



**UROLOGIX®** Annual Report 2002

SETTING THE STANDARD  
FOR CARE

**Corporate Overview** *Urologix, Inc., founded in 1991, is setting the standard for care in the treatment of benign prostatic hyperplasia (BPH) through the development, manufacturing and marketing of minimally invasive medical devices.*

*BPH currently affects nearly 23 million men worldwide. As the population ages, this condition will become more prevalent, building on a tremendous opportunity for the safe and effective treatment provided by Urologix.*

*The cornerstone of Urologix' business is its Cooled ThermoTherapy™ technology, a minimally invasive office-based treatment that delivers targeted transurethral microwave energy to heat and destroy enlarged prostate tissue, combined with unique cooling mechanisms to protect surrounding, healthy tissue, maximizing patient comfort. Cooled ThermoTherapy technology has firmly established its place as the leading office-based BPH treatment over the past year, providing simple but effective solutions for the unmet needs of BPH patients.*



Michael M. Selzer Jr.  
*President and Chief Executive Officer*

*Since its beginnings in 1991, Urologix has operated with a very clear vision: to provide simple solutions for the unmet needs of the urology patient.*

This year, in addition to achieving record financial performance, we brought this vision to life for a patient every 25 minutes. We have established our clinically superior Cooled ThermoTherapy treatment as the market leader, accounting for more than 50 percent of the minimally invasive BPH treatments performed in the United States today.

While much has been accomplished during the last year, much remains to be done. We are focused on developing the fundamentals of our business: increasing the number of sites providing Cooled ThermoTherapy and increasing the number of urology patients who receive the benefit of our treatment. As we reflect on our course over the past year, we are even more enthusiastic about our franchise and its potential for rapid growth.

**Fiscal 2002 Review** Fiscal 2002 was a record year for Urologix on many fronts. Our success was fueled by a rapid increase in the number of urology practices that offered Cooled ThermoTherapy to their patients through either a direct installation or a mobile service provider. During 2002, we installed 103 new Cooled ThermoTherapy systems, increasing our installed base to nearly 300. Through direct installations and mobile service providers, we

are now able to offer Cooled ThermoTherapy in more than 600 offices and hospitals across the United States.

As a result of our success expanding access to Cooled ThermoTherapy, revenues increased 48 percent to \$23 million this year, led by a 58 percent increase in revenues for single-use treatment catheters. We made significant progress toward transitioning our revenue mix from less predictable equipment sales to more predictable treatment sales, which accounted for nearly 80 percent of our total revenues in fiscal 2002. Our gross margins of 66 percent continued to show improvement from last year through material cost reductions and economies of scale in production.

As we expanded the number of Cooled ThermoTherapy installations, we also looked for additional growth by increasing the number of treatments performed at each site. While utilization was steady at six to eight treatments per month, we are working to overcome the challenges to growing utilization beyond current levels. I am confident, however, that we will be able to overcome these barriers, just as other new, clinically significant procedures have ultimately gained broad adoption by the medical community.

We strengthened our supply chain after experiencing a short-term supply interruption involving Targis® control units at the beginning of the year. This interruption was painful for a small, rapidly growing company like ours, but we took swift and appropriate action to resolve the situation. Beyond resolving the Targis supply issue, we are taking steps to develop redundant manufacturing capabilities for our other products, minimizing the risk of future interruptions. The result of this strategy will be the ability to manufacture our products both internally and with external suppliers of choice.

Over the years, we have developed a strong fence around our franchise that today includes 43 U.S. patents, 5 U.S. patent applications, 31 grants outside of the United States and 13 non-U.S. applications in progress. This is one of our most important assets and a significant competitive advantage for us in the BPH market. Late in the fiscal year, it became clear that an overseas competitor planned to market a BPH treatment system in the United States that we believe infringes on our intellectual property. Legal fees for protecting these assets are high. While profitability will be delayed as a result of our decision to protect our intellectual property through litigation, we believe the actions taken are critical to the long-term success of our company.

**Building on our Clinical Advantage** Our clinical advantage has established Cooled ThermoTherapy as a standard of care by which all other minimally invasive BPH treatments are measured. Urologists want to know that the treatments they prescribe will provide effective, lasting results, and they want to work with reputable companies and technologies to avoid the mistakes of the past.

I am proud of our clinical integrity and believe it sets us apart from the competition. Our results speak for themselves. More than 120 clinical papers have been published since 1992, supporting the benefits of Cooled ThermoTherapy. Multi-center clinical studies continue to demonstrate the industry-leading, long-term durability of Cooled ThermoTherapy in both the 60-minute and shorter 30-minute protocols. One of these long-term

studies was selected by the American Urological Association (AUA) as newsworthy and was highlighted at the recent AUA national meeting in Orlando.

Our clinical advantage is enhanced by our commitment to physician education and our high level of customer service. Our direct sales team has increased from 15 to more than 25 members, supported by additional reimbursement specialists, clinical nurses and practice enhancement specialists to support the growth in our business.

Equally important is our long-standing commitment to physicians. Our customers tell us that bringing in new patients takes effort and dedication from an already busy office staff. That is why we created individualized practice development programs designed to help physicians integrate Cooled ThermoTherapy into their practices and ultimately increase the number of patients who benefit from our treatment.

**Looking Ahead** Our strategy is to build our business in three ways: by expanding our BPH business; by applying Cooled ThermoTherapy to new, unmet medical needs; and by introducing new products that meet the needs of the urologist in the office.

To grow our BPH franchise, we are focused on expanding the number of physician practices that can offer Cooled ThermoTherapy, while we work to increase treatment volume at existing sites. To accomplish this goal, we will continue to leverage the flexibility inherent in the features, options and price points of our products, while selling the clinical benefits of our technology.

We have several products before the U.S. Food and Drug Administration (FDA) for review under premarket approval (PMA) supplements. The most significant is Cooled ThermoCath™, which we submitted in June following a successful launch outside of the United States. This product may allow us to shorten the overall treatment and recovery times because of its greater cooling capacity. We expect an FDA review during the next several months, with release later in 2003.

We have recently received approval of the first new antenna length for Targis. This shorter antenna will be used for patients with smaller prostates—a market segment where our competitors have been focusing—and should help to increase our market share even further.

In addition, we are working to expand the number of individuals who can benefit from Cooled ThermoTherapy. Recently the FDA allowed us to remove restrictions on treating BPH in patients who have been diagnosed with prostate or bladder cancer, and it approved our treatment for patients with prosthetics, such as hip replacements and pacemakers.

Beyond BPH, we continue to look for new uses for our cooled microwave technology and see a great opportunity in the treatment of prostatitis, an inflammation of the prostate that results in one million urology office visits every year. We are partnering with four centers outside of the United States to investigate the treatment of prostatitis with Cooled ThermoTherapy and are currently collecting data on patients participating in our clinical study.

We also are evaluating our ability to ablate small tumors in the kidney through a proprietary combination of cooling and heating. Early pre-clinical feasibility studies are promising.

Finally, we are pursuing a number of opportunities, both internal and external, that may increase our presence in the urologist's office. With a sales force skilled in the development of new markets, we can quickly bring new and innovative products into the hands of the urologist. Market development in the physician's office is a unique competency of Urologix, and it will continue to open doors to new and exciting future products. To help us maximize these opportunities for growth, Kirsten Doerfert, who previously led our marketing efforts, will apply her deep knowledge of the urology market to lead our new business development efforts.

To ensure our long-term success, we continue to add leaders with a proven track record and a wealth of medical device experience. I am pleased to announce the addition of two of these new leaders. In March, Craig Palmer joined our company as vice president

of U.S. sales and is focused on building our sales team and executing our growth strategies. In August, Lance Wallin joined us as vice president of global marketing. He will work to strengthen our U.S. market development competency. Our strong sales and marketing teams, in conjunction with our dedicated operating and financial teams, give us the structure we need to take advantage of the opportunities in BPH and urology in the years ahead.

We also are pleased to report that Dan Starks, president and chief operating officer of St. Jude Medical, has joined our Board of Directors. Dan brings extensive experience in high growth medical products companies, and his insight will be extremely valuable as we expand our business. I also would like to express my sincere thanks to Dr. David Utz and Rick Randall for their service on our board. Both individuals have made significant contributions to our company during their tenure. Dr. Utz retires from the board this November after eight years of service during the formative stages of Urologix. Rick has assumed leadership of a medical technology company, causing him to limit his involvement on several boards.

