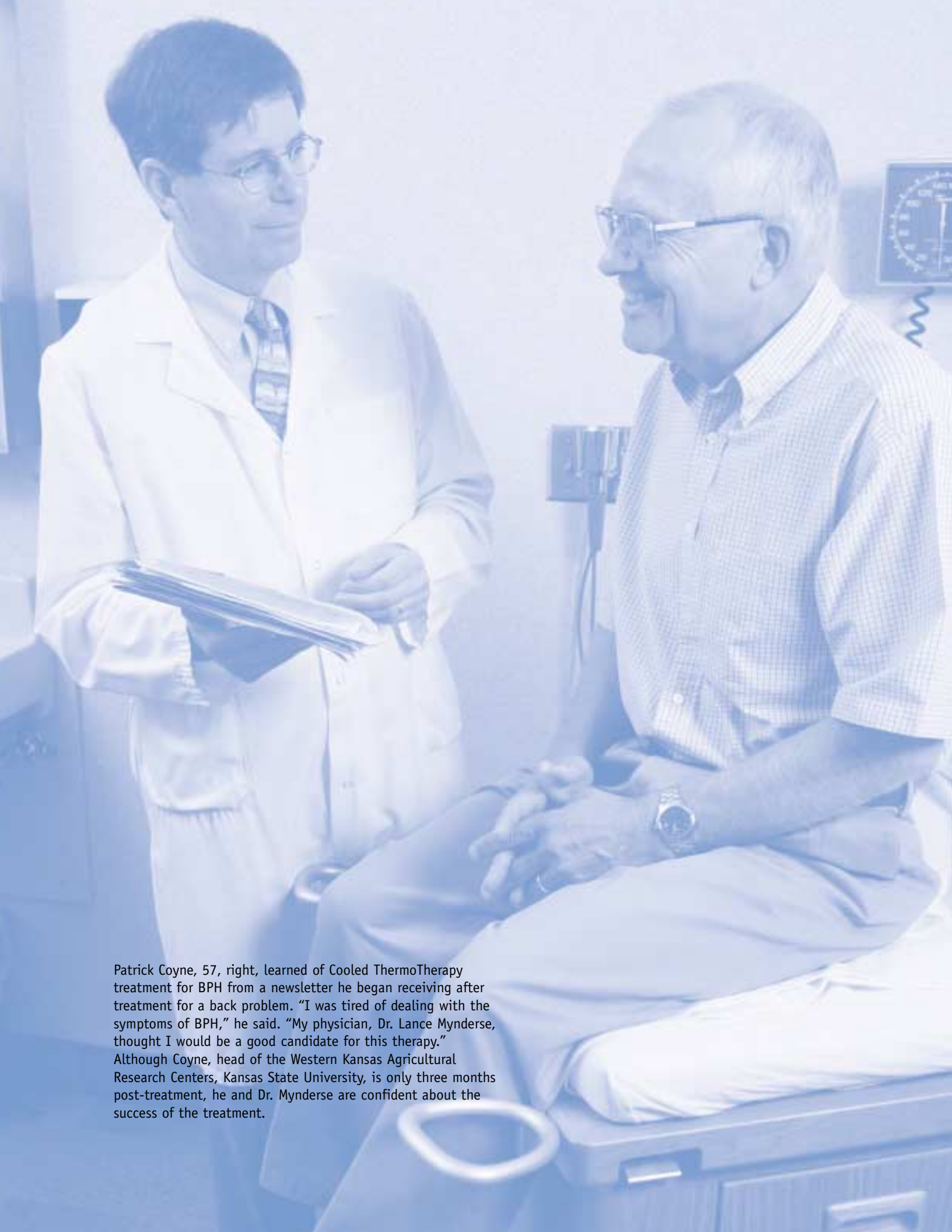
Cooled ThermoTherapy also is less costly than either medication or surgery. Medication must be taken every day for life and may cost up to \$3,000 annually. The most common surgery for BPH can cost as much as \$8,500.

**Performed in the doctor's office**

No one wants to spend a night at the hospital unnecessarily or even go to the hospital for a simple procedure. That's why Cooled ThermoTherapy was designed to be performed in the comfort of a urologist's office. The single, non-surgical treatment takes only 30 to 60 minutes, depending on the needs of the individual patient, and the patient is free to go home following the procedure.

**Chosen by more patients than any other minimally invasive BPH treatment**

In the United States, Cooled ThermoTherapy is performed more than any other office-based minimally invasive BPH treatment, and eight out of ten patients surveyed say they would recommend Cooled ThermoTherapy to a friend or relative. The numbers say it all. Men put their trust in us.



Patrick Coyne, 57, right, learned of Cooled ThermoTherapy treatment for BPH from a newsletter he began receiving after treatment for a back problem. "I was tired of dealing with the symptoms of BPH," he said. "My physician, Dr. Lance Mynderse, thought I would be a good candidate for this therapy." Although Coyne, head of the Western Kansas Agricultural Research Centers, Kansas State University, is only three months post-treatment, he and Dr. Mynderse are confident about the success of the treatment.



## PHYSICIANS EMBRACE A LEADING STANDARD OF CARE.

Embraced by physicians worldwide, Cooled ThermoTherapy from Urologix is setting a higher standard of care for the minimally invasive treatment of BPH. With more than seven years of clinical data, Cooled ThermoTherapy has proven its effectiveness and durability to the medical community.

### Comfort and long-term results

Physicians want the best for their patients and often seek alternatives to medication and surgery. Urologists report that men who do not want to take medication or who do not respond to medication find lasting relief from their BPH symptoms with Cooled ThermoTherapy – without the side effects and at a fraction of the cost. While the majority of urologists agree that transurethral resection of the prostate (TURP) surgery is effective, an increasing number are now recommending Cooled ThermoTherapy as a way to help their patients avoid the pain and potential complications that accompany TURP.

