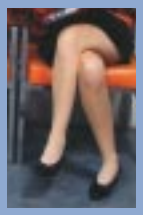
POSSIS®

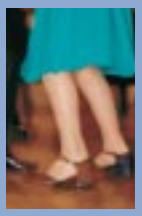
*Bringing Medical Possibilities to Life®*

# The other half of the story

2003 annual report

Despite decades of progress in medical innovation and healthcare delivery, coronary artery disease (CAD) remains the number one cause of death among Americans. Rapid, safe and effective removal of blood clots, or thrombus, is the key to allowing definitive treatment of heart attack victims, saving their lives or improving their quality of life. With its pioneering AngioJet® Rheolytic™ Thrombectomy System, Possis Medical is the leader in coronary thrombectomy, or removal of blood clots from coronary arteries and saphenous vein bypass grafts. The coronary market in the U.S. is the largest segment of Possis Medical's business and we are investing significant resources to grow this business in the future. However, peripheral vascular disease





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(PVD) is strongly associated with coronary artery disease and a major predictor of death from CAD. The AngioJet System alone, and in conjunction with appropriate drug regimens, is a powerful tool in removing blood clots from the legs, often preserving the limb and allowing patients to maintain mobility and an active lifestyle. Blood clots in the legs can occur in the arteries and in the veins, vascular territories with their own distinct treatment challenges for physicians. PVD does not yet have the visibility of coronary artery disease, and some conditions, like deep vein thrombosis (DVT), are vastly undertreated. As Possis helps its physician-customers pioneer this growing therapeutic area, we thought we would tell you **the other half of the story.**

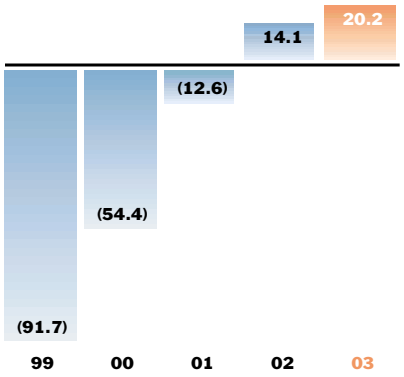
## Firm ground to stand on

In order to meet our growing customer requirements, Possis Medical's business model must stand on firm ground. As a result of our solid financial position, we will be able to continue to improve the performance of our products, develop new ways to use our technology, and support our movement into new markets with extensive clinical research. ■ In fiscal 2003, Possis Medical realized its tenth profitable quarter in a row, exceeding earnings estimates based on record sales and net income. Record sales of $57.4 million were up 35 percent from fiscal 2002. At year-end, pre-tax income per diluted share was $0.64, nearly double the

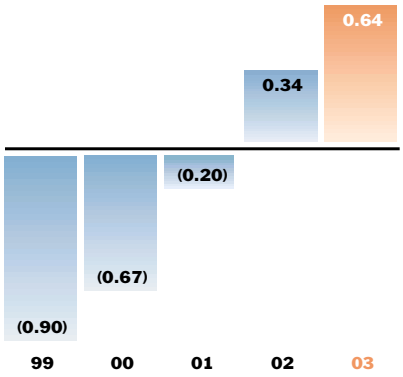
$0.34 reported for fiscal 2002. ■ Increasing revenues and strong cash flow have given us the opportunity to complete and extend our share repurchase program, expand our sales force and increase our presence in the clinical and investigational communities. It is also supporting our introduction of new catheter products that will help drive our market penetration in fiscal 2004 and beyond.

**35%**

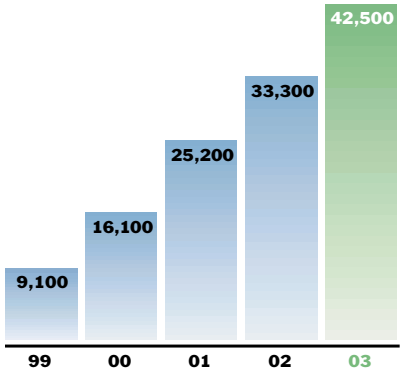
**Record sales of $57.4 million were up 35 percent from fiscal 2002.**



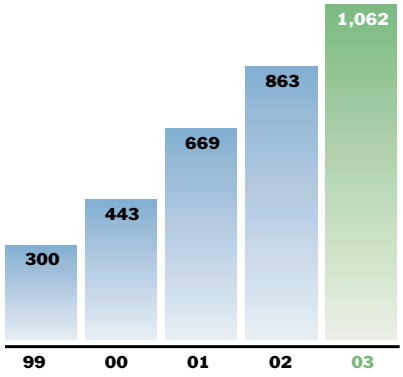

**Operating Margin – Percent**




**Earnings (Loss) per Share – Pretax**




**Catheter Sets Sold – Units**




**U.S. Drive Units in the Field**

## We've got a leg up on the competition

Peripheral vascular disease (PVD) affects approximately 1 in 20 people over the age of 50, or about 10 million people in the United States. It develops most commonly as a result of atherosclerosis, a condition associated with coronary artery disease. With PVD, the same type of atherosclerotic plaque that clogs coronary arteries causes arteries that carry blood to the arms or legs to become narrowed or clogged, diminishing blood flow. In some cases, PVD may lead to blood clots that close the arteries and restrict blood flow.

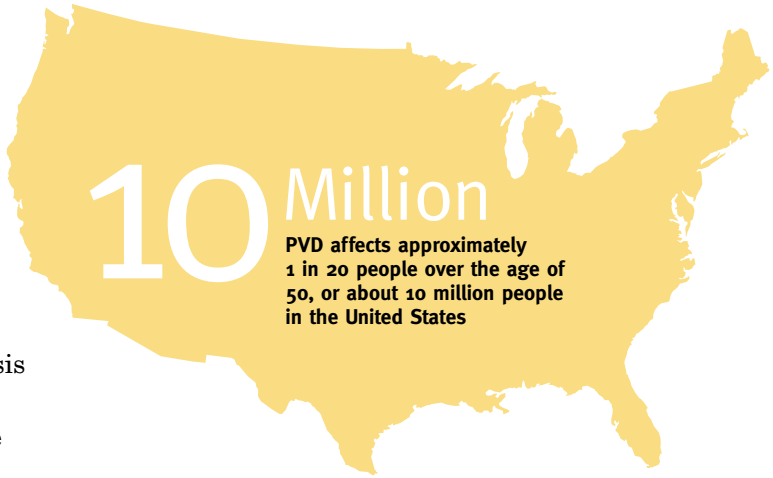
■ If left untreated, the narrowing of arteries may lead to serious and potentially life-threatening complications including debilitating leg pain and a high risk of gangrene, tissue ulceration and loss of limbs. When a vessel is obstructed by thrombus it is important to restore blood flow quickly since, without treatment, nerves and

# PVD

**Risk factors for PVD include diabetes, smoking, obesity, lack of exercise, age, high blood pressure, high cholesterol and a family history of heart or vascular disease. More than half the people with PVD experience leg pain, numbness or other symptoms, but many dismiss these as signs of aging and don't seek medical help. And, while PVD is currently under diagnosed and under treated, its incidence has increased over the past decade, reflecting both the aging U.S. population and the continuing growth in the number of patients affected by diabetes, hypertension and tobacco use.**

**Approximately 17.0 million people, or 6.2% of the U.S. population, have diabetes that, if left untreated may lead to kidney damage and, ultimately, end-stage renal disease. The number of patients suffering from end-stage renal disease, and thus requiring hemodialysis, is increasing by 3 to 5% per year. Their arteriovenous grafts and fistulas, used for hemodialysis, commonly need to be de-clotted 1 to 2 times per year.**

muscle begin to break down and tissue begins to die within 4 to 6 hours. In the United States, approximately 1.5 to 2.0 million people are diagnosed annually with peripheral atherosclerosis but only about one quarter of them undergo some kind of treatment. ■ Standard therapies for treating PVD, such as using thrombolytic drugs to dissolve clots, prolong the time before intervention, often taking hours and increasing risks to the patient, particularly in high risk sub-groups like the elderly. With the AngioJet System, treatment time can be reduced to minutes, quickly restoring blood flow and significantly diminishing the risk of limb loss and trauma for the patient.

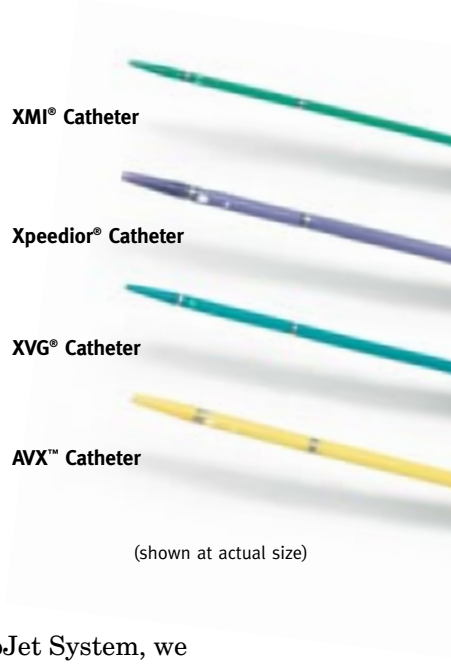



# Dr. Gary Ansel/Interventional Cardiologist

The AngioJet catheter is a familiar item in the cardiologist's toolbox, and physicians are readily adapting its use in treating peripheral vascular disease, a condition also commonly plaguing many coronary patients. ■ Dr. Gary Ansel, an interventional cardiologist at Riverside Methodist Hospital in Columbus, Ohio, has been treating patients with acute peripheral vascular disease using the AngioJet System. ■ "Traditionally, many of these patients would be referred to surgery for treatment of acute peripheral thrombus where the risk of death is 7% to 25%. We've found the AngioJet System to be highly effective in removing thrombus in vessels from shoulders to toes. It is less invasive, there is less trauma to the patient and our success rate has

**Dr. Gary Ansel**

Interventional Cardiologist
Riverside Methodist Hospital, Columbus, Ohio

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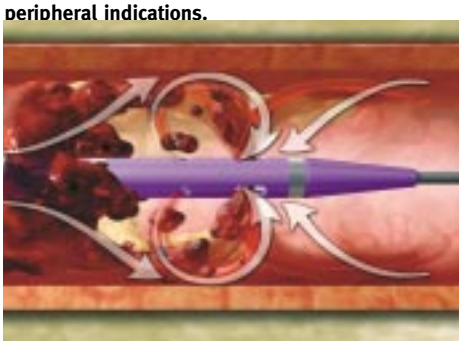
been very high. In our multi-center study, we were able to remove almost the entire clot in 70% of cases and we had a positive response in 92% of our cases. Patients see a return of limb function almost immediately and we've been able to convert 96% of initially threatened limbs (that is, limbs at risk for amputation) to viable status by the time of discharge from the hospital. As doctors, we are looking for anything to help prevent blood clots from traveling downstream in the circulatory system during procedures that open blocked arteries. Using the AngioJet System, we can ensure significant clot removal and greatly reduce the risk of distal migration of this clot material."