I feel strongly that Urologix is setting a new standard for care in today's BPH marketplace, and we continue to make solid progress toward our goals. Our investments are creating a strong and growing franchise in BPH treatments and reflect our expanding presence in urology. With the increase in new customers, and the anticipated increase in customer usage, we look forward to strengthening our position in the market through steady growth. Our prospects continue to be bright, and I believe Urologix is well positioned to provide simple solutions for the unmet needs of urology patients for years to come.

As always, we appreciate your continued support.

Sincerely,



Michael M. Selzer Jr.

*President and Chief Executive Officer*

*A New Standard of Care: Urologix' patented technology, Cooled ThermoTherapy, has become a new standard of care for patients with BPH, redefining the way BPH treatment is delivered.*

**Benign Prostatic Hyperplasia—A Growing Concern** BPH, also known as enlarged prostate, is a non-cancerous condition in which prostate cells continue to grow as a man ages. An enlarged prostate often compresses the urethra, causing uncomfortable and painful symptoms, including the frequent and urgent need to urinate, especially at night; a weak or intermittent urine flow; urinary tract infections and sexual dysfunction. BPH generally affects men after the age of 50, and medical experts suggest that nearly every man will be affected by this condition at some time in his life.

**Treatment Options** Today, BPH is treated with watchful waiting, medication, minimally invasive therapies or surgery. Patients often begin with the most conservative approach and continue down the clinical path as symptoms progress.

**Watchful Waiting.** When symptoms are vague and only mildly bothersome, men often begin with watchful waiting, encouraged by their physicians to monitor symptoms through annual exams. While this course of action gives patients and their physicians time to observe changes in symptoms, patients have to live with the inconveniences until a treatment option is selected.

**Medication.** Alpha-blockers and other medications are sometimes prescribed to relax the muscles in and around the prostate, relieving some of the symptoms of BPH. While often effective, medication can be costly over a lifetime, and there can be undesirable side effects, such as fatigue, headache, dizziness and impotence. Medication, however, only addresses the symptoms of BPH. The prostate continues to enlarge while a patient takes alpha-blockers. Not surprisingly, when a patient stops taking the medication, he may experience more severe symptoms than before beginning treatment.

**Minimally Invasive Treatments.** Treatment options that are more aggressive than medication but less extreme than surgery include minimally invasive treatments that are designed to reduce the symptoms of BPH. Some options involve radio frequency ablation, low energy microwave or laser coagulation. While these therapies provide benefits, some generate high temperatures in the urethra or use rigid scopes, compromising patient comfort. Others have limited durability and may provide inconsistent BPH relief.

**Surgery.** Surgery is often the last resort for many men, as it has the potential for serious complications and may not be possible for some patients because of co-existing medical conditions. Transurethral resection of the prostate (TURP) is the most common surgery. Using a resectoscope, a metal tube inserted into the urethra, physicians pass instruments through to the prostate to remove both healthy and enlarged prostatic tissue. While surgery generally provides the longest-term relief, it also requires general or spinal anesthesia, a hospital stay of one to three days and a recovery period of up to six weeks. Surgery also involves potential complications, including bleeding, urinary incontinence, retrograde ejaculation and impotence.

**Cooled ThermoTherapy—A New Standard for Care** Urologix' patented technology, Cooled ThermoTherapy, has become a new standard of care for patients with BPH, redefining the way BPH treatment is delivered. Cooled ThermoTherapy is a minimally invasive, non-surgical procedure using microwave energy delivered through a catheter. Clinical studies have proven that high temperatures are necessary to provide the deep coagulative necrosis required for a durable BPH treatment. Cooled ThermoTherapy delivers high temperatures deep into the prostate while cool water is circulated through outer channels of the catheter to protect healthy urethral tissue, enhance patient comfort and shorten recovery time. The result of this unique combination of heating and cooling is lasting relief of BPH symptoms without the negative side effects of other therapies.

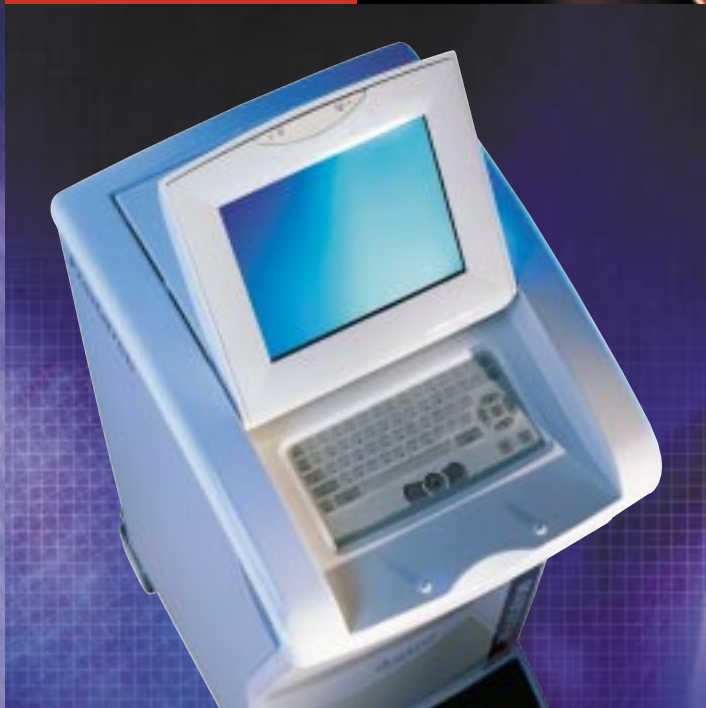
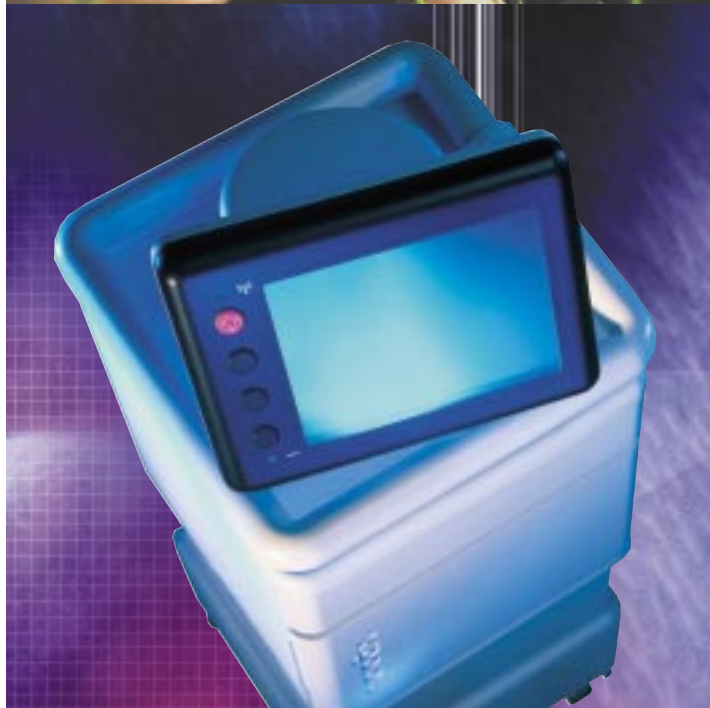
Cooled ThermoTherapy offers BPH patients lasting results in a single, minimally invasive treatment. Patients have the convenience of an in-office procedure, without the need for anesthesia. With this treatment, patients are able to return home immediately following the procedure. Although symptom relief may not be immediate, the treatment has been shown to provide long-lasting relief with a low risk of complications. Cooled ThermoTherapy is more cost-effective than a lifetime of drugs and avoids medication side effects. The patented cooling technology provides greater patient comfort and faster recovery in a safe and effective treatment. Recently, Cooled ThermoTherapy, as delivered by the Urologix Targis and Prostatron® systems, was recommended by the World Health Organization, as well as by worldwide urological associations, for the treatment of BPH.



< Lawrence Thome, 75, was tired of the pain caused by his enlarged prostate, and his wife was tired of his multiple nightly bathroom trips. In 2000, Thome's physician, Dr. Jerome Keating, suggested Cooled ThermoTherapy. Today, Thome is back to playing golf and tending his rose garden. "I feel great," he said. "I don't even think about my former symptoms any more."

> A normal prostate (top) allows for a normal flow of urine through the urethra, while an enlarged prostate (bottom) compresses the urethra and causes symptoms.

v The Targis System (left) and the Prostatron System (right) both provide excellent, long-term clinical outcomes.