The scientific integrity backing the numerous clinical studies of Cooled ThermoTherapy enables Urologix to demonstrate significant improvements in key clinical measurement areas, such as symptom relief, peak flow rate and quality of life. In addition, urologists say their patients have minimal post-treatment complications and a high rate of satisfaction with Cooled ThermoTherapy. As a result, physicians have embraced Cooled ThermoTherapy as a leader among minimally invasive treatment options. The high temperatures achieved within the prostate, combined with cooling to preserve the urethra, provide a level of durability that sets a new standard in the minimally invasive treatment of BPH.

The benefits of using in-office Cooled ThermoTherapy technology have not been lost on the urology community. To date, more than 80 physician practice groups have installed Targis or Prostatron Systems in their offices.

### Two systems, one solution

Urologix offers Cooled ThermoTherapy in two technically advanced, but distinct, systems – Prostatron and Targis – each designed with the unique needs of physicians and patients in mind.

The Prostatron System offers a fully automated solution for BPH that effectively treats the bladder neck as well as the enlarged prostate. The Targis System provides treatment protocols that can be customized, resulting in optimal treatment flexibility and maximum patient comfort. Both Prostatron and Targis systems use temperature-sensing feedback technology to ensure consistent, controlled therapeutic heat, making them easy and reliable for physicians to use. The recent introduction of 30-minute treatment protocols for both systems has increased a physician's flexibility and widened the acceptance of Cooled ThermoTherapy.

### Committed to urology, committed to our customers

Urologix has an unwavering commitment to the field of urology. Our long-term product development strategy mirrors that commitment – providing innovative, new technologies to treat BPH and other urological disorders more effectively. Our research continues in related areas, including the treatment of localized tumors and prostatitis, an inflammation of the prostate gland.

We are equally committed to the customers who put their trust in us. By providing complete clinical and technical support, we make it easy for urologists to integrate Cooled ThermoTherapy into their practices. We also offer the reimbursement support and business development assistance that today's physician needs to succeed in the marketplace. With reimbursement for in-office procedures now a reality, our Prostatron and Targis Systems have a marked advantage over other treatment options.



Proprietary technology is key to the Urologix Prostatron (top) and Targis (bottom) Cooled ThermoTherapy Systems. Continued focus on research and development will ensure quality in the years ahead.



**EIGHT MILLION IN NEED.  
ONE COMPANY IN THE LEAD.**

In the United States alone, more than eight million men suffer from moderate to severe BPH symptoms. As the population continues to age, that number undoubtedly will increase. It has been estimated that nearly \$10 billion is spent annually worldwide on the management of BPH. Urologix is the one company best positioned to capture this growing market opportunity because of our proprietary industry-leading technology, our understanding of the marketplace, our scientific integrity and our never-ending commitment to quality.

**Proprietary technology**

Cooled ThermoTherapy is a proprietary technology. No other minimally invasive treatment delivers microwave energy directly to the prostate with such precision – while protecting the surrounding healthy tissue. Seven years of clinical data have proven the benefits of this technology and the durable outcomes it provides. As the leading minimally invasive BPH treatment, Cooled ThermoTherapy gives Urologix unparalleled strength in the marketplace – providing a solid foundation on which to build continued success.

As a result of urologists’ strong embrace of Cooled ThermoTherapy, sales of disposable procedure kits exceeded a record 14,000 units in fiscal 2001. The acquisition of the Prostatron product line in October 2000, combined with increased sales of Targis units, resulted in a more than 150 percent increase in unit sales from the previous year.

**Understanding of the marketplace**

As part of our long-term strategy to extend the reach of Cooled ThermoTherapy, we have successfully implemented education and training programs for physicians and patients worldwide. We also will continue to look for strategic acquisitions that further cement our leadership position, such as the acquisition of the Prostatron line last year, which enabled us to grow our base of revenue rapidly and gain market share.

We also are driving continued growth through increased distribution outside the United States. Urologix has developed a skilled distribution network throughout Europe and Japan and is slowly increasing its penetration of Cooled ThermoTherapy systems in Asia.

**Commitment to quality**

Proprietary technology, a solid leadership position, durable clinical outcomes and favorable reimbursement are just a few of the reasons why Urologix has attracted the interest of patients, physicians and investors. Our primary goal, however, is to help physicians improve the quality of life for patients with BPH. We are committed to maintaining high quality standards for our products, our people and our relationships. With the growing need for BPH treatment and the growing acceptance of Cooled ThermoTherapy, our future looks bright.



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## STATEMENTS OF OPERATIONS DATA

*(In thousands, except per share data)*

Years Ended June 30	2001	2000	1999	1998	1997
<b>SALES</b>	<b>\$ 15,337</b>	\$ 8,163	\$ 6,110	\$ 11,194	\$ 5,504
<b>COST OF GOODS SOLD</b>	<b>5,804</b>	4,357	5,910	9,162	4,866
Gross profit (loss)	<b>9,533</b>	3,806	200	2,032	638
<b>COSTS AND EXPENSES</b>					
Research and development	<b>3,533</b>	3,614	5,106	6,676	5,049
Sales, general and administrative	<b>10,799</b>	8,767	10,856	9,049	5,655
Amortization of intangibles	<b>1,082</b>	-	-	-	-
Total costs and expenses	<b>15,414</b>	12,381	15,962	15,725	10,704
<b>OPERATING LOSS</b>	<b>(5,881)</b>	(8,575)	(15,762)	(13,693)	(10,066)
<b>INTEREST INCOME, NET</b>	<b>746</b>	1,477	1,746	2,056	1,833
<b>LITIGATION EXPENSE</b>	<b>-</b>	-	-	(3,376)	-
<b>NET LOSS</b>	<b>\$ (5,135)</b>	\$ (7,098)	\$ (14,016)	\$ (15,013)	\$ (8,233)
<b>BASIC AND DILUTED NET LOSS PER COMMON SHARE</b>	<b>\$ (0.40)</b>	\$ (0.62)	\$ (1.24)	\$ (1.44)	\$ (0.90)
<b>SHARES USED IN COMPUTING NET LOSS PER SHARE</b>	<b>12,760</b>	11,514	11,346	10,429	9,173