## The AngioJet Technology

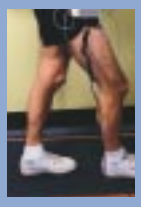
**The AngioJet® Rheolytic™ Thrombectomy System is the most effective thrombus removal system on the market and Possis has a family of catheters designed, or in development, to treat vascular thrombus from head-to-toe. The unique AngioJet System uses pressurized saline delivered through multiple jet holes arranged in a halo design and contained inside the tip of a catheter. The catheter is inserted into the blood vessel using standard guide wires. The high-pressure saline jets travel inside the catheter at about two-thirds the speed of sound creating a near-perfect vacuum (the Bernoulli principle), drawing in the thrombus, or blood clot, and breaking it into microscopic fragments that are then propelled back through the catheter and out of the patient's body. Because the jets are contained within the catheter tip and do not come into direct contact with the vessel wall, it is safe for use in even very small vessels.**

**The AngioJet System consists of three components – the drive unit, the disposable pump set and the family of disposable catheters. Possis continues to design new, more powerful, more effective catheters, including the newest AVX™ catheter, which is 25% more powerful than its predecessor. The AngioJet family of catheters now includes the XMI® catheter for peripheral and coronary indications, the XVG® catheter for peripheral indications, the Xpeedior® catheter for peripheral indications, and the AVX™ catheter for use with arteriovenous grafts and fistulas. And in 2004, Possis Medical plans to introduce its XMI Rapid Exchange catheter for both coronary and peripheral indications.**



**Thrombus is drawn into the catheter where it is fragmented by the jets and evacuated from the body.**

## Stepping toward the future

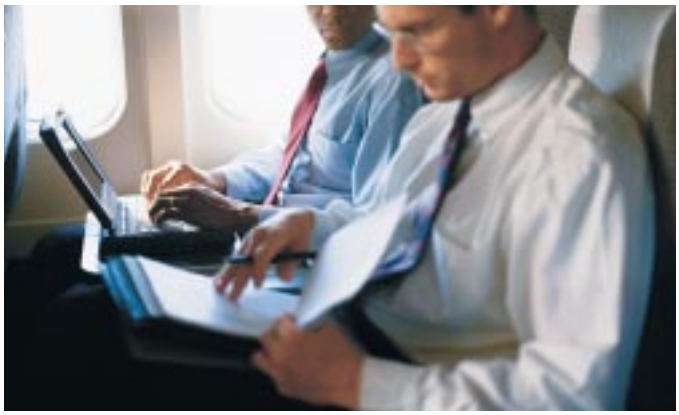


As the U.S. population ages, there is growing awareness of PVD and deep vein thrombosis (DVT) as potentially significant public health concerns. In their search for effective treatments for these conditions, interventional cardiologists, vascular surgeons and interventional radiologists are devising innovative ways to combine drug and device therapies. **The AngioJet System** is readily adaptable to this type of **combination therapy**. In fact, Possis has plans to support clinical and investigational trials designed to explore the use of the AngioJet System in combination with lytic drugs for accelerated treatment of symptomatic iliofemoral or femoral DVT. ■ Possis Medical's market

development efforts for combination therapies will include efforts to improve the **reimbursement patterns** for these innovative treatments. ■ As we step toward the future, Possis is also investing more in **post-market clinical studies** to gather additional clinical data supporting both peripheral and coronary use of the AngioJet technology. The AJILE study (of AngioJet for Ischemic Arterial Occlusions in Lower Extremities) of 42 patients is now complete, and we have accelerated enrollment for the AiMI (AngioJet in Myocardial Infarction) study with enrollment currently at more than 360 patients. This study explores the use of AngioJet Rheolytic thrombectomy in patients undergoing primary angioplasty for acute myocardial infarction or heart attack.

## Walk before you run

There are two types of peripheral blood vessels – peripheral arteries, which carry oxygen-rich blood to the extremities, and peripheral veins which carry oxygen-poor blood from the extremities back to the heart. The deep veins near the center of the leg do most of the work of the venous system. Approximately 85% of the circulating blood is returned to the heart through these veins. Deep vein thrombosis (DVT) is the formation of a blood clot in a large vein, most typically in the lower extremities. Possis is working with physicians to explore the use of the AngioJet System to aggressively treat DVT, one of the most common peripheral vascular disorders. ■ If untreated, DVT can block the blood supply to the legs and cause tissue death or gangrene that requires the amputation of all or part of the leg. It can also result in death because of the



# DVT

**Blood clots form due to sluggish blood flow, resulting from sitting still or lying down for a long time, such as on an airplane ride or with prolonged bed rest following surgery or injury. In addition, clotting factors – substances in the blood that regulate the formation of clots – may increase after an operation or injury or during pregnancy. Other risk factors associated with the likelihood of developing DVT include obesity, a trauma (fractures, heart, hip or obstetric/gynecologic surgery) and the use of medications such as birth control pills and estrogen.**

potential for blood clots to break off, travel through the heart and get trapped in the lung causing a pulmonary embolism, a potentially fatal complication in which the blood clot can block oxygen supply, causing heart failure. In the U.S. alone, more than 600,000 new cases of DVT are diagnosed each year, and one in every 100 patients who develop DVT dies due to pulmonary embolism. Possis is committed to helping improve the quality of life for patients with debilitating DVT and pulmonary embolism, the number one killer of patients with DVT.

**1.2 Million**

**The annual incidence of DVT in the United States, 600,000 of which go undiagnosed and untreated.**

# Dr. Peter Lin/Vascular Surgeon

Dr. Peter Lin, a vascular surgeon at Baylor College of Medicine in Houston, Texas, first began using the AngioJet System to de-clot arteriovenous grafts in dialysis patients approximately six years ago. For the past three years, he has been conducting clinical studies for the treatment of DVT and pulmonary embolism. In a change from normal procedure, he first adjusts the AngioJet System so that it infuses lytic drugs directly into the thrombus, a technique called Power Pulse Spray, significantly shortening treatment time.

■ "It intrinsically makes sense to utilize the unique physics of the AngioJet System to forcefully deliver thrombolytic drugs directly to the blood clots to help dissolve them more quickly. Historically, patients with

**Dr. Peter Lin**

Vascular Surgeon
Baylor College of Medicine, Houston, Texas

DVT have been treated with traditional thrombolysis, typically involving a stay in the intensive care unit (ICU) of 24 to 36 hours. Most of our procedures, using the AngioJet System to spray the thrombus directly with clot-busting drugs and then to break up and extract the clot material, take about 45 minutes. By effectively removing DVT in one setting, patients are more comfortable and more satisfied with the process. Patients don't have to incur the cost of a stay in the ICU. And, we have the immediate benefit of reducing the likelihood of pulmonary embolism, the greatest risk to patients. We also need to treat the underlying condition since untreated DVT can also result in post-thrombotic syndrome resulting from damage to venous valves, which can cause chronic, or acute leg pain. There is no question that pharmacomechanical thrombectomy will become the standard of care for DVT."

## Success is a marathon

**Continually adapting to the changing medical needs of our physician-customers and their patients is key to our growing and developing our markets. Medical technology does not stand still and neither will we. Our future includes specific, targeted strategies that will keep us in the lead in the coronary thrombectomy market and take us into new expanding markets for peripheral vascular disease, deep vein thrombosis and related conditions.**

**We're increasing therapy adoption by cardiologists, interventional radiologists and surgeons by:**

- **Bringing new catheters to market to meet their needs.**
- **Improving the current AngioJet System to enhance ease of use through upgrades that include new set-up tools, a new pump set and connections.**
- **Development of a future AngioJet drive unit that is easier to use, has a smaller footprint size, more power modes and an intuitive set-up.**

**We're expanding into related markets, including:**

- **Embolic Protection — the use of the AngioJet System to prevent distal embolization that can occur during an intervention, such as the placement of a stent. During some procedures thrombus and other debris may dislodge and be sent downstream, potentially blocking smaller vessels. Embolic protection involves creating a temporary occlusion downstream from the lesion, using the new GuardDOG temporary occlusion guide wire, and then removing any debris with the AngioJet.**
- **Venus thrombectomy – for the treatment of DVT and, in particular, the removal of older thrombus in large vessels. We continue to learn from physicians who are experimenting with off-label use of the AngioJet System and are encouraged by the potential offered by the use of the AngioJet System in conjunction with clot busting drugs.**

**We're expanding worldwide:**

- **Possis has a multi-country distributorship based in Italy and will soon be marketing the XMI Rapid Exchange catheter throughout Europe.**
- **In Japan, we are following an independent regulatory strategy and are seeking XMI regulatory approval and reimbursement.**

**Mechanical thrombectomy is here to stay and, in this marathon, Possis is the leader by far. We have demonstrated substantial earnings growth from our base business, have a strong cash position and we are investing in the future to grow our leadership position**

"We continue to be a high growth company with a strong balance sheet and no long-term debt."