**Urologix' Strong Product Platform** Urologix has invested more than \$80 million in the development and advancement of Cooled ThermoTherapy through two unique products: Targis and Prostatron. The Targis system, introduced in 1996, was Urologix' first Cooled ThermoTherapy product. Prostatron, the pioneering product launched in Europe in 1991, was purchased by Urologix in 2000, providing Urologix with the full range of Cooled ThermoTherapy technology.

Both systems consist of a control unit, a single-use, catheter-based device for microwave delivery that includes a cooling system and a rectal, temperature-monitoring probe. The control unit, which is mobile and can be moved from one treatment location to another, supplies the microwave energy and coolant to the treatment catheter. At the same time, it monitors and processes data from the catheter and the rectal monitoring probe to ensure patient safety and correct treatment parameters.

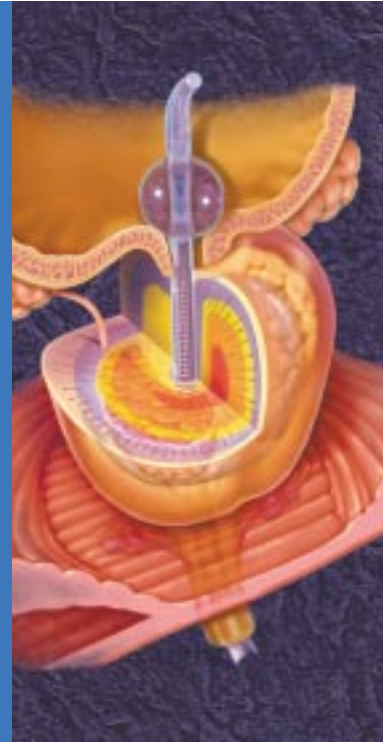
Targis offers the urologist a flexible high-energy system that can be customized for the individual patient, providing treatment times of 28.5 and 60 minutes. Prostatron, a high-energy 30-minute treatment, is the only thermotherapy device on the market that is patented and FDA approved to treat the bladder neck of the prostate – a choice of some physicians to improve urine flow rate. With both products, the higher energy treatments have been shown to be more clinically effective and durable than the longer, lower energy treatments.

**Cooled ThermoCath** Cooled ThermoCath, the next generation of Cooled ThermoTherapy for BPH, was recently launched in Europe and is pending U.S. FDA approval. Preliminary findings indicate Cooled ThermoCath provides increased tissue necrosis in a shorter period of time with a continued high level of patient comfort during the treatment. This is achieved by incorporating unique, patented cooling channels that allow the urethral tissue to conform more closely to the catheter. This enhances urethral cooling and allows for more efficient heat penetration into the prostate.

**Commitment to Physician Support** Urologix significantly expanded its customer base during the past year. Today Cooled ThermoTherapy systems are used in more than 600 locations,

> This cross section of a prostate gland shows placement of the Cooled ThermoTherapy catheter.

For Vincent Lioce, 63, the symptoms of his enlarged prostate made it impossible to enjoy his hobbies of playing golf and riding motorcycles. Medications had not been successful. On the advice of his physician, Dr. Michael O'Leary, Lioce received Cooled ThermoTherapy. "My life has had a complete turnaround," he said. "The treatment has made a tremendous difference."

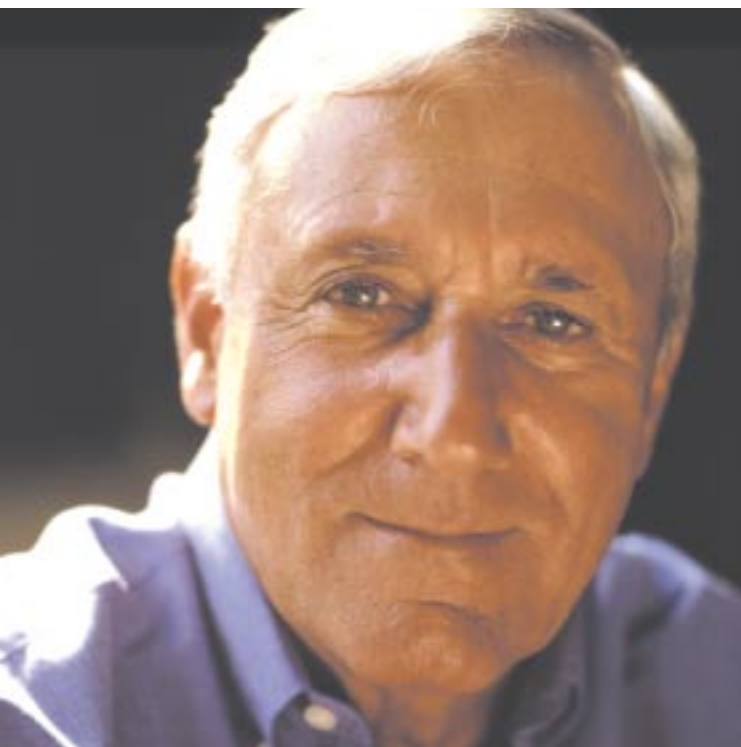


creating access to this leading technology throughout the United States.

Working in close partnership with urologists, Urologix provides clinical training, reimbursement support and practice development programs, including the most useful, up-to-date educational materials in the industry. Customers are supported by a direct sales force and a network of mobile service providers who are committed to helping urologists make Cooled ThermoTherapy a valuable part of their practice.

**Service.** Urologix provides comprehensive clinical and technical support 24 hours a day, seven days a week from experienced Targis and Prostatron clinical specialists and service technicians.

**Education.** Urologix takes pride in the scientific integrity that surrounds the multitude of clinical studies and educational resources available to support Cooled ThermoTherapy. It has a strong focus on providing extensive physician and staff training, supporting



clinical publications and developing educational materials, including patient education resources.

**Practice development.** To help office-based urologists capture more of the under-served BPH market, Urologix provides practice development tools, as well as dedicated sales and market development professionals to customize marketing programs to meet the needs of individual practices.

**Reimbursement support.** Approximately 60 to 80 percent of Urologix' patients in the United States are eligible for Medicare coverage. Urologix has also developed a strong initiative to help the office urologist obtain coverage from commercial insurance carriers who insure non-Medicare patients. Urologix provides dedicated reimbursement professionals to work directly with individual practices to ensure that their local carriers cover Cooled ThermoTherapy.

**Untapped Opportunities for Growth** Beyond developing its BPH franchise, Urologix is also exploring new indications for its

technology that may present tremendous market opportunities and potential for growth in the years ahead.

**Prostatitis.** Prostatitis, or inflammation of the prostate, results in one million annual urology office visits. While antibiotics are used to treat bacterial prostatitis, there is no proven effective treatment for the more prevalent non-bacterial prostatitis. A major opportunity exists to provide treatment for the many prostatitis patients for whom current treatments are ineffective.

**Prostate Cancer Pre-Treatment.** There are 150,000 new cases of prostate cancer diagnosed each year in the United States alone. Physicians have reported results showing that treatment with Cooled ThermoTherapy prior to brachytherapy has shown promise in reducing the swelling and resulting urinary retention often caused by that method of cancer treatment. Experts estimate 40,000 brachytherapy seed treatments are performed annually, creating a significant opportunity to use Cooled ThermoTherapy.

**Renal Cell Carcinoma.** Cooled ThermoTherapy may provide distinct advantages over other minimally invasive technologies as an ablative tool for solid tumors such as renal cell carcinoma. With 30,000 cases diagnosed annually, renal cell carcinoma is the eighth most common cancer in men, and the tenth most common in women, usually occurring in adults between the ages of 50 and 70.

**Opportunities Now and in the Future** Urologix continues to offer simple solutions for the unmet needs of urology patients. Those who depend on the company to provide them with safe and effective treatment options appreciate the clinical integrity behind Urologix' products and therapies. Likewise, urologists have come to know they can trust Urologix to support their efforts with sophisticated educational materials, superior service and a wide range of practice development tools to help them stay ahead of the clinical curve.

Driven by the needs of patients and urologists worldwide, led by a dedicated team of highly knowledgeable professionals, and fueled by present and future market opportunities, Urologix continues to set the standard for care in the treatment of BPH.