## BALANCE SHEET DATA

*(In thousands)*

Years Ended June 30	2001	2000	1999	1998	1997
Cash, cash equivalents and available-for-sale securities	<b>\$14,921</b>	\$23,598	\$28,036	\$36,500	\$26,101
Working capital	<b>14,935</b>	23,131	28,803	41,375	27,013
Total assets	<b>46,860</b>	31,956	38,988	53,489	35,582
Total liabilities	<b>7,351</b>	3,186	3,521	4,152	3,185
Accumulated deficit	<b>(68,029)</b>	(62,894)	(55,796)	(41,780)	(26,767)
Total shareholders' equity	<b>\$39,509</b>	\$28,770	\$35,467	\$49,337	\$32,397

## MANAGEMENT'S DISCUSSION AND ANALYSIS

The following discussion and analysis of Urologix' financial condition and results of operations should be read in conjunction with the financial statements and related notes included elsewhere in this Annual Report and in Form 10-K for the year ended June 30, 2001, filed with the U.S. Securities and Exchange Commission.

### Cautionary Statement Regarding Forward-Looking Statements

This Management's Discussion and Analysis of Financial Condition and Results of Operations contains, in addition to historical information, forward-looking statements that are based on our current expectations, beliefs, intentions or future strategies. These statements are subject to risks and uncertainties that could cause actual results to differ materially from the statements, including the extent to which the physicians performing Cooled ThermoTherapy™ procedures are able to obtain third-party reimbursement; changes in the reimbursement environment; market acceptance and the rate of adoption of Cooled ThermoTherapy for the treatment of benign prostatic hyperplasia (BPH) by the medical community; the ability of our key suppliers to provide product; the ability to integrate the recently acquired Prostatron product line into our operations; the impact of competitive treatments, products and pricing; and the effectiveness of our sales and marketing organization. We do not take responsibility for updating such forward-looking statements to reflect events that arise after the date of this report.

### Overview

Urologix, Inc., based in Minneapolis, develops, manufactures and markets minimally invasive medical products for the treatment of urological disorders.

We have developed and offer non-surgical, catheter-based treatments that use a proprietary cooled microwave technology for the treatment of BPH, a disease that dramatically affects more than 23 million men worldwide by causing adverse changes in urinary voiding patterns. We market our products under the Targis™ and Prostatron® names. Both systems utilize Cooled ThermoTherapy, a targeted microwave energy combined with a unique cooling mechanism that protects healthy tissue and enhances patient comfort while providing safe, effective, lasting relief from the symptoms of BPH. Cooled ThermoTherapy can be performed without anesthesia or intravenous sedation and, as a result, can be performed in a physician's office or an outpatient clinic. We believe Cooled ThermoTherapy provides an efficacious, safe and cost-effective solution for BPH that is clinically 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 payers.

Third-party reimbursement is essential to acceptance of the Cooled ThermoTherapy procedure. We estimate that 60% to 80% of patients who receive treatment in the United States are eligible for Medicare coverage, making Medicare reimbursement critical for widespread market acceptance in the United States. The remaining patients will either be covered by private insurers, including traditional indemnity health insurers and managed care organizations, or be private-paying patients.

The rate of Medicare reimbursement for Cooled ThermoTherapy is dependent on the site of service. Through July 31, 2000, Medicare had reimbursed hospitals on a reasonable cost basis for each Cooled ThermoTherapy procedure performed. Under the reasonable cost basis of reimbursement, Medicare reimbursed all reasonable costs the hospital incurred in conducting the procedures. Beginning August 1, 2000, Medicare replaced the reasonable cost basis of reimbursement for outpatient hospital-based procedures with a new fixed rate or "prospective payment system." Under this new method of reimbursement, a hospital receives a fixed reimbursement for each procedure performed in its facility.

Medicare began to reimburse for Cooled ThermoTherapy procedures performed in a physician's office on a fixed-rate basis on January 1, 2001. The change was a significant milestone, as it marked the first time patients were covered directly by Medicare for in-office Cooled ThermoTherapy procedures. We believe that this change in reimbursement allows Cooled ThermoTherapy treatments to be performed in the environment the technology was designed to serve and will lead to increased demand for our products.

With the recent changes in reimbursement rates and site of care for which Medicare will reimburse procedures, we are in a period of transition. We will continue to support our hospital-based business while making the preparations necessary to service and accelerate the volume of business in urologists' offices. Our strategy will continue to focus on generating physician access to and awareness of Cooled ThermoTherapy while creating patient demand by providing education on the benefits of the treatment.

We will continue to market our products through a direct sales force in the United States and utilize a network of distributors and agents internationally.

### Results of Operations

#### *Fiscal Years Ended June 30, 2001 and 2000*

Net sales for fiscal 2001 increased \$7.2 million or 88% to \$15.3 million, compared to sales of \$8.2 million in the prior fiscal

year. The growth in sales was the direct result of a favorable reimbursement change that allowed physicians to perform Cooled ThermoTherapy in their office, and an approximately \$6.2 million increase in sales generated by the acquisition of the Prostatron Cooled ThermoTherapy product line from EDAP TMS S.A (EDAP). Domestic revenue increased by 72% over fiscal 2000 to \$13.6 million, fueled by a 143% increase in domestic disposable sales. We are continuing to offer our "per procedure" rental program to generate rapid acceptance and adoption of Cooled ThermoTherapy. This rental program is designed to provide physicians easy access to Cooled ThermoTherapy on a trial basis without a large capital commitment. At the end of the trial period, the physician or hospital can purchase the unit, extend the trial or transition to a mobile service provider. To date, the majority of control units we have sold have been per procedure rental program units that were purchased at the completion of the trial period.