**Robert G. Dutcher**

Chairman, President and Chief Executive Officer

# A strong foothold on the future

**To Our Shareholders** I'm pleased to report that Possis Medical had a record-breaking year in fiscal 2003. At the end of the year, we charted our tenth profitable quarter in a row, based on record sales and net income. We continue to be a high growth company with a strong balance sheet and no long-term debt.

We exceeded our sales goal in 2003, realizing revenues of $57.4 million, an increase of $15.0 million in fiscal 2002. Our business continues to expand, due to steady growth in the total number of drive units sold. This year we crossed the 1,000 unit mark and now have 1,062 drive units in the field. Higher volume sales of disposables and an increase in the XMI® and XVG catheters within our product mix contributed to our improving margins. Our gross margin rate for the year was 75%, an increase of 5% from last year. The average catheter utilization rate per installed drive unit, a measure of recurring usage, remained steady at 10.9.

We ended the year with pre-tax earnings of $12.0 million and diluted earnings per share of $0.88 compared to $6.3 million and to $0.96, respectively, in fiscal 2002. At the end of the year, cash and marketable securities amounted to $31.9 million. Over the past year, we repurchased 246,900 shares of common stock. Between now and the end of fiscal 2004, we have the authorization to repurchase up to an additional $4 million, offsetting dilution from current employee incentive programs.

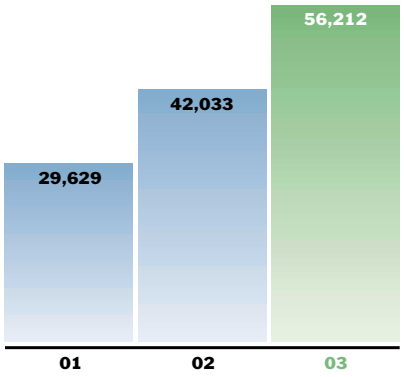
In addition, our strong balance sheet allowed us to meet our goals of expanding our clinical sales force, increasing our investment in research and development and growing our presence in the clinical and investigational communities with significant investments in extensive clinical research.

**Our Technology is Our Future** Our continuing investment in our unique and pioneering technology is the key to our future success. As the marketplace leader in the field of mechanical thrombectomy for the treatment of coronary heart disease, we continue to invest resources in growing this business. We will continue to introduce new and better catheter designs and to improve the performance of our supporting pump and drive unit products. And, we are expanding use of the AngioJet technology for new applications and expanded markets including those for peripheral vascular disease (PVD) involving deep vein thrombosis (DVT).

In 2003, we introduced the new AVX™ catheter, which is 25% more powerful than its predecessor and designed specially for use with arteriovenous dialysis access grafts. We are enjoying continued customer acceptance of our coronary and peripheral product lines which, in addition to the AVX, now include the XMI catheter for peripheral and coronary indications and the XVG and Xpeedior+ catheter for peripheral use. The introduction of the XMI Rapid Exchange catheter is expected to help drive market penetration even more significantly.

We have also been at work making improvements to the AngioJet System, enhancing ease of use through upgrades that include new set up tools, and an improved pump set with new connections. In fiscal 2004, we will continue our development of a brand new AngioJet drive unit.

In April 2003, we also filed a 510(k) with the FDA for our proprietary temporary occlusion guide wire, GuardDOG™. We hope to begin enrolling patients for a coronary distal protection clinical trial involving the combined use of GuardDOG and AngioJet in the later part of fiscal 2004.




**U.S. AngioJet Revenue – in Thousands of Dollars**

**New Markets and New Customers** While the coronary market in the U.S. remains the largest segment of our business, we also see significant growth potential among the populations suffering from PVD, involving peripheral arterial occlusion (PAO) and DVT; and we believe the AngioJet system can be significantly effective when used in the treatment of these conditions. PAO develops most commonly as a result of atherosclerosis, a condition closely associated with coronary heart disease. At present, it affects approximately 1 in 20 people in the United States over the age of 50, many of whom suffer from debilitating leg pain and a high risk of limb loss. DVT is the formation of blood clots in the large veins, usually in the legs. This condition, diagnosed in more than 600,000 people in the U.S. each year, carries the deadly added risk of pulmonary embolism, the cause of death for one in every 100 patients with DVT.

Possis is committed to helping patients maintain mobility and active lifestyles by providing products to help treat these conditions, either through use of the AngioJet System alone or in conjunction with appropriate drug therapies such as thrombolytic drugs.

Internationally, our business in Europe is beginning to grow. We now have a multi-country distributorship in Italy and will soon be marketing the XMI Rapid Exchange catheter throughout Europe. While we believe Japan still has a potential $10 million market for AngioJet catheters, it will take longer than anticipated to meaningfully enter that market because of Japan's different regulatory environment and reimbursement structure. We will continue to pursue regulatory approval followed by reimbursement approval in Japan.

**Clinical Trials and Other R&D** In fiscal 2003, we continued to pursue our goal of a heightened presence in the clinical and investigational community through investments in extensive clinical research. We believe this will further support the adoption of AngioJet technology in the treatment of both peripheral and coronary conditions.

In order to better treat PAO and DVT, we are developing catheters optimized for bigger vessels, longer lesions and older thrombus. We are also supporting scientific studies and regulatory strategies to widen the use of the AngioJet Power Pulse Spray technique in PAO and DVT. The Power Pulse Spray technique delivers thrombolytic drugs right to blood clots to quickly soften and weaken the clot and prepare it for removal by standard AngioJet thrombectomy. Dr. David Allie from the Cardiovascular Institute of the South has studied the Power Pulse Spray technique in peripheral arteries. His registry of 49 patients, presented at the 2003 TCT Conference, concluded that the Power Pulse Spray technique is a safe and effective technique that offers potential treatment benefits. In this way, the AngioJet System can be used effectively not only in breaking up recently occurring clots but also in treating older thrombus, common in both PAO and DVT.

We have accelerated enrollment for the AiMI (AngioJet in Myocardial Infarction) study. Currently at over 360 patients with a goal of approximately 468, this large study will test the AngioJet System against the current standard of care for treating heart attacks. Through measurement using nuclear scans, we will learn if we save more heart muscle by including AngioJet therapy as part of the primary intervention. Positive results will encourage adoption of the AngioJet System as a standard of care for heart attack patients.

With the advent of drug-eluting stents, there is growing interest among the medical community in other ways to combine drug and device therapies for greater effectiveness for patients. The AngioJet System is particularly well suited to collaborations of this type. For example, the new drug-eluting stents have not been shown to be effective in vessels containing unresolved thrombus. As a result, we are pointing out to the medical community that AngioJet is the most effective therapy for resolving thrombus.

During fiscal 2003, we also made the decision to close our TIME 1 Clinical Trial for Ischemic Stroke. TIME stands for Thrombectomy in Middle Cerebral Embolism. Ischemic stroke is caused by a clot or other material lodging in the middle cerebral artery. At the conclusion of Phase I of the trial, the investigators, including some of

the world's leading clinicians and researchers in treating ischemic stroke, concluded that the device in use, the NV 150 neurocatheter, while safe, had not met the clinical challenges of being effective enough to warrant a Phase II trial. This trial was aimed at one of the most debilitating medical conditions and, while we were disappointed in the short-term outcome, we will continue our research efforts to discover a therapy with the right balance of safety and effectiveness. Combination therapies, such as those referenced above, may provide the ultimate solution.

**Important Business Recognition** We received some important, unsolicited business recognition during fiscal 2003 that was very gratifying and that affirms our business model as one that will truly support our continued growth and profitability.

In April, *Forbes* magazine ranked Possis tenth overall on its list of the "25 Fastest-Growing Tech Companies" in 2003. Companies on the list, representing several industries and including computer hardware and software companies and biotech and medical equipment companies, were ranked by their five-year historical sales growth, on an annualized basis. Among the listed companies, Possis Medical was the top company marketing medical devices in the cardiovascular markets.

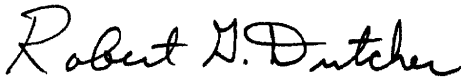
Possis Medical was also named to the 2003 *StarTribune* list of the Top 100 publicly held companies headquartered in Minnesota, ranked by revenue. Possis was the top medical device company, ranking 9th overall on return on assets and 6th overall on greatest percent change in profits over a twelve-month period.

We were excited to learn that Possis Medical was ranked number 418 in the 2003 Deloitte & Touche Technology Fast 500, a ranking of the 500 fastest growing technology companies in North America. Additionally, Possis Medical was ranked number 13 among the fastest growing technology companies in Minnesota in the 2003 Minnesota Technology Fast 50. Among the Fast 50, Possis is a four-time winner, sharing that distinction with eleven other companies in the Fast 50.

Each year, the Minnesota Manufacturers Alliance, our peers in the manufacturing community, honors other Minnesota companies. In 2003, we were honored to receive a "Manufacturer of the Year Award" for the outstanding progress we have made in better delivering high tech, high quality medical devices to our physician customers. I am very proud of our employees in our manufacturing and product development organizations for their contributions to our success in this effort.

I'm also pleased to report that, as Chairman of Possis Medical, I was named a finalist for the 2003 Ernst & Young Entrepreneur of the Year Award. The rigorous evaluation by this competition presented not only a learning opportunity but also confirmation that we are pursuing sound business strategies for Possis Medical.