*Clinical Integrity: Urologix is setting the standard for care through proven clinical durability and industry leading clinical integrity.*

Cooled ThermoTherapy is accepted as a standard of care for many of the 23 million men worldwide who suffer from benign prostatic hyperplasia (BPH). With more than five years of clinical data and more than 100,000 patients treated worldwide, Cooled ThermoTherapy is the most clinically proven, minimally invasive in-office treatment for BPH in the industry today.

**BPH Diagnosis Leading to Treatment** Clinical studies generally use four standard measures to identify and rank BPH symptoms.

**AUA Symptom Score Index.** The American Urological Association (AUA) created a simple index to help physicians and patients determine the type and severity of symptoms. Scores are calculated on answers to seven questions regarding a patient’s urinary voiding patterns. Scores from zero to seven are considered to reflect mild BPH, eight to 19 reflect moderate BPH, and 20 to 35 indicate severe BPH. Patients with higher scores are more likely to need treatment.

**Peak Flow Rate.** Peak urinary flow rate (Qmax measured in mL/sec) is a measure of how quickly a patient can empty his bladder. A high urinary flow rate correlates to mild symptoms and a low flow rate to moderate or severe symptoms. It is often the diminished urinary stream and inability to completely empty his bladder that causes a man to seek treatment.

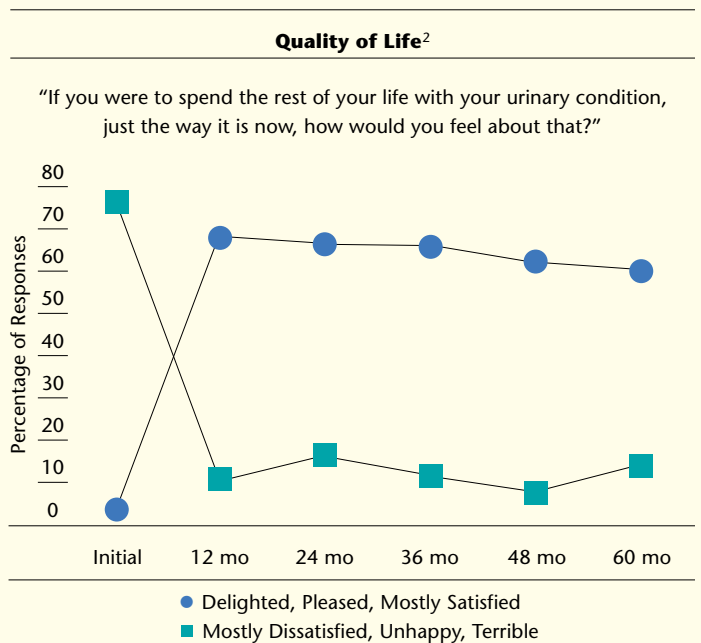
**Quality of Life.** BPH is a quality of life disease, and it is important to measure the impact of any treatment on a patient’s quality of life. Following treatment, patients are asked, “If you were to spend the rest of your life with your urinary condition just the way it is now, how would you feel about that?” Responses range from “delighted” (0 points) to “terrible” (6 points). Generally this is measured before and 12 months after treatment.

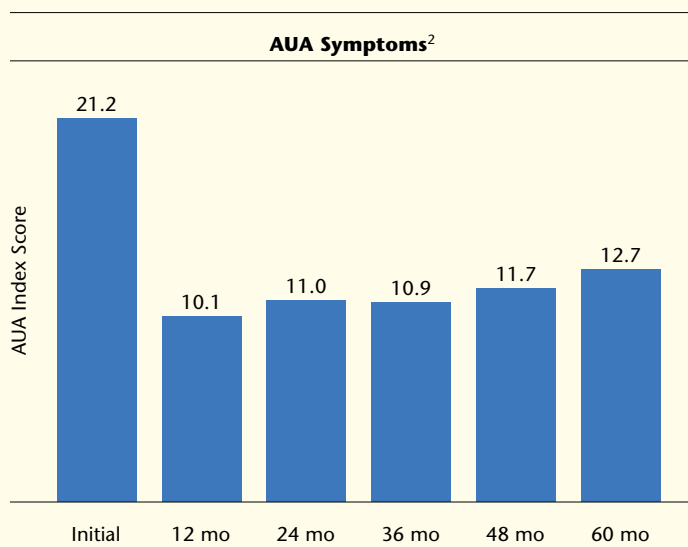
**Patient Satisfaction.** Patient satisfaction is the ultimate measure of a successful treatment. Urologix has included a patient satisfaction measure in each of its clinical studies. Patients are asked at each follow-up visit to describe how satisfied they are with their treatment so far, using a scale from “very satisfied” to “dissatisfied.”

**Recent Clinical Studies Demonstrating Consistent, Long-Term Effectiveness**

**Multi-study analysis from 16 centers.** Researchers at Johns Hopkins University recently completed an analysis of studies involving 16 centers in the United States, England and Canada evaluating the efficacy of Cooled ThermoTherapy to improve BPH symptoms.<sup>1</sup> A total of 541 men treated with Cooled ThermoTherapy compared their baseline AUA scores, peak flow rates and quality of life to scores gathered at 3, 12 and 24 months after treatment. The authors of the study found significant improvement in all three areas at all three time intervals. Each of the three measures of lower urinary tract BPH symptoms improved by approximately 50 percent compared to the baseline measures, and the level of change was remarkably consistent across all studies, indicating that Cooled ThermoTherapy is highly reproducible and provides consistent results when used by a wide range of urologists.

**Five-year efficacy and durability study.** Data from a five-year study of 345 patients by Steven Kaplan, M.D., Michael Blute, M.D. and others<sup>2</sup> revealed long-term efficacy and durable improvements





in AUA symptom score, peak flow rates and quality of life. The mean improvement in AUA symptom score was 40 percent at five years, demonstrating the durability and effectiveness of Cooled ThermoTherapy with the Urologix Targis system through five years post-treatment.

**Randomized 28.5-minute protocol study.** Claus Roehrborn, M.D., Michael Blute, M.D., and others recently conducted a randomized, multi-center, double-blinded study using the Targis system to determine the feasibility and tolerability of an abbreviated protocol<sup>3</sup>. Ninety-four men with symptomatic BPH were treated in either a 60-minute protocol or a 28.5-minute protocol. Patients in both study arms had significant improvement in AUA symptom score, peak flow rate and quality of life score. Data from the study revealed similar long-term efficacy with the Targis 28.5-minute treatment protocol compared with the 60-minute treatment.

**Two-year study with 30-minute protocol.** Ronald Sorensen, M.D., conducted a study evaluating the efficacy of the Prostatron 30-minute protocol on 140 BPH patients over two years<sup>4</sup>. Two years after treatment, patients demonstrated an 81 percent improvement in symptom score, an 84 percent improvement in quality of life and a 64 percent improvement in peak flow rate. The authors stated that the 30-minute treatment protocol was “a dramatic

improvement” over previous treatments including the low-energy, 2.0 protocol that took up to 60 minutes to perform.

**Established Patient Comfort, Clinical Outcomes and Durability** Cooled ThermoTherapy has established an unprecedented outcome and durability standard for in-office treatment of BPH. Treating both the symptoms and the obstruction, Cooled ThermoTherapy reaches higher intraprostatic temperatures in order to shrink enlarged prostate tissue. Studies show that our unique combination of high energy delivered deep into the prostate while cooling the urethra results in increased patient comfort during treatment, minimal urethral damage and decreased post-treatment morbidity.

Studies continue to support the consistent, long-term durability of Urologix’ products and improved clinical outcomes over time, making Cooled ThermoTherapy a treatment of choice for men worldwide.

<sup>1</sup> Trock BJ, Brotzman MJ, Utz W, et. al: A Pooled Analysis of Multi-Center Studies of Cooled ThermoTherapy™ for Benign Prostatic Hypertrophy (BPH): Results at 3, 12 and 24 Months. Paper presented at: Annual Meeting of the American Urological Association, May 28, 2002; Orlando, Fla.

<sup>2</sup> Kaplan SA, Blute M, Bruskewitz RC, et al: Long-Term Efficacy and Durability in 345 Patients Treated with Transurethral Microwave ThermoTherapy for Benign Prostatic Hyperplasia: Five-Year Results. Paper presented at: Annual Meeting of the American Urological Association, May 28, 2002; Orlando, Fla.

<sup>3</sup> Roehrborn CG, Blute M, Partin A, et. al: Long-Term Efficacy of a 28.5-Minute Cooled ThermoTherapy™ (TUMT) Treatment Compared with 60-Minute Treatment for Benign Prostatic Hyperplasia. Paper presented at: Annual Meeting of the American Urological Association, May 28, 2002; Orlando, Fla.