International sales for fiscal 2001 increased by \$1.5 million to \$1.7 million compared to sales of approximately \$300,000 in the prior fiscal year. The growth in sales was primarily attributable to sales of Prostatron products, both disposable procedure kits and equipment, acquired from EDAP.

Due to a production shutdown at a third-party supplier, we expect Targis System control units to go into backorder during the first half of fiscal 2002. As a result, revenue forecasts have been reduced during the first two quarters of fiscal 2002 to coincide with the expected resolution of the third-party supplier issue. We expect revenue for the first two quarters of fiscal 2002 to be fairly consistent with the fourth quarter of fiscal 2001, with sequential growth in revenue beginning in the third and fourth quarters following the anticipated resolution of the Targis System control unit supply issue. The Targis System control unit is the only product affected by the shutdown at the third-party supplier.

Cost of goods sold includes raw materials, labor, overhead and royalties incurred in connection with the production of our Cooled ThermoTherapy control units and disposable procedure kits. Cost of goods sold increased to \$5.8 million in fiscal 2001 compared to \$4.4 million in fiscal 2000, due to higher sales volume. Gross profit as a percentage of sales increased to 62% in fiscal 2001 from 47% in fiscal 2000, due primarily to continued manufacturing process improvements, increased production volumes, decreased raw material costs and the elimination of royalties previously paid to EDAP.

Sales, general and administrative expenses increased to \$10.8 million from \$8.8 million in the prior fiscal year. The increased expenses were primarily attributable to the expansion of our direct sales force, investments in customer training, advertising and expenditures related to the integration of acquired Prostatron products. We expect sales and marketing expenses to continue to increase as we intensify our efforts to generate awareness and acceptance of Cooled ThermoTherapy.

Research and development expenses, which include expenditures for product development, regulatory compliance and clinical studies, decreased to \$3.5 million in fiscal 2001 from \$3.6 million in the prior fiscal year. The slight decrease in research and development expenses resulted from reduced clinical study activity offset by increased staffing. We expect research and development expenses to increase as we begin clinical trials on our next generation of Cooled ThermoTherapy treatment catheters.

Amortization of goodwill and other intangible assets was \$1.1 million for fiscal 2001. The amortization of goodwill and other intangible assets was a result of the purchase of the Prostatron product line from EDAP in October 2000. In July 2001, the Financial Accounting Standards Board (FASB) issued Statement 141, "Business Combinations," and Statement 142, "Goodwill and Other Intangible Assets," (collectively, "the Statements"). The Statements eliminate the pooling of interests method of accounting for business combinations and the systematic amortization of goodwill. We intend to adopt the Statements during the first quarter of fiscal 2002 and estimate that this will reduce fiscal 2002 amortization expense, on a pretax basis, by approximately \$500,000 to \$600,000.

Net interest income decreased to \$746,000 during fiscal 2001 from \$1.5 million in the prior fiscal year. The decrease was primarily attributable to lower interest income due to lower cash and investment balances as well as higher interest expenses resulting from debt assumed in the EDAP product line acquisition.

#### ***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 kit sales was primarily the result of the per procedure sales and marketing business model implemented in March 1999. International sales decreased in fiscal 2000 due to existing inventories of our products held by our international distributors.

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, we established a reserve of \$1.3 million for excess inventory. Second, we 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 fiscal 1999, due primarily to improved manufacturing efficiency, decreased product cost and the impact of the two events noted above.

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.

Sales, general and administrative expenses decreased in fiscal 2000 to \$8.8 million from \$10.9 million in fiscal 1999. The expenses for fiscal 1999 include a \$1.6 million charge incurred in connection with an operational realignment. Excluding the impact of this charge, expenses decreased primarily as a result of reductions in administrative staffing and decreased international sales and marketing expenses, which were partially offset by increased investment in U.S. sales and marketing efforts.

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

### **Liquidity and Capital Resources**

We have financed our operations since inception through sales of equity securities and, to a lesser extent, sales of our Cooled ThermoTherapy systems. As of June 30, 2001, we had total cash, cash equivalents and available-for-sale securities of \$14.9 million and working capital of \$14.9 million.

During fiscal 2001, we used \$3.8 million in operating activities, primarily as a result of our net loss of \$5.1 million, which was offset by depreciation and amortization of \$1.9 million. We used approximately \$200,000 in investing activities, primarily reflecting the \$7.6 million of cash used in the acquisition of the Prostatron product line and net purchases of equipment of approximately \$900,000, offset by the net sale of \$8.3 million in investment securities. We generated proceeds of \$3.5 million in financing activities during fiscal 2001, reflecting \$3.7 million received through the issuance of common stock, offset by \$263,000 in payments on capital lease obligations.

In January 2000, we amended the International Distribution Agreement with Boston Scientific Corporation. Under the amended agreement, Boston Scientific compensated us 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 us. The agreement with Boston Scientific ended on June 30, 2001.

On October 1, 2000, we paid \$8.0 million in cash to EDAP in connection with the acquisition of EDAP's Cooled ThermoTherapy product line, related patents and technologies. This acquisition was funded through existing cash balances and the issuance of common stock and warrants to purchase common stock.

As part of the acquisition, we agreed to assume approximately \$1.5 million in lease obligations related to control units located at customer sites within the United States. This obligation will be paid over 40 months in monthly installments of \$54,000. Additionally, we issued a promissory note to pay EDAP \$575,000 plus interest on December 30, 2003.

In June 2001, we received proceeds of \$2.5 million through the exercise of a warrant held by EDAP to purchase 327,466 shares of our common stock. We issued the warrant to EDAP on October 1, 2000, in connection with our acquisition of EDAP's Cooled ThermoTherapy product line. We will use the proceeds from the warrant exercise for working capital purposes.

As of June 30, 2001, we did not have any significant purchase commitments.

We expect to continue to incur additional losses and will use our working capital as we incur expenses related to our sales, marketing, and research and development activities. In addition, we plan to continue offering customers a per procedure rental program. Depending on the growth of this program, we may use substantial capital to finance the units rented by customers.