**Stepping Forward with Confidence** We have consistently achieved sales growth and profitability and have proven that our business model is a pathway to success. We can step forward with confidence, knowing that we have a strong foothold on our future in a broad and growing market coupled with our ongoing commitment to saving lives and limbs and improving quality of life for patients worldwide. Thanks to our employees who live and breathe that commitment every day. It is through their efforts and hard work that we will achieve our goals. And thanks to our shareholders for believing both in our commitment and supporting our journey on the path to success.



Robert G. Dutcher

Chairman, President and Chief Executive Officer

## Management's Discussion and Analysis of Financial Condition and Results of Operations

**Forward-Looking Statements**

Certain statements made in Management's Discussion and Analysis of Financial Condition and Results of Operations and elsewhere in this Annual Report are "forward-looking statements" as defined in the Private Securities Litigation Reform Act of 1995. Such statements can be identified by the use of terminology such as "anticipate," "believe," "could," "estimate," "expect," "forecast," "intend," "may," "plan," "possible," "project," "should," "will," and similar words or expressions. Our forward-looking statements relate to the Company's ability to increase sales of disposable product and capital equipment in the face of new product introductions from competitors; its ability to obtain additional regulatory approvals in a timely basis; the ability to obtain regulatory clearance in new foreign markets; customer responses to the Company's marketing strategies; ability to retain and motivate skilled employees especially sales positions; ability to expand the sales force; deferred tax asset valuation allowance; its outlook including future revenue, earnings, earnings per share and expense levels; future equity financing needs; and the Company's ability to develop new products and enhance existing ones. These forward-looking statements are based on current expectations and assumptions and entail various risks and uncertainties that could cause actual results to differ materially from those expressed in such forward-looking statements. Certain factors that may affect whether these anticipated results occur include clinical and market acceptance of our products; factors affecting the health care industry such as restricting sales time at interventional labs; consolidation, cost containment due to rising expenditures on drug-eluting stents and trends toward managed care; changes in supplier requirements by group purchasing organizations; unanticipated costs or other difficulties and uncertainties associated with lengthy and costly new product development and regulatory clearance processes; changes in governmental laws and regulations; changes in reimbursement; the development of new competitive products such as filterwires and compounds that may make our products obsolete; sudden restrictions in supply of key materials; and deterioration of general market and economic conditions. We also caution you not to place undue reliance on forward-looking statements, which speak only as of the date made. Any or all forward-looking statements in this report and in any other public statements we make may turn out to be inaccurate or false. They can be affected by inaccurate assumptions we might make or by known or unknown risks and uncertainties. Except as required by federal securities laws, we undertake no obligation to update any forward-looking statement. A discussion of these and other factors that could impact the Company's future results are set forth in the risk factors included in Exhibit 99.1 to the Company's Form 10-K for the year ended July 31, 2003 as filed with the Securities and Exchange Commission.

**General**

The Company was incorporated in 1956 and went public in 1960 as Possis Machine Corporation. Initial operations consisted of design, manufacturing and sales of industrial equipment and a division that provided temporary technical personnel. The Company's involvement with medical products began in 1976. In 1990, the Company made the decision to focus on medical products and subsequently divested all non-medical operations.

The Company operates in one business segment – the manufacture and sale of medical devices. The Company evaluates revenue performance based on the total revenues of each major product line and profitability based on an enterprise-wide basis due to shared infrastructures to make operating and strategic decisions.

The Company generates revenue from the sale of its products. The resulting cash flow, together with the net proceeds from the Company's debt and equity offerings, has been used to fund the Company's operations, including research and development related to its products. Approximately 98% of fiscal 2003 revenues were from product sales in the United States. The high concentration of United States revenue generation is expected to continue for the foreseeable future.

**Critical Accounting Policies**

The consolidated financial statements include accounts of the Company and all wholly-owned subsidiaries. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions in certain circumstances that affect amounts reported in the accompanying consolidated financial statements and related footnotes. In preparing these financial statements, management has made its best estimates and judgments of certain amounts included in the financial statements, giving due consideration to materiality. The Company's most critical accounting policies are those described below. Application of these accounting policies involves the exercise of judgment and use of assumptions as to future uncertainties and, as a result, actual results could differ from these estimates.

***Revenue Recognition*** Revenues associated with products that are already maintained at customer locations are recognized and ownership and risk of loss are transferred to the customer when the Company receives a valid purchase order from the customer. Revenues associated with products that are not maintained at the customer locations are recognized and title and risk of loss are transferred to the customer when a valid purchase order is received and the products are received at the customer's location. Provisions for returns are recorded in the same period the related revenues are recognized. Revenue recognition for drive unit extended warranties is amortized on a straight-line basis over the life of the warranty period.

***Allowance for Returns*** Accounts receivable are reduced by an allowance for items that may be returned in the future. The allowance requires us to make estimates at the time the account receivable is recorded concerning the likelihood for returns in the future. The estimate is based upon historical experience, information received from our customers and assumptions that are believed to be reasonable under the circumstances. Management, on a quarterly basis, evaluates the adequacy of the allowance for returns. Management believes the amount of the allowance for returns is appropriate; however, actual returns incurred could differ from the original estimate, requiring adjustments to the allowance.

***Allowance for Doubtful Accounts*** Substantially all of the Company's receivables are due from health care facilities located in the United States. The estimated allowance for doubtful accounts is based upon the age of the outstanding receivables and the payment history and creditworthiness of each customer. Management, on a quarterly basis, evaluates the adequacy of the allowance for doubtful accounts. Management believes the amount of the allowance for doubtful accounts is appropriate; however, nonpayment of accounts could differ from the original estimate, requiring adjustments to the allowance.

***Inventories*** Inventories are valued at the lower of cost or market. In order to determine the market value of inventory on a quarterly basis, management assesses the inventory quantities on hand to estimated future usage and sales and, if necessary, writes down inventory deemed excess or obsolete to estimated market value.

***Warranty Reserve*** The Company provides a one-year limited warranty on its AngioJet System drive unit and a limited warranty on AngioJet System disposable products. The Company establishes a warranty reserve at the time products are sold which is based upon historical frequency of claims relating to the Company's products and the cost to replace disposable products and to repair drive units under warranty. Management, on a quarterly basis, evaluates the adequacy of the warranty reserve. Management believes the amount of the warranty reserve is appropriate, given our historical experience; however, actual claims incurred could differ from the original estimate, requiring adjustments to the reserve.

***Deferred Tax Asset Valuation Allowance*** The Company became profitable starting in the third quarter of fiscal 2001. It has maintained profitability for ten quarters, including the fourth quarter of fiscal 2003. Prior to the fourth quarter of fiscal 2002, the Company reduced its net deferred tax asset to zero through a valuation allowance due to the uncertainty of realizing such asset. In the fourth quarters of fiscal 2003 and 2002, the Company reassessed the likelihood that the deferred tax asset will be recovered from future taxable income. Due to the previous two full years' operating results projected forward through the carryforward period, the Company reduced its valuation allowance on the deferred tax asset by $9,060,000 and $12,269,000 during the fourth quarter of fiscal 2003 and 2002, respectively. Management believes the remaining valuation allowance is necessary as $740,000 of the deferred tax asset will not be realizable due to the expiration of research and development tax credits.

In our Selected Financial Data, Management's Discussion and Analysis, and Notes to Consolidated Financial Statements, the Company makes reference to a non-GAAP (general accepted accounting principles) financial measure – income per common share before income taxes. The Company believes that this non-GAAP financial measures is useful to investors because it provides investors with another measure to consider, in conjunction with the GAAP results, that may be helpful to meaningfully compare the Company's operating performance. It is especially useful for fiscal 2003 and 2002, when the Company had an unusual tax benefit due to the reduction of the tax valuation allowance. In each case that the Company makes reference to a non-GAAP financial measure, the Company also provides a reconciliation to the comparable GAAP financial measure.

**Results of Operations**

***Fiscal Years Ended July 31, 2003, 2002 and 2001*** Total product sales for fiscal 2003 increased $14,957,000, or 35%, to $57,428,000, compared to $42,471,000 in fiscal 2002. Total product sales for fiscal 2002 increased $12,470,000, or 42%, to $42,471,000, compared to $30,001,000 in fiscal 2001. The Company recorded pre-tax net income of $12,013,000, or $0.64 per diluted share, in fiscal 2003 and $6,256,000 or $0.34 per diluted share, in fiscal

2002. This compared to a net loss of $3,304,000, or $0.20 per diluted share, in fiscal 2001. In fiscal 2003, the Company recorded a benefit for income taxes in the amount of $9,060,000 due to the reduction of the deferred tax asset valuation allowance and changes in temporary differences. This income tax benefit offset the Company's income tax provision of $4,505,000 and this resulted in a net income tax benefit of $4,555,000 and resulted in net income after income taxes in fiscal 2003 of $16,568,000, or $0.88 per diluted share. In fiscal 2002, the Company recorded a benefit for income taxes in the amount of $11,526,000 due to the reduction of the deferred tax asset valuation allowance. This resulted in net income after income taxes in fiscal 2002 of $17,782,000, or $0.96 per diluted share.

***Revenue – AngioJet System*** U.S. AngioJet System revenue for fiscal 2003 increased $14,179,000, or 34%, to $56,212,000 compared to $42,033,000 in fiscal 2002. U.S. AngioJet System revenue for fiscal 2002 increased $12,404,000 or 42%, to $42,033,000 compared to $29,629,000 in fiscal 2001. The Company markets the AngioJet System worldwide. The AngioJet System consists of a drive unit (capital equipment) that powers a disposable pump and a family of disposable catheters, each aimed at a specific indication. The main factors in the AngioJet System revenue increase were increased sales resulting from the Company commencing U.S. marketing of the AngioJet System with additional labeling claims and the expansion of its direct sales force. During fiscal 2003, 2002 and 2001, the Company began U.S. marketing of three new catheters for the removal of blood clots in leg (peripheral) arteries: the Xpeedior® Plus 120 in August 2002, the XVG in April 2002 and the XMI in March 2001. In addition, the Company received clearance to market the Company's XMI catheter for coronary use in December 2001. The XVG, XMI and Xpeedior catheters feature the Company's proprietary Cross-Stream® Technology. This exclusive technology platform intensifies the action at the tip of the catheter, which doubles the clot removal rate and triples the treatable vessel size compared to other available mechanical thrombectomy devices on the market today. In addition, Cross-Stream Technology has been able to deal more effectively than previous catheters with "mural thrombus," the older, more organized material that adheres to vessel walls and can complicate patient results.