<sup>4</sup> Sorensen RB, Sorensen A. Initial Experience with 30-Minute Cooled Microwave ThermoTherapy for the Treatment of BPH: 2-Year Outcomes. Paper presented at: Annual Meeting of the American Urological Association, May 28, 2002; Orlando, Fla.

*Selected Quarterly Financial Data*

(In thousands, except per share data)	Year Ended June 30, 2002			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Sales	\$ 5,184	\$ 5,257	\$ 6,027	\$ 6,274
Gross profit	3,346	3,446	3,913	4,193
Net loss	(733)	(470)	(95)	(353)
Basic and diluted net loss per share	\$ (0.05)	\$ (0.03)	\$ (0.01)	\$ (0.03)

(In thousands, except per share data)	Year Ended June 30, 2001			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Sales	\$ 1,935	\$ 3,202	\$ 4,509	\$ 5,691
Gross profit	1,097	1,997	2,794	3,645
Net loss	(1,460)	(1,607)	(1,214)	(854)
Basic and diluted net loss per share	\$ (0.13)	\$ (0.12)	\$ (0.09)	\$ (0.06)

<b>Contents</b>	10	11	11	12	16
	Selected Quarterly Financial Data	Statements of Operations Data	Balance Sheet Data	Management's Discussion & Analysis	Report of Independent Public Accountants
	17	18	18	19	20
	Balance Sheets	Statements of Operations	Statements of Shareholders' Equity	Statements of Cash Flows	Notes to Financial Statements

(In thousands, except per share data)	Years Ended June 30,				
	2002	2001	2000	1999	1998
Sales	\$22,742	\$15,337	\$ 8,163	\$ 6,110	\$ 11,194
Cost of goods sold	7,844	5,804	4,357	5,910	9,162
Gross profit	14,898	9,533	3,806	200	2,032
Costs and expenses:					
Research and development	4,073	3,533	3,614	5,106	6,676
Sales, general and administrative	12,046	10,799	8,767	10,856	9,049
Amortization of intangibles	664	1,082	-	-	-
Total costs and expenses	16,783	15,414	12,381	15,962	15,725
Operating loss	(1,885)	(5,881)	(8,575)	(15,762)	(13,693)
Interest income, net	234	746	1,477	1,746	2,056
Litigation settlement expense	-	-	-	-	(3,376)
Net loss	\$ (1,651)	\$ (5,135)	\$ (7,098)	\$ (14,016)	\$ (15,013)
Basic and diluted:					
Net loss per common share	\$ (0.12)	\$ (0.40)	\$ (0.62)	\$ (1.24)	\$ (1.44)
Weighted average shares used in computing net loss per share	13,810	12,760	11,514	11,346	10,429

## Balance Sheet Data

(In thousands)	Years Ended June 30,				
	2002	2001	2000	1999	1998
Cash, cash equivalents and available-for-sale investments	\$12,713	\$14,921	\$23,598	\$28,036	\$36,500
Working capital	14,007	14,935	23,131	28,803	41,375
Total assets	46,437	46,860	31,956	38,988	53,489
Long-term obligations	926	1,439	-	3	9
Total liabilities	7,490	7,351	3,186	3,521	4,152
Shareholders' equity	38,947	39,509	28,770	35,467	49,337

The following discussion should be read in conjunction with our consolidated financial statements and related notes contained elsewhere in this annual report. This discussion may contain forward-looking statements based upon current expectations that involve risks and uncertainties. Our actual results and the timing of selected events could differ materially from those anticipated in these forward-looking statements as a result of selected factors, including those set forth in this Management's Discussion and Analysis and under "Risks Related to Our Business" in Item 1 of our Form 10-K for the year ended June 30, 2002. All forward-looking statements included here are based on information available to us as of the date hereof, and we assume no obligation to update any such forward-looking statements.

**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 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. We believe Cooled ThermoTherapy provides an efficacious, safe and cost-effective solution for BPH that is superior to medication without the complications and side effects inherent in surgical procedures.

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 they will 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, the Center for Medicare and Medicaid Services (CMS), which administers 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.

Our goal is to grow Cooled ThermoTherapy as a standard of care for the treatment of BPH. Our business strategy to achieve this goal is to: (i) increase market awareness of Cooled ThermoTherapy, (ii) create access to Cooled ThermoTherapy through both the sale and rental of Cooled ThermoTherapy systems and (iii) increase the use of Cooled ThermoTherapy by physicians who already have access to a Cooled ThermoTherapy system.

We expect to continue to incur operating losses as we expand our marketing and sales activities, continue clinical trials in support of regulatory and reimbursement approvals, and continue to invest in our effort to protect our intellectual property. Our future profitability will be dependent upon, among other factors, our success in achieving market acceptance of the Cooled ThermoTherapy procedures in the physician's office, our success in obtaining and maintaining necessary regulatory clearances, our ability to manufacture at the volumes and quantities the market requires, the extent to which Medicare and other health care payers continue to reimburse costs of Cooled ThermoTherapy procedures performed in hospitals, ambulatory surgery centers and physicians' offices, and the amount of reimbursement provided.

**Critical Accounting Policies** In accordance with recent Securities and Exchange Commission guidance, we set forth below those material accounting policies that we believe are the most critical to an investor's understanding of our financial results and condition, and require complex management judgment.

**Revenue Recognition** We recognize revenue in accordance with Securities and Exchange Commission Staff Accounting Bulletin 101. Revenue from product sales is recognized at the time of shipment, net of estimated returns, which also are established 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. We also record a provision for estimated sales returns on product sales in the same period as the related revenue is recorded. These estimates are based on historical sales returns, analysis of credit memo data and other known factors. If the historical data we used to calculate these estimates do not properly reflect future returns, revenues could be overstated.

**Product Warranty** We record a liability for warranty claims at the time of sale. The amount of the liability is based on the trend in the historical ratio of product failure rates, material usage and service delivery costs to sales, the historical length of time between the sale and resulting warranty claim, and other factors. Should actual product failure rates, material usage or repair costs differ from our estimates, revisions to the estimated warranty liability would be required.

**Inventory Reserves** We record reserves for inventory shrinkage and for potentially excess, obsolete and slow moving inventory. The amounts of these reserves are based upon historical experience and forecasted demand. Our reserve requirements could be materially different if demand for our products decreased because of competitive conditions or market acceptance, or if products become obsolete because of advancements in the industry.

**Allowance for Doubtful Accounts** We maintain allowances for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. This allowance is a significant estimate and is regularly evaluated by us for adequacy by taking into consideration factors such as past experience, credit quality of the customer base, age of the receivable balances, both individually and in the aggregate, and current economic conditions that may affect a customer's ability to pay. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

**Valuation of Long-Lived and Intangible Assets and Goodwill** In fiscal 2002, we adopted Statement of Financial Accounting Standards (SFAS) 142, "Goodwill and Other Intangible Assets," and as a result, we have ceased to amortize approximately \$10.2 million of goodwill and \$1.1 million of trademarks. Goodwill is tested for impairment annually or more frequently if changes in circumstance or the occurrence of events suggests an impairment exists. The test for impairment requires us to make several estimates about fair value, most of which are based on projected future cash flows. Our estimates associated with the goodwill impairment tests are

considered critical, due to the amount of goodwill recorded on our balance sheets and the judgment required in determining fair value amounts, including projected future cash flows.

Other intangible assets consist of purchased technology, customer base and trademarks. Purchased technology and customer base are amortized using the straight-line method over their estimated useful lives of 15 and 14 years, respectively. The trademark asset is considered to be an intangible asset with an indefinite useful life, and it will not be amortized until its useful life is determined to be no longer indefinite. We review these definite and indefinite lived intangible assets for impairment annually or as changes in circumstance or the occurrence of events suggests the remaining value is not recoverable.

### Results of Operations

**Fiscal Years Ended June 30, 2002 and 2001** Net sales for fiscal 2002 increased \$7.4 million or 48% to \$22.7 million, compared to sales of \$15.3 million in the prior fiscal year. The growth in revenue was fueled primarily by a 58% increase in sales of single-use treatment catheters. Revenue in fiscal 2002 was also positively affected by a full year of revenue from the Prostatron product line, compared to nine months in fiscal 2001.