Although we believe that existing cash, cash equivalents and available-for-sale securities will be sufficient to fund our operations for at least the next 12 months, there can be no assurance that we will not require additional financing in the future or that any additional financing will be available to us on satisfactory terms, if at all.

### **Quantitative and Qualitative Disclosures About Market Risk**

Our financial instruments include cash and cash equivalents. The fair value of our financial investment portfolio at June 30, 2001, 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.

Our policy is not to enter into derivative financial instruments. We do not have any significant foreign currency exposure since we do not generally transact business in foreign currencies. Therefore, we do not have significant overall currency exposure. In addition, we do not enter into any futures or forward contracts and, therefore, do not have significant market risk exposure with respect to commodity prices.

## 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, 2001 and 2000, 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, 2001. 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, 2001 and 2000, and the results of its operations and its cash flows for each of the three fiscal years in the period ended June 30, 2001, in conformity with accounting principles generally accepted in the United States.

ARTHUR ANDERSEN LLP  
Minneapolis, Minnesota  
July 31, 2001

**BALANCE SHEETS**  
(In thousands, except per share data)

	June 30	
	2001	2000
<b>ASSETS:</b>		
Cash and cash equivalents	\$ 26	\$ 459
Available-for-sale securities	14,895	23,139
Accounts receivable, net of allowance of \$396 and \$285	3,284	1,027
Inventories, net	2,203	1,454
Prepays and other current assets	439	238
Total current assets	20,847	26,317
<b>PROPERTY AND EQUIPMENT:</b>		
Machinery, equipment and furniture	6,847	5,259
Less accumulated depreciation	(4,240)	(3,580)
Property and equipment, net	2,607	1,679
Deposits and other assets	3,003	3,960
Goodwill and other intangible assets, net of amortization of \$1,082 and \$0	20,403	-
Total assets	\$ 46,860	\$ 31,956
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable	\$ 1,781	\$ 1,084
Accrued expenses	1,566	1,488
Current portion of lease obligation	419	-
Deferred income	2,146	614
Total current liabilities	5,912	3,186
Long-term debt	575	-
Long-term lease obligation	864	-
Total liabilities	7,351	3,186
<b>COMMITMENTS AND CONTINGENCIES (Notes 7 and 9)</b>		
<b>SHAREHOLDERS' EQUITY:</b>		
Common stock, \$.01 par value, 25,000 shares authorized; 13,630 and 11,608 shares issued and outstanding	136	116
Additional paid-in capital	107,397	91,583
Accumulated deficit	(68,029)	(62,894)
Accumulated other comprehensive income (loss)	5	(35)
Total shareholders' equity	39,509	28,770
Total liabilities and shareholders' equity	\$ 46,860	\$ 31,956

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

## STATEMENTS OF OPERATIONS

*(In thousands, except per share data)*

For the Years Ended June 30	2001	2000	1999
<b>SALES</b>	<b>\$ 15,337</b>	\$ 8,163	\$ 6,110
<b>COST OF GOODS SOLD</b>	<b>5,804</b>	4,357	5,910
Gross profit	<b>9,533</b>	3,806	200
<b>COSTS AND EXPENSES:</b>			
Research and development	<b>3,533</b>	3,614	5,106
Sales, general and administrative	<b>10,799</b>	8,767	10,856
Amortization of goodwill and other intangible assets	<b>1,082</b>	-	-
Total costs and expenses	<b>15,414</b>	12,381	15,962
<b>OPERATING LOSS</b>	<b>(5,881)</b>	(8,575)	(15,762)
<b>INTEREST INCOME</b>	<b>993</b>	1,477	1,749
<b>INTEREST EXPENSE</b>	<b>(247)</b>	-	(3)
<b>NET LOSS</b>	<b>\$ (5,135)</b>	\$ (7,098)	\$ (14,016)
<b>BASIC AND DILUTED NET LOSS PER COMMON SHARE</b>	<b>\$ (0.40)</b>	\$ (0.62)	\$ (1.24)
<b>BASIC AND DILUTED WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING (Note 2)</b>	<b>12,760</b>	11,514	11,346

## STATEMENTS OF SHAREHOLDERS' EQUITY AND COMPREHENSIVE INCOME (LOSS)

*(In thousands)*

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
<b>BALANCE, JUNE 30, 1998</b>	11,240	\$ 112	\$ 91,016	\$ (41,780)	\$(12)	\$ 49,336
Change in unrealized losses on investments	-	-	-	-	10	10
Net loss	-	-	-	(14,016)	-	(14,016)
Comprehensive loss	-	-	-	-	-	(14,006)
Stock options exercised	159	2	69	-	-	71
Stock awards, net of related amortization	30	-	65	-	-	65
<b>BALANCE, JUNE 30, 1999</b>	11,429	114	91,150	(55,796)	(2)	35,466
Change in unrealized losses on investments	-	-	-	-	(33)	(33)
Net loss	-	-	-	(7,098)	-	(7,098)
Comprehensive loss	-	-	-	-	-	(7,131)
Stock options exercised	147	2	313	-	-	315
Stock awards, net of related amortization	32	-	120	-	-	120
<b>BALANCE, JUNE 30, 2000</b>	11,608	116	91,583	(62,894)	(35)	28,770
Change in unrealized gains on investments	-	-	-	-	40	40
Net loss	-	-	-	(5,135)	-	(5,135)
Comprehensive loss	-	-	-	-	-	(5,095)
Value of options issued to consultants	-	-	172	-	-	172
Stock options and warrants exercised	633	6	3,663	-	-	3,669
Issuance of common stock for acquisition, net	1,365	13	11,896	-	-	11,909
Stock awards, net of related amortization	24	1	83	-	-	84
<b>BALANCE, JUNE 30, 2001</b>	13,630	\$ 136	\$ 107,397	\$ (68,029)	\$ 5	\$ 39,509