As of July 31, 2003, the Company had a total of 1,062 domestic AngioJet System drive units in the field, compared to 863 and 669 at the end of the previous two years. During fiscal 2003, the Company sold approximately 42,500 catheters and pump sets versus approximately 33,300 in fiscal 2002 and 25,200 in fiscal 2001. This represents a 28% and 32% increase in unit catheters sales from the previous years. During the fiscal years ended July 31, 2003, 2002 and 2001, the Company sold 212, 161 and 160 AngioJet System drive units worldwide, respectively. The number of AngioJet System drive unit sales in fiscal 2003, 2002 and 2001 resulted from a continued increase in market penetration and the overall acceptance of the AngioJet System by physicians.

The Company employs a variety of flexible drive unit acquisition programs including outright purchase and various evaluation programs. The purchasing cycle for the AngioJet System drive unit varies depending on the customer's budget cycle. The Company has signed contracts with seven purchasing groups in order to accelerate orders and increase market penetration. These purchasing groups evaluate and screen new medical technologies on behalf of their members, and once they recommend a technology, such as the AngioJet System, they negotiate predetermined discounts on behalf of their members. The benefit for the Company is access to the recommended vendor list, along with marketing support provided by the purchasing group. The purchasing groups receive a marketing fee on their member purchases from the Company. These discounts and marketing fees have been offset by the increase in sales to the member hospitals of the purchasing group. There has been no material negative effect on the Company's margins due to these discounts and marketing fees. The discounts reduce gross revenue on the income statement, while marketing fees are included in selling, general and administrative expense on the income statement.

The Company expects U.S. AngioJet System sales to continue to grow primarily through obtaining additional Food and Drug Administration (FDA) approved product uses, introduction of new catheter models for existing indications, introduction of AngioJet System-related products, more face-time selling to existing accounts, peer-to-peer selling, and the publication of clinical performance and cost-effectiveness data.

Foreign sales of the AngioJet System were $1,215,000 in fiscal 2003, $438,000 in fiscal 2002 and $372,000 in fiscal 2001. The increase in sales in fiscal 2003 is primarily due to the introduction of the XMI and XVG catheters and the increase in drive unit sales in the European market. The Company has recently expanded the sales territory of one of its existing European distributors to expand product penetration in Europe. The limited foreign sales are primarily due to cost constraints in overseas markets. In foreign markets, where public sector funds are more crucial for hospital operation, Euro devaluations generated higher public sector deficits, which, in turn, forced reductions in hospital

procedure and equipment budgets. In Japan, the Company has decided to independently pursue an alternative regulatory strategy that will utilize the Company's U.S. coronary clinical trial results and extensive body of published clinical studies which is expected to result in regulatory approval and satisfactory reimbursement for the AngioJet System with the XMI catheter in treating coronary thrombus. Currently, the Japanese Ministry is reviewing the Company's regulatory approval submission. The Company has responded to two rounds of questions and are waiting for their response to the Company's answers. Once the Company receives regulatory approval, the Company will apply for an appropriate national medical insurance reimbursement. The timing of the regulatory approval and satisfactory reimbursement is dependent upon Japanese Ministry response to the Company's submissions.

***Revenue – Vascular Grafts*** Revenue from Perma-Seal Dialysis Access Grafts was $75,000 in fiscal 2001. The Company received no revenue in fiscal 2003 and 2002, respectively, from Perma-Seal Dialysis Access Grafts. No additional sales of Perma-Seal Dialysis Access Grafts are expected.

The assets of this business have been written off, and the Company is not optimistic that the assets can bring significant value in a sale.

***Cost of Medical Products*** Cost of medical products, compared to prior years, increased 14% in fiscal 2003 and 8% in fiscal 2002. The increases are primarily due to the significant growth in the U.S. AngioJet System product sales. Medical product gross margins improved by $13,137,000 in fiscal 2003 and $11,517,000 in fiscal 2002 over the prior years. The gross margin percentage in fiscal 2003 was 75% compared to 70% in fiscal 2002 and 61% in fiscal 2001. The improvement in gross margins was driven by higher volumes of XMI, XVG and Xpeedior Plus 120 catheters that carry higher margins than the catheters they replaced and an improvement in the XMI, XVG and Xpeedior Plus 120 product catheter mix in the year ended July 31, 2003. This was partially offset by the impact of higher international sales versus the prior year. The Company believes that gross margins will continue to improve slightly as product sales and related volumes continue to grow and as product and process improvements are made.

***Selling, General and Administrative Expenses*** Selling, general and administrative expenses increased $4,455,000 in fiscal 2003 and $2,126,000 in fiscal 2002, as compared to prior periods. The primary factors for the expense increase for fiscal 2003 were increased sales and marketing expenses related to the expansion of the Company's U.S. direct sales organization for the AngioJet System, increased commission expense due to increased AngioJet System product sales, increased marketing fees for the national purchasing contracts, increased patient enrollment in the Company's marketing studies, increased sales demos and sales materials, increased outside services and higher medical insurance expense. The primary factors for the expense increase for fiscal 2002 were increased sales and marketing expenses related to the expansion of the Company's U.S. direct sales organization for the AngioJet System, increased commission expense due to increased AngioJet System product sales, increased marketing fees for the national purchasing contracts, increased patient enrollment in the Company's marketing studies and an increase in management and key employee cash compensation. In fiscal 2002 and 2001, expense increases were partially offset by the reduction in costs related to a work force reduction in January 2001, a 2001 Special Equity Compensation Program, discussed in the next paragraph, and a reduction in sales product demonstrations and samples. The Company expects that the current U.S. sales force will be sufficient to continue to grow sales and service the current customer base for the Company's AngioJet System through fiscal 2004.

The Company issued stock option awards totaling 1,800,865 shares in fiscal 2001. In August 2000, stock option awards of 443,800 were issued that related to the Company's fiscal 2000 performance, since the fiscal 2000 year ended in July. In fiscal 2001, the Company was faced with two issues: 1) potential of additional dilutive financing due to the prospect of continuing losses, and 2) the hiring away of key employees by competitors. Consequently, 403,885 net stock option awards were issued to conserve cash and reduce expenses. These stock option awards reduced management and key employee cash compensation and sales commissions by approximately $810,000. An additional 733,800 stock option awards were issued to retain management and key employees in fiscal 2001. Of the 733,800 stock option awards, 539,800 relate to fiscal 2001 performance stock option awards that are normally issued in August 2001, subsequent to fiscal 2001 year-end. Accelerating the issuance of these awards was, in the opinion of management, a necessary and effective retention tool to ensure the continuity of business growth and the achievement of profitability goals.

***Research and Development Expenses*** Research and development expense increased 70% in fiscal 2003 as compared to fiscal 2002. The increase was largely due to the timing of expenses incurred for various R&D projects including the new drive unit, rapid exchange catheter and the distal protection balloon.

Research and development expense decreased 8% in fiscal 2002 as compared to fiscal 2001. The decrease in fiscal 2002 is due to the timing of outlays in different stages of development of new AngioJet System applications and related products. The Company believes that research and development expense for AngioJet System applications and related products will increase in fiscal 2004 over fiscal 2003 levels as the Company completes the development of its current products and invests in the development of new AngioJet System thrombectomy applications and related products including clinical trials.

***Interest Income*** Interest income increased $102,000 in fiscal 2003 from fiscal 2002. The increase is due to the investing of excess cash and cash equivalents in an enhanced cash management portfolio of marketable securities. Interest income decreased $224,000 in fiscal 2002 from fiscal 2001 due to declining market interest rates. The Company expects interest income to increase in fiscal 2004 as compared to fiscal 2003 as cash is generated from operations.

***Benefit for Income Taxes*** The Company became profitable starting in the third quarter of fiscal 2001. It has maintained profitability for ten quarters. Prior to the fourth quarter of fiscal 2002, the Company reduced its net deferred tax asset to zero through a valuation allowance due to the uncertainty of realizing such asset. In the fourth quarters of fiscal 2003 and 2002, the Company reassessed the likelihood that the deferred tax asset will be recovered from future taxable income. Due to the previous two full years' operating results projected forward, the Company reduced its valuation allowance on the deferred tax asset by $9,778,000 and $13,713,000 during the fourth quarter of fiscal 2003 and 2002, respectively. These amounts are offset by changes in temporary differences. In fiscal 2003 and 2002, the Company increased the deferred tax asset by an additional $2,777,000 and $743,000, respectively related to tax benefit from disqualified stock options that are recorded directly in the Consolidated Statement of Changes in Shareholders' Equity. Management believes the remaining valuation allowance is necessary as $740,000 of the deferred tax asset will not be realizable due to the expiration of research and development tax credits.

***Effects of Inflation*** Due to the low rate of inflation and small changes in prices, there has been very little effect on the Company's net revenues and net income from operations as of fiscal 2003.

**Liquidity and Capital Resources**

The Company's cash, cash equivalents and marketable securities totaled approximately $31,944,000 at July 31, 2003 compared to $18,557,000 at July 31, 2002. The primary factors in the increase were cash provided by operations of $12,995,000 and the issuance of stock and exercise of stock options and warrants of $5,883,000, which was partially offset by the repurchase of Company's stock for $3,994,000 and capital expenditures of $1,428,000.