We expect revenue in fiscal 2003 to increase as the sale of the single-use treatment catheters continues to grow, and more physicians begin to use Cooled ThermoTherapy. Sales increases in the domestic market will be partially offset by decreased international sales as reimbursement declines in Japan affect sales in that marketplace.

Cost of goods sold increased to \$7.8 million in fiscal 2002 compared to \$5.8 million in fiscal 2001. The increase in cost of goods sold resulted from an increase in the volume of Cooled ThermoTherapy systems and single-use treatment catheters sold in 2002, partially offset by a reduction in the per unit production costs of our products, due to increased manufacturing efficiencies and lower product cost.

Gross profit as a percentage of sales increased to 66% in fiscal 2002 from 62% in fiscal 2001, due primarily to continued manufacturing process improvements, increased production volumes, decreased raw material costs, price reductions from key suppliers, and a continued shift in mix to the sale of our higher margin single-use treatment catheters from Cooled ThermoTherapy system sales.

Research and development expenses, which include expenditures for product development, regulatory compliance and clinical studies, increased to \$4.1 million in fiscal 2002 from \$3.5 million in the

prior fiscal year. The increase in research and development expenses resulted from increased investments in new product development and clinical study activity. We expect research and development expenses to increase as we continue clinical trial activity on our next generation of Cooled ThermoTherapy treatment catheters.

Sales, general and administrative expenses increased to \$12 million from \$10.8 million in the prior fiscal year. The increase in expenses resulted from the continued expansion of our direct sales force, training and promotional activities, and expenses related to a patent infringement suit that we filed to protect our intellectual property. We expect sales and marketing expenses to increase as we expand our direct sales force, intensify our efforts to generate awareness and acceptance of Cooled ThermoTherapy, and protect our intellectual property.

Amortization of goodwill and other intangible assets decreased to \$664,000 in fiscal 2002 from \$1.1 million in fiscal 2001. The decrease in the amortization of goodwill and other intangible assets resulted from the adoption of Financial Accounting Standards Board (FASB) Statement 141, "Business Combinations," and Statement 142, "Goodwill and Other Intangible Assets," effective July 1, 2001. These statements eliminate the pooling of interests method of accounting for business combinations and the systematic amortization of goodwill and other indefinite-lived intangible assets. We expect future annual amortization expense to be consistent with fiscal 2002 levels.

Net interest income decreased to \$234,000 during fiscal 2002 from \$746,000 in the prior fiscal year. The decrease was attributable to lower interest income due to lower cash and investment balances and lower average investment yields.

**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 fiscal 2000. The growth in sales was the direct result of a favorable reimbursement change that allowed physicians to perform Cooled ThermoTherapy procedures in their offices, and approximately \$6.2 million increase in sales generated by the acquisition of the Prostatron Cooled ThermoTherapy product line from EDAP TMS S.A (EDAP) in October 2000.

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 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 in fiscal 2001 from \$8.8 million in fiscal 2000. 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.

Research and development expenses decreased to \$3.5 million in fiscal 2001 from \$3.6 million in fiscal 2000. The slight decrease in research and development expenses resulted from reduced clinical study activity offset by increased staffing.

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.

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.

**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 and single-use treatment catheters. As of June 30, 2002, we had total cash, cash equivalents and available-for-sale securities of \$12.7 million and working capital of \$14 million.

During fiscal 2002, we used cash of \$1.5 million in operating activities, primarily as a result of our net loss of \$1.7 million. Additionally, depreciation and amortization of \$1.8 million and an increase in accounts payable and accrued expenses of \$412,000 were offset by increases in net accounts receivable of \$1.4 million, prepaid and other assets of \$441,000 and inventories of \$221,000.

Our investing activities generated \$2.4 million of cash in 2002, primarily resulting from the net sale of investments of \$3.8 million, offset by purchases of equipment of approximately \$1.4 million.

Our financing activities generated proceeds of \$602,000 during fiscal 2002, reflecting \$1 million received through the issuance of common stock, offset by \$419,000 in payments on capital lease obligations.

On October 1, 2000, we paid \$7.6 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 and also issued a promissory note to pay EDAP \$575,000 plus accrued interest on December 30, 2003.

Total future contractual commitments will affect cash flows as follows:

(In thousands)	Total	FY2003	FY2004
Acquired lease obligation	\$1,019	\$644	\$ 375
Promissory note	693	0	693
Building lease	180	180	0
<b>Total</b>	<b>\$1,892</b>	<b>\$824</b>	<b>\$1,068</b>

We have no contractual commitments beyond fiscal year 2004.

As of June 30, 2002, we did not have any significant purchase commitments.

We expect to continue to incur additional losses in the near future 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. As of June 30, 2002, our Property and Equipment, net, included approximately \$2.2 million of control units under per procedure or rental agreements. 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 investments 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, 2002, 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 1% change in interest rates for the issues contained in the investment portfolio and was not materially different from the year-end carrying value. Due to the nature of our short-term investments, we have concluded that we do not have a material market risk exposure.

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.

*To The Board of Directors and Shareholders, Urologix, Inc:* We have audited the accompanying balance sheet of Urologix, Inc. as of June 30, 2002, and the related statements of operations, shareholders' equity and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit. The accompanying financial statements of Urologix, Inc. as of June 30, 2001, and for the years ended June 30, 2001 and 2000, were audited by other auditors who have ceased operations. Those auditors expressed an unqualified opinion on those financial statements in their report dated July 31, 2001.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. 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 audit provides a reasonable basis for our opinion.

In our opinion, the fiscal 2002 financial statements referred to above present fairly, in all material respects, the financial position of Urologix, Inc. as of June 30, 2002, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in note 2 to the financial statements, the Company adopted the provisions of Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets," on July 1, 2001.

**KPMG LLP**

*Minneapolis, Minnesota*

*August 2, 2002*

(In thousands, except per share data)	June 30,	
	2002	2001
<b>Assets</b>		
<i>Current assets:</i>		
Cash and cash equivalents	\$ 1,604	\$ 26
Available-for-sale investments	11,109	14,895
Accounts receivable, net of allowance of \$483 and \$396	4,554	3,284
Inventories, net	2,424	2,203
Prepaid and other current assets	880	439
<b>Total current assets</b>	<b>20,571</b>	<b>20,847</b>
<i>Property and equipment:</i>		
Machinery, equipment and furniture	8,227	6,847
Less accumulated depreciation	(5,007)	(4,240)
Property and equipment, net	3,220	2,607
Other assets	2,676	3,003
Goodwill, net	10,193	9,961
Other intangible assets, net	9,777	10,442
<b>Total assets</b>	<b>\$ 46,437</b>	<b>\$ 46,860</b>
<b>Liabilities and shareholders' equity</b>		
<i>Current liabilities:</i>		
Accounts payable	\$ 2,117	\$ 1,781
Accrued compensation	686	705
Other accrued expenses	1,357	861
Current portion of lease obligation	513	419
Deferred income	1,891	2,146
<b>Total current liabilities</b>	<b>6,564</b>	<b>5,912</b>
Long-term debt	575	575
Long-term lease obligation	351	864
<b>Total liabilities</b>	<b>\$ 7,490</b>	<b>\$ 7,351</b>
<b>Commitments and contingencies (Note 10)</b>		
<i>Shareholders' equity:</i>		
Common stock, \$.01 par value, 25,000 shares authorized; 13,902 and 13,630 shares issued and outstanding	139	136
Additional paid-in capital	108,449	107,397
Accumulated deficit	(69,680)	(68,029)
Accumulated other comprehensive income	39	5
<b>Total shareholders' equity</b>	<b>38,947</b>	<b>39,509</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$ 46,437</b>	<b>\$ 46,860</b>

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,		
	2002	2001	2000
<b>Sales</b>	\$22,742	\$15,337	\$ 8,163
<b>Cost of goods sold</b>	7,844	5,804	4,357
Gross profit	14,898	9,533	3,806
<b>Costs and expenses:</b>			
Research and development	4,073	3,533	3,614
Sales, general and administrative	12,046	10,799	8,767
Amortization of goodwill and other intangible assets	664	1,082	-
Total costs and expenses	16,783	15,414	12,381
<b>Operating loss</b>	(1,885)	(5,881)	(8,575)
<b>Interest income</b>	495	993	1,477
<b>Interest expense</b>	(261)	(247)	-
<b>Net loss</b>	\$ (1,651)	\$ (5,135)	\$ (7,098)
<b>Basic and diluted net loss per common share</b>	\$ (0.12)	\$ (0.40)	\$ (0.62)
<b>Basic and diluted weighted average number of common shares outstanding</b>	13,810	12,760	11,514