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

## STATEMENTS OF CASH FLOWS

(In thousands)

For the Years Ended June 30	2001	2000	1999
<b>OPERATING ACTIVITIES:</b>			
Net loss	\$ (5,135)	\$ (7,098)	\$ (14,016)
Adjustments to reconcile net loss to net cash used for operating activities net of effects of acquisition			
Depreciation and amortization	1,949	1,516	1,469
Value of options issued to consultants	172	-	-
Loss on disposal of assets	-	-	773
Change in operating items			
Accounts receivable	(1,333)	233	2,753
Inventories	(3)	982	1,877
Prepays and other assets	1,695	350	156
Accounts payable and accrued expenses	(1,100)	(324)	(605)
<b>Net cash used for operating activities</b>	<b>(3,755)</b>	<b>(4,341)</b>	<b>(7,593)</b>
<b>INVESTING ACTIVITIES:</b>			
Purchase of property and equipment	(873)	(487)	(991)
Purchase of securities	(114,063)	(55,620)	(37,535)
Proceeds from sales of securities	122,346	59,826	45,784
Cash paid for acquisition, net of cash acquired	(7,578)	-	-
<b>Net cash provided by (used for) investing activities</b>	<b>(168)</b>	<b>3,719</b>	<b>7,258</b>
<b>FINANCING ACTIVITIES:</b>			
Proceeds from issuance of common stock, net	3,753	435	136
Payments made on capital lease obligations	(263)	(12)	(26)
<b>Net cash provided by financing activities</b>	<b>3,490</b>	<b>423</b>	<b>110</b>
<b>NET DECREASE IN CASH AND CASH EQUIVALENTS</b>	<b>(433)</b>	<b>(199)</b>	<b>(225)</b>
<b>CASH AND CASH EQUIVALENTS:</b>			
Beginning of year	459	658	883
End of year	\$ 26	\$ 459	\$ 658

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

## NOTES TO FINANCIAL 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. We have developed and offer non-surgical, catheter-based therapies that use a proprietary cooled microwave technology for the treatment of BPH, a disease that dramatically affects more than 23 million men worldwide by causing adverse changes in urinary voiding patterns. We market our products under the Targis™ and Prostatron® names. Both systems utilize Cooled ThermoTherapy™, a targeted microwave energy combined with a unique cooling mechanism that protects healthy tissue and enhances patient comfort while providing safe, effective, lasting relief from the symptoms of BPH. Cooled ThermoTherapy can be performed without anesthesia or intravenous sedation and, as a result, can be performed in a physician's office or an outpatient clinic.

Prior to fiscal 1997, we were considered a development stage enterprise, having devoted substantially all of our efforts to proprietary product development and selling the Targis System to international distributors. These early efforts also included raising capital, performing clinical trials and developing commercial markets. Although we began actively selling our products in 1997 and no longer consider ourselves to be in the development stage, we have not operated profitably to date, and there are no assurances that we will operate profitably in the future.

### 2. Significant Accounting Policies

#### *Cash and Cash Equivalents*

We classify 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*

We invest in money market funds and U.S. government and investment-grade corporate debt or equity 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. The unrealized gains and losses were not material as the fair value approximates amortized costs. The gross realized gains and losses on sales of available-for-sale securities were not material for the years ended June 30, 2001, 2000 and 1999. Current available-for-sale securities are quoted at their estimated fair value based on current market quotes.

#### *Revenue Recognition*

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

#### *Major Suppliers*

We obtain our Targis and Prostatron control units and the Prostatron Prostateprobe from single sources. If the supply of a single-sourced product were to be delayed or curtailed, our ability to ship related products in desired quantities and in a timely manner could be adversely affected. Our business and financial performance could also be adversely affected depending on the time required to obtain sufficient quantities from the original source, or to identify and obtain sufficient quantities from an alternative source. We have a supply agreement with Colorado MEDtech, Inc. to manufacture the Targis control unit through 2003. Colorado MEDtech has experienced production delays related to a warning letter it received from the U.S. Food and Drug Administration (FDA) in January 2001 concerning compliance with the FDA's quality system regulation in Colorado MEDtech's Longmont, Colorado, facility. Although Colorado MEDtech has undertaken an effort to address the deficiencies noted by the FDA, there can be no assurance that it will be able to begin production before substantial delays in the delivery of Targis control units occur.

#### *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.

### **Inventories**

Inventories are stated at the lower of first-in, first-out cost or market, net of reserves, and consist of (in thousands):

June 30	2001	2000
Raw materials	\$ 1,041	\$ 444
Work in process	385	210
Finished goods	777	800
	\$ 2,203	\$ 1,454

### **Goodwill and Other Intangible Assets**

Goodwill represents excess of the cost over the fair value of net assets of acquired businesses while other intangible assets consist primarily of purchased technology and customer base. Goodwill and intangible assets are being amortized using the straight-line method over their estimated useful lives, ranging from 14 to 15 years. We periodically review goodwill and other intangible assets for impairment and assess whether significant events or changes in business circumstances indicate that the carrying value of the assets may not be recoverable, based on an undiscounted cash flow analysis. No impairment charges have been recognized to date or are anticipated.

### **Recently Issued Accounting Standards**

In December 1999, the Securities and Exchange Commission (SEC) issued SEC Staff Accounting Bulletin No. 101 – “Revenue Recognition in Financial Statements,” or SAB 101. SAB 101 provides guidance on the recognition, presentation and disclosure of revenue in financial statements. SAB 101 is effective for years beginning after December 15, 1999, and was adopted by us in the fiscal year beginning July 1, 2000. SAB 101 did not have a significant effect on our operating results, financial position or cash flows.