During fiscal 2003, cash provided by operating activities was $12,995,000, which resulted primarily from $16,568,000 net income, depreciation of $2,085,000, stock compensation expense of $161,000, an increase in accounts payable and accrued liabilities of $1,781,000, partially offset by an increase in receivables of $2,093,000, an increase in inventories of $697,000 and an increase in deferred tax assets of $4,798,000. Depreciation includes company-owned drive units at customer locations, as well as property and equipment. The increase in trade accounts payable and accrued liabilities was due to the timing of the payments, an increase in accrued clinical and marketing trials, an increase in accrued outside services and an increase in deferred drive unit warranty revenue. The $2,093,000 increase in receivables was due to increase in revenue in fiscal 2003 as compared to fiscal 2002. Inventory increased due to the increase in demand for the AngioJet System. Deferred tax assets increased due to the reduction of the valuation allowance. Cash used in investing activities was $28,658,000. This includes the net purchase of marketable securities of $27,272,000 of marketable securities and the purchase of $1,428,000 of property and equipment. Net cash provided by financing activities was $1,889,000, which resulted from the cash received in connection with the exercise of stock options and warrants for $5,883,000, offset by the repurchase of 246,900 shares for $3,994,000 of the Company's stock in the open market transactions.

The Company expects its cash on hand and funds from operations to be sufficient to cover both short-term and long-term operating requirements.

During fiscal 2002, cash provided by operating activities was $6,966,000, which resulted primarily from $17,782,000 net income, depreciation of $2,119,000, stock compensation expense of $187,000, write-down due to the impairment of assets of $70,000 and an increase in accrued liabilities of $1,140,000. The net cash provided by operations was partially offset by an expense reimbursement from a city government of $84,000, an

increase in receivables of $1,605,000, an increase in inventories of $635,000, an increase in other current assets of $420,000, an increase in deferred tax assets of $11,526,000 and a decrease in accounts payable of $59,000. Depreciation includes company-owned drive units at customer locations, as well as property and equipment. The increase in accrued liabilities was due to the timing of the payments and the increase in accrued corporate incentives. The expense reimbursement from a city government of $84,000 relates to debt forgiven by the city government due to the Company achieving minimum headcount employment objectives. The $1,605,000 increase in receivables was due to increase in revenue in fiscal 2002 as compared to fiscal 2001. Inventory increased due to the increase in demand for the AngioJet System. The increase in other current assets was due to the increase in prepaid insurance and a grant receivable. The Company received a grant from the National Institute of Neurological Disorders and Stroke in the amount of $248,000. The grant helped fund development of the AngioJet NV150 catheter for ischemic stroke. The Company received the grant funds subsequent to July 31, 2002. Deferred tax assets increased due to the reduction of the valuation allowance. The $59,000 decrease in trade accounts payable was due to timing of year-end payables. Cash used in investing activities of $895,000 was primarily due to $903,000 for the purchase of property and equipment. Net cash provided by financing activities was $2,971,000, which resulted from the cash received in connection with the issuance of stock and exercise of stock options and warrants of $2,997,000.

During fiscal 2001, cash used in operating activities was $2,755,000, which resulted primarily from the $3,304,000 net loss, an expense reimbursement from a city government of $102,000, an increase in receivables of $1,328,000, and a decrease in trade accounts payable of $595,000, partially offset by non-cash charges, a decrease in inventories, and an increase in accrued liabilities totaling $2,638,000. The expense reimbursement from a city government of $102,000 relates to debt forgiven by the city government due the Company achieving minimum headcount employment objectives. The $1,328,000 increase in receivables was due to increase in revenue in fiscal 2001 as compared to fiscal 2000. The $595,000 decrease in trade accounts payable was due to timing of year-end payables, especially for software and computer upgrades. The decrease in inventories of $218,000 was due to record sales, implementation of lean manufacturing initiatives and the write-down of certain raw material inventories related to the LF140 catheter during the fourth quarter of fiscal 2001. Cash provided by investing activities was $22,545,000 of proceeds from the maturity of marketable securities, offset by purchase of marketable securities of $13,628,000 and the purchase of property and equipment of $1,334,000. Net cash provided by financing activities was $633,000, which resulted from the cash received in connection with the issuance of stock and exercise of stock options of $638,000.

**Off-Balance Sheet Obligations**

The Company does not have any debt or off-balance-sheet financial obligations.

**Outlook**

The Company expects that overall revenue from the AngioJet System, primarily in the United States, will be in the range of $70 million to $73 million in fiscal 2004. Gross margin percent for fiscal 2004 is expected to be in the mid-seventies as a percent of total sales. The Company expects selling, general and administrative expenses to increase in fiscal 2004 due to anticipated growth in revenue and an increase in marketing scientific studies. Research and development expenditures are expected to increase from the fiscal 2003 level as the Company completes development of projects and invests in development of new AngioJet System thrombectomy applications and related products including clinical trials. The Company expects diluted earnings per share for the full year in the range of $0.54 to $0.62. The quarterly revenue and earnings progression should build steadily through the year from a low in the first quarter, with the profile being affected by the timing of the rapid exchange catheter introduction and regulatory approvals as well as the patient enrollment rates in key clinical and marketing trials. In addition, the Company expects that increasing working capital investments in trade receivables and inventory will be required to support growing product sales.

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

The Company invests its excess cash in a professionally managed, institutional fixed income portfolio of short duration. The market risk on a diversified portfolio of relatively short duration is minimal, while enhancing returns above money market levels.

The product sales for the Company's foreign subsidiary are in U.S. Dollars ("USD"). As of July 31, 2003, the Company's foreign bank accounts were closed.

## Consolidated Balance Sheets

| | JULY 31, 2003 | JULY 31, 2002 |
|---|---|---|
| **Assets** | | |
| **Current Assets:** | | |
| Cash and cash equivalents (Note 1) | **$ 4,782,942** | $ 18,556,663 |
| Marketable securities | **27,161,223** | – |
| Trade receivables (less allowance for doubtful accounts and returns of $507,000 and $582,000, respectively) | **7,966,394** | 5,873,358 |
| Inventories (Note 1) | **4,165,253** | 4,134,817 |
| Prepaid expenses and other assets | **729,936** | 762,615 |
| Deferred tax asset (Note 4) | **806,000** | 646,000 |
| Total current assets | **45,611,748** | 29,973,453 |
| **Property and Equipment,** net (Note 1) | **3,055,335** | 3,092,644 |
| **Deferred Tax Asset** (Note 4) | **19,098,000** | 11,623,000 |
| **Total Assets** | **$ 67,765,083** | $ 44,689,097 |
| **Liabilities and Shareholders' Equity** | | |
| **Current Liabilities:** | | |
| Trade accounts payable | **$ 1,585,776** | $ 1,262,711 |
| Accrued salaries, wages, and commissions | **2,777,189** | 2,471,557 |
| Other liabilities | **2,367,645** | 1,200,763 |
| Total current liabilities | **6,730,610** | 4,935,031 |
| **Commitments and Contingencies** (Note 9) | | |
| **Shareholders' Equity** (Note 5): | | |
| Common stock-authorized, 100,000,000 shares of $0.40 par value each; issued and outstanding, 17,757,531 and 17,274,222 shares, respectively | **7,103,013** | 6,909,689 |
| Additional paid-in capital | **83,743,496** | 79,128,073 |
| Unearned compensation | **(15,000)** | (18,900) |
| Accumulated other comprehensive loss | **(100,000)** | – |
| Retained deficit | **(29,697,036)** | (46,264,796) |
| Total shareholders' equity | **61,034,473** | 39,754,066 |
| **Total Liabilities and Shareholders' Equity** | **$ 67,765,083** | $ 44,689,097 |

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

## Consolidated Statements of Operations and Comprehensive Income (Loss)

| YEARS ENDED JULY 31 | 2003 | 2002 | 2001 |
|---|---|---|---|
| Products sales (Note 10) | **$57,427,709** | $42,470,693 | $30,000,547 |
| Cost of sales and other expenses: | | | |
| Cost of medical products | **14,510,064** | 12,689,835 | 11,736,253 |
| Selling, general and administrative | **23,808,304** | 19,352,991 | 17,227,164 |
| Research and development | **7,502,763** | 4,426,663 | 4,820,037 |
| Total cost of sales and other expenses | **45,821,131** | 36,469,489 | 33,783,454 |
| Operating income (loss) | **11,606,578** | 6,001,204 | (3,782,907) |
| Interest income | **356,495** | 254,519 | 478,496 |
| Gain on sale of securities | **49,687** | – | – |
| Income (loss) before income taxes | **12,012,760** | 6,255,723 | (3,304,411) |
| Income tax benefit (Note 4) | **4,555,000** | 11,526,000 | – |
| Net income (loss) | **16,567,760** | 17,781,723 | (3,304,411) |
| Other comprehensive loss, net of tax – | | | |
| Unrealized loss on securities | **(100,000)** | – | – |
| Comprehensive income (loss) | **$16,467,760** | $17,781,723 | $(3,304,411) |
| Net income (loss) per common share: | | | |
| Basic | **$ 0.95** | $ 1.04 | $ (0.20) |
| Diluted | **$ 0.88** | $ 0.96 | $ (0.20) |
| Weighted average number of common shares outstanding: | | | |
| Basic | **17,501,573** | 17,078,759 | 16,739,277 |
| Diluted | **18,889,245** | 18,602,156 | 16,739,277 |