Statements of Shareholders' Equity

(In thousands)	Common Stock		Additional Paid-In Capital	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
	Shares	Amount				
<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
Common shares issued under employee stock purchase plan	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
Common shares issued under employee stock purchase plan	24	1	83	-	-	84
<b>Balance, June 30, 2001</b>	13,630	136	107,397	(68,029)	5	39,509
Change in unrealized gains on investments	-	-	-	-	34	34
Net loss	-	-	-	(1,651)	-	(1,651)
Comprehensive loss	-	-	-	-	-	(1,617)
Value of options issued to consultants	-	-	34	-	-	34
Stock options exercised	266	3	958	-	-	961
Common shares issued under employee stock purchase plan	6	-	60	-	-	60
<b>Balance, June 30, 2002</b>	13,902	\$139	\$108,449	\$(69,680)	\$ 39	\$38,947

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

(In thousands)	For the Years Ended June 30,		
	2002	2001	2000
<b>Operating activities</b>			
Net loss	\$(1,651)	\$(5,135)	\$(7,098)
Adjustments to reconcile net loss to net cash used for operating activities, net of effects of acquisition			
Depreciation and amortization	1,759	1,949	1,516
Value of options issued to consultants	34	172	-
Provision for bad debts	212	137	163
Change in operating items			
Accounts receivable	(1,568)	(1,470)	70
Inventories	(221)	(3)	982
Prepays and other assets	(441)	1,695	350
Accounts payable	336	399	247
Accrued expenses	76	(1,499)	(571)
Net cash used for operating activities	(1,464)	(3,755)	(4,341)
<b>Investing activities</b>			
Purchase of property and equipment	(1,380)	(873)	(487)
Purchase of investments	(61,758)	(114,063)	(55,620)
Proceeds from sales of investments	65,578	122,346	59,826
Cash paid for acquisition, net of cash acquired	-	(7,578)	-
Net cash provided by (used for) investing activities	2,440	(168)	3,719
<b>Financing activities</b>			
Proceeds from issuance of common stock	1,021	3,753	435
Payments made on capital lease obligations	(419)	(263)	(12)
Net cash provided by financing activities	602	3,490	423
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>1,578</b>	<b>(433)</b>	<b>(199)</b>
<b>Cash and cash equivalents</b>			
Beginning of year	26	459	658
End of year	\$ 1,604	\$ 26	\$ 459

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”) designs, develops, manufactures and markets innovative devices for the treatment of benign prostatic hyperplasia (BPH), a disease that affects more than 23 million men worldwide by causing adverse changes in urinary voiding patterns. We have developed a catheter-based therapy that uses a proprietary cooled microwave technology for the treatment of BPH. 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 can be performed in a physician’s office or an outpatient clinic. Although we began actively selling our products in 1997, 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 Investments** We invest in money market funds and U.S. government and investment-grade corporate debt investments 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 gross realized gains and losses on sales of available-for-sale investments were not material for the years ended June 30, 2002, 2001 and 2000. Current available-for-sale investments are quoted at their estimated fair value based on current market quotes. Short-term investments consisted of the following at June 30, 2002 and 2001 (in thousands):

	June 30, 2002			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Market Value
Commercial paper and cash	\$ 76	\$ 0	\$ 0	\$ 76
Corporate and government bonds	10,994	47	(8)	\$11,033
	\$11,070	\$47	(\$8)	\$11,109

	June 30, 2001			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Market Value
Commercial paper and cash	\$ 8,302	\$ 0	\$ 0	\$ 8,302
Corporate and government bonds	6,588	8	(3)	6,593
	\$14,890	\$8	(\$3)	\$14,895

**Major Suppliers** We obtain our Targis and Prostatron control units and the Prostatron Prostatprobe 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.

**Revenue Recognition** Revenue from product sales is recognized at the time of shipment, net of estimated returns, which also are established 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.

**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, 2002	June 30, 2001
Raw materials	\$ 936	\$ 1,041
Work-in-process	415	385
Finished goods	1,073	777
Total inventories	\$ 2,424	\$ 2,203

**Goodwill and Other Intangible Assets** For fiscal 2001 and 2000, our policy was to review goodwill and other intangible assets periodically for impairment and assess whether significant events or changes in business circumstances indicated that the carrying value of the assets may not be recoverable, based on an undiscounted cash flow analysis.

In fiscal 2002, we adopted Statement of Financial Accounting Standards (SFAS) 142, “Goodwill and Other Intangible Assets,” and, as a result, we have ceased to amortize approximately \$10.2 million of goodwill and \$1.1 million of trademarks. Goodwill is tested for impairment annually or more frequently if changes in circumstance or the occurrence of events suggest an impairment

exists. The test for impairment requires us to make several estimates about fair value, most of which are based on projected future cash flows. We have completed our initial assessment upon adoption and have concluded that no impairment existed as of July 1, 2001, or as of June 30, 2002.

Other intangible assets consist of purchased technology, customer base and trademarks. Purchased technology and customer base are amortized using the straight-line method over their estimated useful lives of 15 and 14 years, respectively. The trademark asset is considered to be an intangible with an indefinite useful life, and it will not be amortized until its useful life is determined to be no longer indefinite. We review these definite and indefinite-lived intangible assets for impairment annually or as changes in circumstance or the occurrence of events suggests the remaining value is not recoverable.

**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 shorter of the useful life or term of the lease.

**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 twenty-four months. The estimated warranty cost is recorded at the time of sale and is adjusted periodically to reflect actual experience.

**Stock-Based Compensation** We account for stock-based employee compensation arrangements in accordance with the provisions and related interpretations of Accounting Principles Board Opinion 25, "Accounting for Stock Issued to Employees," and have elected to follow the "disclosure only" alternative prescribed by FASB 123, "Accounting for Stock-Based Compensation."

**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.

As we have been in a net loss position for the fiscal years 2002, 2001 and 2000, the potential dilution from the conversion of options and warrants to common stock of 921,772; 1,315,779 and 452,078 as of June 30, 2002, 2001 and 2000, respectively, were not used to compute diluted loss per share, as the effect was antidilutive.

**Financial Instruments** The carrying amounts of our financial instruments approximate 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.

**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, as well as 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.

**Recently Issued Accounting Standard** SFAS 144 supersedes the accounting and reporting provisions of Accounting Principles Board (APB) Opinion 30, "Reporting of Operations – Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions," for the disposal of a segment of a business. However, this Statement retains the requirement of APB 30 to report discontinued operations separately from continuing operations and extends that reporting to a component of an entity that either has been disposed of or is classified as held for sale. We plan to adopt the provisions of SFAS 144 effective July 1, 2002. We do not expect that SFAS 144 will have a material effect on our financial statements.

### **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 on December 30, 2003, \$575,000 plus accrued interest at a compound annual rate of 6.31%.

The statements of operations include the operating results of the acquired business beginning October 1, 2000. Unaudited pro forma results of operations for the year ended June 30, 2001, include revenue of \$18.1 million, a net loss of \$7.6 million or a net loss per share of \$0.58 if the transaction had occurred on July 1, 2000. 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 actually have resulted had the combinations been in effect on July 1, 2000, or of future results of operations.

#### 4 Goodwill and Other Intangible Assets

As discussed in Note 2, we adopted SFAS 142 effective July 1, 2001, and determined that the developed technologies and customer base we acquired from EDAP in October 2000 would continue to be amortized over useful lives of 15 and 14 years, respectively. We ceased amortizing the acquired goodwill and trademarks, which were determined to be indefinite-lived intangible assets. We performed an initial impairment analysis and will perform an annual impairment test for goodwill and the indefinite-lived intangible assets. We expect our future annual amortization expense for acquired intangible assets to be approximately \$700,000 for each of the next five fiscal years.