Effective July 1, 2000, we have adopted the provisions of Statement of Financial Accounting Standards (SFAS) 133, “Accounting for Derivative Instruments and Hedging Activities” (SFAS 133) and SFAS 137, “Accounting for Derivative Instruments and Hedging Activities – Deferral of the Effective Date of FASB Statement No. 133” (SFAS 137). SFAS 133 establishes accounting and reporting standards requiring that every derivative instrument (including certain derivative instruments imbedded in other contracts) be recorded in the balance sheet as either an asset or liability measured at its fair value. SFAS 133 requires changes in the derivatives’ fair value be recognized currently in earnings unless specific hedge accounting criteria are met. SFAS 133 did not have any impact on our consolidated statements of operations or balance sheets.

On June 29, 2001, the Financial Accounting Standards Board (FASB) approved for issuance SFAS 141, “Business Combinations,” and SFAS 142, “Goodwill and Intangible Assets.” Major provisions of these statements are as follows: All business combinations initiated after June 30, 2001, must use the purchase method of accounting; the pooling of interest method of accounting is prohibited except for transactions initiated before July 1, 2001; intangible assets acquired in a business combination must be recorded separately from goodwill if they arise from contractual or other legal rights or are separable from the acquired entity and can be sold, transferred, licensed, rented or exchanged, either individually or as part of a related contract, asset or liability; and goodwill and intangible assets with indefinite lives are not amortized but tested for impairment at least annually. We intend to adopt the statements during the first quarter of fiscal 2002 and estimate that the adoption of the statements will reduce fiscal 2002 amortization expense, on a pretax basis, by approximately \$500,000 to \$600,000.

### **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 their 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 and furniture. Leasehold improvements are amortized over the term of the lease.

### **Deposits and Other Assets**

Other assets consist of prepaid royalties resulting from patent licensing agreements. The agreements require us to pay a royalty on sales of equipment. The license fees and amounts we prepaid are charged to expense as sales are recognized.

### **Warranty Costs**

Certain of our products are covered by warranties against defects in material and workmanship for periods of up to 12 months. The estimated warranty cost is recorded at the time of sale and is adjusted periodically to reflect actual experience.

### **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 because the effect would be antidilutive.

### Financial Instruments

The carrying amount of our financial instruments approximates fair value, as the majority of these instruments are short-term in nature. The fair value of our long-term debt approximates carrying value based on quoted current rates offered to us for debt of the same remaining maturities.

### 3. Acquisition of Certain Assets From EDAP

On October 1, 2000, we purchased the Prostatron Cooled ThermoTherapy product line and related patents and technologies from EDAP TMS S.A., a French corporation; EDAP Technomed, a French corporation and EDAP Technomed Inc., a Delaware corporation (collectively "EDAP"). We paid total consideration of \$7,988,000 in cash, and issued 1,365,000 shares of common stock and a five-year warrant to purchase 327,466 shares of Urologix common stock at a price of \$7.725 per share. We also agreed to assume approximately \$1.5 million in lease obligations related to equipment located at customer sites and issued a promissory note to pay EDAP \$575,000 plus accrued interest at a compound annual rate of 6.31% on December 30, 2003.

We accounted for the acquisition of the Prostatron product line and related patents and technologies using the purchase method. The purchase price was allocated to the acquired assets and assumed liabilities based on the determination of the fair value of the assets purchased and liabilities assumed. Amounts assigned to intangible assets include \$7.5 million for developed technologies, which will be amortized over 15 years; \$2.3 million for customer base, which will be amortized over 14 years; and \$1.2 million for trademarks, which will be amortized over 15 years. The purchase price and related acquisition costs exceeded the values assigned to the identifiable tangible and intangible net assets by approximately \$10.5 million, which was allocated to goodwill.

The statements of operations include the operating results of the acquired business only since the date of acquisition beginning on October 1, 2000. The following unaudited pro forma condensed results of operations for the periods ended June 30, 2001 and 2000, have been prepared as if the transaction occurred on July 1, 2000 and 1999, respectively, (in thousands, except per share data):

June 30	2001	2000
Revenues	\$ 18,098	\$ 15,346
Operating loss	(8,014)	(12,762)
Net loss	(7,555)	(11,907)
Net loss per share	\$ (0.58)	\$ (0.92)

These unaudited pro forma results have been prepared for comparative purposes only and do not purport to be indicative of the results of operations that would have resulted had the combinations been in effect on July 1, 2000 or 1999, or of future results of operations.

### 4. Income Taxes

A reconciliation of our statutory tax rate to the effective rate is as follows:

	2001	2000	1999
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, 2001, we had net operating loss carry forwards of approximately \$68,000,000 for federal income tax purposes that are available to offset future taxable income through the year 2021. Certain restrictions caused by the change in ownership resulting from sales of stock will limit annual utilization of the net operating loss carry forwards. A valuation allowance equal to the full amount of the related net deferred tax assets has been established due to the uncertainty of its realization.

The components of our deferred tax assets for the years ended June 30 are as follows (in thousands):

	2001	2000	1999
Net operating loss carry forwards	\$ 27,193	\$ 25,204	\$ 22,082
Temporary deductible differences	656	715	720
Valuation allowance	(27,849)	(25,919)	(22,802)
	\$ -	\$ -	\$ -

## 5. Supplemental Cash Flow Information

Selected cash payments and non-cash activities for the years ended June 30 were as follows (in thousands):

	2001	2000
Cash paid for interest	\$ 220	\$ 1
Non-cash investing activities:		
Equity capital issued for acquisition	\$ 11,909	\$ -
Details of acquisition:		
Fair value of assets acquired	\$ 25,425	\$ -
Liabilities assumed	(4,953)	-
Issuance of debt	(575)	-
Stock issued	(11,909)	-
Cash paid	7,988	-
Less cash acquired	(410)	-
Net cash paid for acquisition	\$ 7,578	\$ -

## 6. Deferred Income

Deferred income as of June 30 (in thousands)	2001	2000
Deferred royalty income	\$ 1,814	\$ -
Other deferred income	332	614
	\$ 2,146	\$ 614

Deferred royalty income consists of a prepaid non-exclusive license that EDAP had previously granted to a third party for the use of technologies we acquired through the acquisition of EDAP's Cooled ThermoTherapy product line. Deferred royalty income will be recognized based on sales in future years of products incorporating the licensed technologies. Deferred royalty income is recognized as the greater of amounts due based on actual sales or amortization of the license fee over the remaining license period of ten years.