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

## Consolidated Statements of Cash Flows

| YEARS ENDED JULY 31 | 2003 | 2002 | 2001 |
|---|---|---|---|
| **Operating Activities:** | | | |
| Net income (loss) | **$ 16,567,760** | $ 17,781,723 | $ (3,304,411) |
| Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities: | | | |
| Depreciation | **2,084,604** | 2,119,240 | 1,950,533 |
| Deferred income taxes | **(4,798,000)** | (11,526,000) | – |
| Stock compensation expense | **160,550** | 186,940 | 196,199 |
| Gain on sale of securities | **(49,687)** | – | – |
| Expense reimbursement from city government | **–** | (83,866) | (101,938) |
| Writedown due to impairment of assets | **–** | 70,000 | 87,582 |
| Loss (gain) on disposal of assets | **6,226** | (3,850) | 8,564 |
| Increase in trade receivables | **(2,093,036)** | (1,605,244) | (1,327,617) |
| (Increase) decrease in inventories | **(697,387)** | (635,188) | 217,959 |
| Decrease (increase) in other current assets | **32,679** | (419,620) | (64,504) |
| Increase (decrease) in trade accounts payable | **323,065** | (58,774) | (594,578) |
| Increase in accrued and other current liabilities | **1,458,291** | 1,140,205 | 177,499 |
| Net cash provided by (used in) operating activities | **12,995,065** | 6,965,566 | (2,754,712) |
| **Investing Activities:** | | | |
| Additions to property and equipment | **(1,427,781)** | (902,627) | (1,334,142) |
| Proceeds from sale of fixed assets | **41,211** | 7,344 | 1,402 |
| Proceeds from sale/maturity of marketable securities | **54,299,309** | – | 22,545,000 |
| Purchase of marketable securities | **(81,570,845)** | – | (13,627,749) |
| Net cash (used in) provided by investing activities | **(28,658,106)** | (895,283) | 7,584,511 |
| **Financing Activities:** | | | |
| Proceeds from issuance of stock and exercise of options and warrants | **5,883,234** | 2,997,151 | 637,941 |
| Common stock repurchased | **(3,993,914)** | – | – |
| Repayment of long-term debt | **–** | (26,522) | (5,418) |
| Net cash provided by financing activities | **1,889,320** | 2,970,629 | 632,523 |
| **(Decrease) Increase in Cash and Cash Equivalents** | **(13,773,721)** | 9,040,912 | 5,462,322 |
| **Cash and Cash Equivalents at Beginning of Year** | **18,556,663** | 9,515,751 | 4,053,429 |
| **Cash and Cash Equivalents at End of Year** | **$ 4,782,942** | $ 18,556,663 | $ 9,515,751 |
| **Supplemental Cash Flow Disclosure:** | | | |
| Disqualified stock options | **$ 2,777,000** | $ 743,000 | $ – |
| Cash paid for income taxes | **287,977** | – | – |
| Issuance of restricted stock | **36,000** | 36,000 | 23,900 |
| Inventory transferred to fixed assets | **47,951** | – | – |
| Accrued payroll taxes related to restricted stock | **–** | (12,600) | 46,643 |

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

## Consolidated Statements of Changes in Shareholders' Equity

| | COMMON STOCK | | | | | | |
|---|---|---|---|---|---|---|---|
| | NUMBER OF SHARES | AMOUNT | ADDITIONAL PAID-IN CAPITAL | STOCK COMPENSATION | UNREALIZED LOSS ON SECURITIES | RETAINED DEFICIT | TOTAL |
| **Balance at July 31, 2000** | 16,700,942 | $6,680,377 | $74,581,145 | $(24,809) | $ – | $(60,742,108) | $20,494,605 |
| Employee stock purchase plan | 52,493 | 20,997 | 160,128 | – | – | – | 181,125 |
| Stock options issued to directors and physicians (Note 5) | – | – | 170,190 | – | – | – | 170,190 |
| Stock options exercised | 72,127 | 28,851 | 427,965 | – | – | – | 456,816 |
| Stock grants | 5,000 | 2,000 | 13,500 | (23,900) | – | – | (8,400) |
| Unearned stock compensation amortization | – | – | – | 26,009 | – | – | 26,009 |
| Stock retired | (8,539) | (3,416) | 58,459 | – | – | – | 55,043 |
| Net loss | – | – | – | – | – | (3,304,411) | (3,304,411) |
| **Balance at July 31, 2001** | 16,822,023 | 6,728,809 | 75,411,387 | (22,700) | – | (64,046,519) | 18,070,977 |
| Employee stock purchase plan | 63,242 | 25,297 | 213,023 | – | – | – | 238,320 |
| Stock options issued to directors and physicians (Note 5) | – | – | 147,140 | – | – | – | 147,140 |
| Stock options and warrants exercised | 387,708 | 155,083 | 2,603,748 | – | – | – | 2,758,831 |
| Disqualified stock options | – | – | 743,000 | – | – | – | 743,000 |
| Stock grants | 2,124 | 850 | 22,550 | (36,000) | – | – | (12,600) |
| Unearned stock compensation amortization | – | – | – | 39,800 | – | – | 39,800 |
| Stock retired | (875) | (350) | (12,775) | – | – | – | (13,125) |
| Net income | – | – | – | – | – | 17,781,723 | 17,781,723 |
| **Balance at July 31, 2002** | 17,274,222 | 6,909,689 | 79,128,073 | (18,900) | – | (46,264,796) | 39,754,066 |
| Employee stock purchase plan | 25,267 | 10,107 | 354,923 | – | – | – | 365,030 |
| Stock options issued to directors and physicians (Note 5) | – | – | 120,650 | – | – | – | 120,650 |
| Stock options and warrants exercised | 703,993 | 281,597 | 5,236,607 | – | – | – | 5,518,204 |
| Disqualified stock options | – | – | 2,777,000 | – | – | – | 2,777,000 |
| Stock grants | 2,010 | 804 | 35,196 | (36,000) | – | – | – |
| Unearned stock compensation amortization | – | – | – | 39,900 | – | – | 39,900 |
| Unrealized loss on investments | – | – | – | – | (100,000) | – | (100,000) |
| Stock retired | (1,061) | (424) | (13,799) | – | – | – | (14,223) |
| Common stock repurchased | (246,900) | (98,760) | (3,895,154) | – | – | – | (3,993,914) |
| Net income | – | – | – | – | – | 16,567,760 | 16,567,760 |
| **Balance at July 31, 2003** | **17,757,531** | **$7,103,013** | **$83,743,496** | **$(15,000)** | **$(100,000)** | **$(29,697,036)** | **$61,034,473** |

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

## Notes to Consolidated Financial Statements

# note 1

**Nature of Business and Summary of Significant Accounting Policies**

***Nature of Business*** Possis Medical, Inc. ("the Company") is a developer, manufacturer and marketer of medical devices, operating in one business segment. The Company was incorporated in 1956 and has operated several businesses over the last 47 years. In 1990, the Company decided to focus on medical products and changed its name to Possis Medical, Inc. in 1993. In January 1995, the Company established a 100% owned subsidiary, Possis Medical Europe B.V., in the Netherlands to support international product distribution. The Company received AngioJet Rheolytic Thrombectomy System U.S. marketing approval for use in arterio-venous (AV) access hemodialysis grafts in December 1996, for use in native coronary arteries and coronary bypass grafts in March 1999, and for use in leg arteries in April 2000.

The Company's thrombectomy products utilize new technology and the production processes and equipment used to manufacture them are unique and have been designed and constructed by Company employees. In addition, the medical device industry is subject to the laws and oversight of the United States Food and Drug Administration as well as non-U.S. regulatory bodies in countries where the Company does business.

***Basis of Consolidation*** The consolidated financial statements include the accounts of Possis Medical, Inc. and its wholly-owned subsidiaries: Possis Holdings, Inc., JEI Liquidation, Inc. ("Jet Edge") and Possis Medical Europe B.V., after elimination of intercompany accounts and transactions.

***Use of Estimates*** The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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. Actual results could differ from those estimates.

***Cash Equivalents*** The Company considers highly liquid investments with original maturities of three months or less to be cash equivalents.

***Marketable Securities*** During fiscal 2003, the Company invested its excess cash and cash equivalents in a professionally managed portfolio of marketable securities. All Company securities in this portfolio as of July 31, 2003 are classified as available-for-sale and consist primarily of U.S. government securities and corporate bonds. These investments are reported at fair value with a net unrealized loss of approximately $100,000, net of tax effect, which is included in other comprehensive loss as of July 31, 2003. The cost of securities sold is based on the specific identification method.

Information regarding the Company's available-for-sale marketable securities as of July 31, 2003 is as follows:

| | U.S. GOVT SECURITIES | CORPORATE BONDS | MUNICIPAL BONDS | MUTUAL FUNDS | TOTAL |
|---|---|---|---|---|---|
| Cost | $18,196,000 | $6,630,000 | $1,333,000 | $1,162,000 | $27,321,000 |
| Gross unrealized losses | (129,000) | (7,000) | (24,000) | – | (160,000) |
| Fair value | $18,067,000 | $6,623,000 | $1,309,000 | $1,162,000 | $27,161,000 |

The following information for the year ended July 31, 2003 is as follows:

| | U.S. GOVT SECURITIES | CORPORATE BONDS | MUTUAL FUNDS | TOTAL |
|---|---|---|---|---|
| Proceeds from sales | $16,409,000 | $368,000 | $37,522,000 | $54,299,000 |
| Net gain realized | $ 51,000 | $ 3,000 | $ – | $ 54,000 |
| Net loss realized | $ (2,000) | $ (2,000) | $ – | $ (4,000) |

***Inventories*** Inventories are stated at the lower of cost (on the first-in, first-out basis) or market. Inventory balances at July 31 were as follows:

| | **2003** | 2002 |
|---|---|---|
| Finished goods | **$1,866,397** | $1,883,933 |
| Work-in-process | **884,451** | 805,911 |
| Raw materials | **1,414,405** | 1,444,973 |
| | **$4,165,253** | $4,134,817 |