The statements of operations include the operating results of an acquired business beginning October 1, 2000. For illustrative purposes, the following unaudited pro forma information gives the effect of the adoption of the statements on prior periods:

Year Ended June 30,	2002	2001
Net loss, as reported	\$(1,651)	\$(5,135)
Adjustment to goodwill amortization	-	583
Adjusted net loss	\$(1,651)	\$(4,552)
Net loss per share, as reported	\$(0.12)	\$(0.40)
Adjustment to goodwill amortization	-	0.04
Adjusted net loss per share	\$(0.12)	\$(0.36)

Balances of acquired intangible assets were as follows (in thousands):

As of June 30, 2002	Carrying Amount	Accumulated Amortization	Net
<b>Amortizing intangibles:</b>			
Developed technologies	\$ 7,500	\$ 875	\$ 6,625
Customer base	2,300	288	2,012
<b>Non-amortizing intangibles and goodwill:</b>			
Goodwill	10,716	523	10,193
Trademarks	1,200	60	1,140
Acquired intangible assets	\$21,716	\$1,746	\$19,970

#### 5 Income Taxes

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

	2002	2001	2000
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, 2002, we had net operating loss carryforwards of approximately \$70,000,000 for federal income tax purposes. In addition, we had credit carryforwards of approximately \$288,000 that begin to expire in 2006. Utilization of the net operating losses may be subject to an annual limitation due to the ownership change rules provided by the Internal Revenue Code of 1986 and similar state provisions. 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)	2002	2001	2000
Net operating loss carryforwards	\$ 28,068	\$ 27,193	\$ 25,204
Temporary deductible differences	804	656	715
Valuation allowance	(28,872)	(27,849)	(25,919)
Deferred tax assets	\$ -	\$ -	\$ -

#### 6 Supplemental Cash Flow Information

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

(In thousands)	2002	2001	2000
Cash paid for interest	\$225	\$220	\$1
<b>Non-cash investing activities:</b>			
Equity capital issued for acquisition	-	\$ 11,909	-
<b>Details of acquisition:</b>			
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	-

## 7 Deferred Income

Deferred income as of June 30,

(In thousands)	2002	2001
Deferred royalty income	\$1,630	\$1,814
Other deferred income	261	332
<b>Total deferred income</b>	<b>\$1,891</b>	<b>\$2,146</b>

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 nine years.

Other deferred income relates to prepayments made to us on warranty service contracts. Deferred revenue for these warranty service contracts is recognized over the contract period ranging from 12 to 36 months.

## 8 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:

(In thousands)	2002	2001
Term debt	\$ 575	\$ 575
Long-term lease obligation	864	1,283
Less current portion	(513)	(419)
<b>Total long-term debt</b>	<b>\$ 926</b>	<b>\$1,439</b>

## 9 Stock Options

We have a 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, 2002, we reserved 3,450,910 shares of common stock under this

plan, and 708,910 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 10,000 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.

A summary of the changes in outstanding options for each of the three years ended June 30 is as follows:

	Outstanding Options		
	2002	2001	2000
Outstanding, beginning of year	1,605,670	1,573,644	1,281,386
Options granted	612,675	469,593	891,826
Options canceled	(275,779)	(132,425)	(452,784)
Options exercised	(266,475)	(305,142)	(146,784)
<b>Outstanding, end of year</b>	<b>1,676,091</b>	<b>1,605,670</b>	<b>1,573,644</b>

Stock option weighted average exercise prices during fiscal 2002, 2001 and 2000 are summarized below:

	Weighted Average Exercise Price Per Option		
	2002	2001	2000
Outstanding, beginning of year	\$ 4.75	\$3.72	\$3.81
Options granted	\$14.04	\$7.31	\$3.31
Options canceled	\$ 6.49	\$3.86	\$3.69
Options exercised	\$ 3.65	\$3.74	\$2.14
<b>Outstanding, end of year</b>	<b>\$ 8.06</b>	<b>\$4.75</b>	<b>\$3.72</b>

The following table summarizes information concerning options outstanding and exercisable options as of June 30, 2002:

Range of Exercise Prices	Outstanding as of June 30, 2002	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Exercisable as of June 30, 2002	Weighted Average Exercise Price
\$ - \$ 4.86	865,667	6.9	\$ 3.63	584,908	\$ 3.60
\$ 4.87 \$ 9.72	168,453	7.6	\$ 7.10	80,150	\$ 7.51
\$ 9.73 \$12.15	30,938	4.5	\$12.07	12,708	\$12.13
\$12.16 \$14.58	484,025	8.3	\$13.83	21,000	\$14.00
\$14.59 \$19.44	112,008	9.1	\$15.96	64,941	\$16.00
\$19.45 \$24.30	15,000	8.7	\$20.92	4,686	\$20.85
	<b>1,676,091</b>	<b>7.5</b>	<b>\$ 8.06</b>	<b>768,393</b>	<b>\$ 5.59</b>

We account for stock options under the provisions of Accounting Principles Board Opinion 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)		2002	2001	2000
Net Loss	As reported	\$ (1,651)	\$ (5,135)	\$ (7,098)
	Pro forma	(4,550)	(7,823)	(9,321)
<b>Net Loss</b>				
Per Share	As reported	\$ (0.12)	\$ (0.40)	\$ (0.62)
	Pro forma	(0.33)	(0.61)	(0.81)

The weighted average fair value of our options at the grant date was approximately \$8.99 in 2002, \$4.76 in 2001 and \$2.40 in 2000. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model, with the following assumptions:

	2002	2001	2000
Volatility	83.4%	85.2%	69.3%
Risk-free interest rates	4.1%	4.8%	6.3%
Expected option life	4 Years	4 Years	7 Years
Stock dividend yield	-	-	-

**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, 2002, 84,297 shares have been issued under the Plan since inception for gross proceeds of \$396,262.

## 10 Commitments and Contingencies

**401(k) Plan** The Company provides a 401(k) savings plan to which eligible employees may make pretax payroll contributions up to IRS allowed limits. 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 \$297,000, \$280,000 and \$280,000 for the years ended

June 30, 2002, 2001 and 2000, respectively. Future minimum lease commitments under noncancelable operating leases with initial terms of one year or more are \$180,000 as of June 30, 2002.

**Contingencies** The Company is involved in various legal actions arising in the ordinary course of business. Management believes any losses that may occur from these matters are adequately covered by insurance, and the ultimate outcome of these matters will not have a material effect on the financial position or results of operations of the Company.

In addition, in March 2002, we filed a patent infringement action against ProstaLund AB, ProstaLund Operations AB and ACMI Corporation in the United States District Court for the Eastern District of Wisconsin. We are seeking an injunction prohibiting the manufacture, use, sale or offer for sale of the "ProstaLund Feedback Treatment" and an unspecified amount of damages. Our action alleges that ProstaLund's microwave medical device and method, for which it has sought pre-market approval from the FDA, infringes our United States Patents No. 5,234,004 and No. 5,509,929. Our complaint also alleges that ProstaLund has an agreement with ACMI Corporation to distribute ProstaLund's microwave device in the United States. The defendants have counterclaimed, alleging that they do not infringe our patents, that our patents are invalid and that we have "marked" our products as "patented" in a manner that violates patent law. We believe the defendants' counterclaims are without merit.

## 11 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)	2002	2001	2000
United States	\$21,121	\$13,574	\$7,899
Europe	673	687	201
Asia	948	1,076	63
Total	\$22,742	\$15,337	\$8,163

**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*  
*Medtronic, Inc. and*  
*President, Medtronic Pacing Business*

Daniel J. Starks  
*President and Chief Operating Officer*  
*St. Jude Medical*

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

**Senior Management**

Michael M. Selzer Jr.  
*President and Chief Executive Officer*

Christopher R. Geyen  
*Vice President and Chief Financial Officer*

Kirsten Doerfert  
*Vice President, Business Development*

David A. Montecalvo  
*Vice President, Product Development*  
*and Operations*

Craig G. Palmer  
*Vice President, U.S. Sales*

Lance H. Wallin  
*Vice President, Global Marketing*

**Corporate Headquarters**

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

**Independent Public Accountants**

KPMG LLP  
4200 Wells Fargo Center  
90 South 7th Street  
Minneapolis, Minnesota  
55402-1611

**Legal Counsel**

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

**Investor Relations Counsel**

GCI Group  
825 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 2002 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 last two years.

Fiscal Quarter	First	Second	Third	Fourth
<b>2002:</b>				
High	\$22.60	\$22.02	\$21.35	\$18.70
Low	12.40	11.15	12.70	11.00
<b>2001:</b>				
High	\$ 9.00	\$13.63	\$23.50	\$27.79
Low	3.75	6.88	12.13	18.31

**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.



# **UROLOGIX<sup>®</sup>**

14405 Twenty-First Avenue North  
Minneapolis, Minnesota 55447-4685  
Telephone: (763) 475.1400

[www.urologix.com](http://www.urologix.com)