Other deferred income relates to prepayments made to us under an international distribution agreement and on warranty service contracts. Deferred revenue for the international distribution agreement and the warranty service contracts is recognized over the contract period ranging from 12 to 36 months.

## 7. Long-Term Debt and Lease Obligation

We assumed the long-term lease obligation for capital equipment through our acquisition of EDAP's Cooled ThermoTherapy product line. Amounts due will be repaid in monthly installments of \$54,000, including interest at a rate of approximately 22% through January 2004. Term debt is an unsecured \$575,000 promissory note that was issued to EDAP at the time of the acquisition and accrues interest at a compound annual rate of 6.31%. Both the principal and accrued interest are due on December 30, 2003.

Long-term debt as of June 30 consisted of the following ( <i>in thousands</i> ):	2001	2000
Term debt	\$ 575	\$ -
Long-term lease obligation	1,283	-
Less current portion	(419)	-
Total long-term debt	\$ 1,439	-

## 8. Stock Options

We have a stock option plan ("Stock Option Plan") that provides for the granting of incentive stock options to employees and nonqualified stock options to employees, directors and consultants. As of June 30, 2001, we reserved 2,950,910 shares of common stock under this plan, and 545,588 shares were available for future grants. Options expire seven to ten years from the date of grant and are subject to varying vesting schedules. Under the current terms of our 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 Urologix.

Shares subject to option are summarized as follows:

	Stock Options	Weighted Average Exercise Price
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 granted	469,593	7.31
Options canceled	(132,425)	3.86
Options exercised	(305,142)	3.74
Balance at June 30, 2001	1,605,670	\$ 4.75
Options exercisable at June 30, 2001	619,303	\$ 4.39

We account 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 123, "Accounting for Stock-Based Compensation," the net loss and loss per share would have been increased to the following pro forma amounts (in thousands, except per share data):

	2001	2000	1999
Net loss			
As reported	\$ (5,135)	\$ (7,098)	\$ (14,016)
Pro forma	(7,823)	(9,321)	(15,851)
Net loss per share			
As reported	\$ (0.40)	\$ (0.62)	\$ (1.24)
Pro forma	(0.61)	(0.81)	(1.40)

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 2001, 2000 and 1999, respectively: risk-free interest rates of 4.82%, 6.30% and 6.16%; no expected dividend yield; expected volatility of 85.2% in 2001, 69.27% in 2000 and 70.83% in 1999; and expected lives of four years in 2001 and lives of seven years in 2000 and 1999.

The weighted average fair value of options granted during 2001, 2000 and 1999 was \$4.76, \$2.40 and \$2.62, respectively. Options outstanding at June 30, 2001, have an exercise price between \$0.40 and \$24.30, a weighted average exercise price of \$4.75 and a weighted average remaining contractual life of eight years.

### Employee Stock Purchase Plan

We established an Employee Stock Purchase Plan (the "Plan") and have 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, 2001, 78,767 shares have been issued under the Plan since inception for gross proceeds of \$336,140.

## 9. Commitments and Contingencies

### 401(k) Plan

The Company provides a 401(k) savings plan to which eligible employees may make pretax payroll contributions of up to 20% 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 that expire at various dates through fiscal 2003. Rent expense related to operating leases was approximately \$280,000, \$280,000 and \$195,000 for the years ended June 30, 2001, 2000 and 1999, 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, 2001(in thousands):

	Operating Leases
Fiscal year:	
2002	\$ 297
2003	206
	\$ 503

## 10. Geographic Segment Data

Our business activities include the design, development, marketing and sales of Cooled ThermoTherapy products and have been organized into one operating segment. Our domestic operations primarily consist of product development, sales and marketing. Our foreign operations consist of a direct sales representative and a network of distributors. There were no long-lived assets located outside of the United States. Revenue is attributed to geographic areas based on the location of the customers.

Revenue by geographic area for the years ended June 30 is as follows (in thousands):

	2001	2000	1999
United States	<b>\$13,574</b>	\$ 7,899	\$ 5,604
Europe	<b>687</b>	201	134
Asia	<b>1,076</b>	63	372
Total	<b>\$15,337</b>	\$ 8,163	\$ 6,110

## 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  
Innovative Devices, Inc.

**Eric S. Simon**  
Chief Executive Officer  
EDAP TMS S.A.

**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

### Corporate Headquarters

14405 Twenty-First Avenue North  
Minneapolis, Minnesota  
55447-4685  
(763) 475-1400  
Fax: (763) 475-1443  
www.urologix.com

### Independent Public Accountants

Arthur Andersen LLP  
45 South Seventh Street  
Minneapolis, Minnesota  
55402-1611

### Legal Counsel

Lindquist & Vennum PLLP  
4200 IDS Center  
Minneapolis, Minnesota  
55402-2274

### Investor Relations Counsel

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

### Stock Transfer Agent and Registrar

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

### Form 10-K Availability

Copies of the Company's Form 10-K for  
the 2001 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

### Securities Information

The Company's shares are publicly  
traded on the Nasdaq Stock Market  
under the symbol ULGX.

The following table sets forth  
quarterly high and low last-sale price  
of our common stock for the past two  
years.

Fiscal Quarter	First	Second	Third	Fourth
<b>2001:</b>				
High	\$ 9.00	\$13.63	\$23.50	\$27.79
Low	3.75	6.88	12.13	18.31
<b>2000:</b>				
High	\$ 4.00	\$ 6.13	\$10.44	\$ 6.88
Low	2.38	2.88	4.00	3.81

### Dividends

To date, we have not paid or declared  
dividends on our common stock, and  
we do not intend to do so in the  
foreseeable future.