***Property and Equipment*** Property is carried at cost and depreciated using the straight-line method over the estimated useful lives of the various assets. Property and equipment balances and corresponding lives at July 31 were as follows:

| | **2003** | 2002 | LIFE |
|---|---|---|---|
| Leasehold improvements | **$1,540,965** | $1,454,833 | 10 years |
| Equipment | **7,148,702** | 7,536,959 | 3 to 10 years |
| Assets in construction | **503,722** | 138,271 | N/A |
| | **9,193,389** | 9,130,063 | |
| Less accumulated depreciation | **6,138,054** | 6,037,419 | |
| Property and equipment – net | **$3,055,335** | $3,092,644 | |

***Impairment of Long-Lived Assets*** In September 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," which addresses financial accounting and reporting for the impairment or disposal of long-lived assets. Although SFAS No. 144 supersedes SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of," it retains many of the fundamental provisions of that statement. Management of the Company periodically reviews the carrying value of property equipment owned by the Company by comparing the carrying value of these assets with their related expected future net cash flows. Should the sum of the related expected future net cash flows be less than the carrying value, management will determine whether an impairment loss should be recognized. An impairment loss would be measured by the amount by which the carrying value of the asset exceeds the fair value of the asset. In fiscal 2002 and 2001, the Company wrote down $70,000 and $87,582, respectively, of a fixed asset (included in selling, general and administrative expense). The value of this fixed asset was determined to be impaired due to the unlikely continued use of this fixed asset. The Company wrote the asset down to net realizable value. The adoption of SFAS No. 144 on August 1, 2002 did not have an effect on the Company's consolidated balance sheet, results of operations, or cash flows.

***Income Taxes*** The Company accounts for income taxes under SFAS No. 109, "Accounting for Income Taxes." Deferred taxes are provided on an asset and liability method whereby deferred tax assets are recognized for deductible temporary differences and operating loss or tax credit carryforwards and deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the variances between the amounts of assets and liabilities recorded for income tax and financial reporting purposes. Deferred tax assets are reduced by a valuation allowance to reflect the possibility that some portion or all of the deferred tax assets may not be realized.

***Derivative Instruments and Hedging Activities*** All contracts that contain provisions meeting the definition of a derivative also meet the requirements of, and have been designated as, normal purchases or sales. The Company's policy is to not enter into contracts with terms that cannot be designated as normal purchases or sales.

***Revenue Recognition*** Revenues associated with products that are already maintained at customer locations are recognized when the Company receives a valid purchase order from the customer. At this time ownership and risk of loss is transferred to the customer. Revenues associated with products that are not maintained at the customer locations are recognized when a valid purchase order is received and the products are received at the customer's location. At this time title and risk of loss is transferred to the customer. Provisions for returns are provided for in the same period the related revenues are recorded. Revenue recognition for drive unit extended warranties is amortized on a straight-line basis over the life of the warranty period.

***Shipping and Handling*** The Company recognizes all amounts billed to customers in a sales transaction related to shipping and handling to be classified as product sales. The Company records costs related to shipping and handling in cost of medical products.

***Fair Value of Financial Instruments*** The carrying value of all financial instruments approximates fair value due to the short-term nature of the instruments.

***Income (Loss) Per Share*** Income per share for fiscal 2003 and 2002 and loss per share for fiscal 2001 is computed by dividing net income (loss) by the weighted average number of common shares outstanding. Warrants and options representing 228,850, 373,468 and 3,826,089 shares of common stock at July 31, 2003, 2002 and 2001, respectively, have been excluded from the computations because their effect is antidilutive.

***Reclassifications*** Certain reclassifications have been made to prior years' financial statements to conform to the current year presentation. Such reclassifications had no effect on net income (loss) or shareholders' equity as previously reported.

***Guarantor's Accounting and Disclosure Requirements for Guarantees*** In November 2002, the FASB issued FASB Interpretation No. ("FIN") 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others." FIN 45 clarifies the requirements for a guarantor's accounting for and disclosure of certain guarantees issued and outstanding. The initial recognition and measurement provisions of FIN 45 are applicable to guarantees issued or modified after December 31, 2002. The disclosure requirements of FIN 45 are effective for financial statements of interim or annual periods ending after December 15, 2002. The adoption of FIN 45 did not have an impact on the Company's financial statement disclosures and is not expected to have an impact on the Company's consolidated balance sheet, results of operations, or cash flows.

***Consolidation of Variable Interest Entities*** In January 2003, the FASB issued FIN 46, "Consolidation of Variable Interest Entities". FIN 46 provides guidance on the identification of variable interest entities, and the assessment of a company's interests in a variable interest entity to determine whether consolidation is appropriate. FIN 46 requires the consolidation of a variable interest entity by the primary beneficiary if the entity does not effectively disperse risks among the parties involved. FIN 46 applies immediately to variable interest entities created after January 31, 2003 and is effective for periods beginning after December 15, 2003 for existing variable interest entities. As the Company has no exposures to special purpose entities or other off-balance-sheet arrangements, the Company does not expect the adoption of FIN 46 to have a material effect on the Company's consolidated balance sheet, results of operations, or cash flows.

***Accounting for Asset Retirement Obligations*** In fiscal 2003, the Company adopted SFAS No. 143, "Accounting for Asset Retirement Obligations." SFAS No. 143 requires entities to record the fair value of a liability for an asset retirement obligation in the period in which it is incurred. When the liability is initially recorded, the entity capitalizes the cost by increasing the carrying amount of the related long-lived asset. Over time, the liability is accreted to its present value each period, and the capitalized cost is depreciated over the useful life of the related asset. Upon settlement of the liability, an entity either settles the obligation for its recorded amount or incurs a gain or loss upon settlement. The adoption of SFAS No. 143 did not have a material impact on the Company's consolidated balance sheet, results of operations, or cash flows.

***Accounting for Stock-Based Compensation*** In December 2002, the FASB issued Statement of Financial Accounting Standards No. 148, "Accounting for Stock-Based Compensation – Transition and Disclosure" ("SFAS 148"), which amends Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123"). SFAS 148 provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, SFAS 148 amends the disclosure requirements of SFAS 123 to require more prominent and more frequent disclosures in financial statements of the effects of stock-based compensation. The transition guidance and annual disclosure provisions of SFAS 148 are effective for fiscal years ending after December 15, 2002. The interim disclosure provisions are effective for financial reports containing condensed financial statements for interim periods beginning after December 15, 2002, and such disclosures have been provided in Note 2. The adoption of SFAS 148 did not have a material impact on the Company's consolidated balance sheet, results of operations, or cash flows.

***Accounting for Certain Financial Instruments*** In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity." SFAS No. 150 establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances). Many of those instruments were previously classified as equity. This statement is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. The adoption of this standard did not have an effect on the Company's consolidated balance sheet, results of operations, or cash flows.

## note 2

**Stock-Based Compensation**

Effective August 1, 1996, the Company adopted SFAS No. 123, "Accounting for Stock-Based Compensation." As permitted by SFAS No. 123, the Company has elected to continue following the guidance of APB No. 25 for measurement and recognition of stock-based transactions with employees. No compensation cost has been recognized for stock options issued under the 1999 and 1992 Plans because the exercise price for all options granted was at least equal to the fair value of the common stock at the date of grant. If compensation cost for the Company's stock option and employee purchase plans had been determined based on the fair value at the grant dates for grants during fiscal 2003, 2002 and 2001, consistent with the method provided in SFAS No. 123, the Company's net income (loss) and income (loss) per share would have been as follows:

| | 2003 | 2002 | 2001 |
|---|---|---|---|
| Net income (loss): | | | |
| As reported | **$16,567,760** | $17,781,723 | $(3,304,411) |
| Pro forma | **13,820,760** | 13,602,723 | (7,184,411) |
| Income (loss) per share – basic: | | | |
| As reported | **$ .95** | $ 1.04 | $ (.20) |
| Pro forma | **.79** | .80 | (.43) |
| Income (loss) per share – diluted: | | | |
| As reported | **$ .88** | $ .96 | $ (.20) |
| Pro forma | **.73** | .73 | (.43) |

The fair value of options granted under the various option plans during fiscal 2003, 2002 and 2001 was estimated on the date of grant using the Black-Sholes option pricing model with the following weighted average assumptions and results:

| | 2003 | 2002 | 2001 |
|---|---|---|---|
| Dividend yield | **None** | None | None |
| Expected volatility | **60-80%** | 79-86% | 82% |
| Risk-free interest rate | **3.4-4.3%** | 5.4% | 3.0% |
| Expected life of option | **120 mo.** | 120 mo. | 120 mo. |
| Fair value of options on grant date | **$4,395,000** | $4,179,000 | $8,648,000 |

## note 3

**Long-term Debt**

In fiscal 2001, the Company's note payable and accrued interest to a city government in the amount of $101,938 was forgiven. The note payable and accrued interest were forgiven due to achieving minimum headcount employment objectives with the city government.

In fiscal 2002, the Company's note payable and accrued interest to a city government in the amount of $83,866 was forgiven. The note payable and accrued interest were forgiven due to maintaining minimum headcount employment objectives with the city government.

## note 4

**Income Taxes**

At July 31, 2003, the Company had net operating loss carryforwards of approximately $46,251,000 for federal tax purposes, which expire in 2010 through 2021, and $14,478,000 for Minnesota tax purposes, which expire in 2010 through 2016.

In addition, at July 31, 2003, the Company has approximately $2,619,000 in federal tax credits, substantially all of which are research and development tax credits, which expire from 2004 through 2022, and approximately $65,000 alternative minimum tax credit which does not expire. The Company established a valuation allowance for $740,000 against these research and development tax credits as a portion of them may not be realizable due to expiration in future years.

The components of the income tax benefit as of July 31, 2003, 2002 and 2001 are as follows:

| | 2003 | 2002 | 2001 |
|---|---|---|---|
| Current: | | | |
| Federal | **$ 243,000** | $ – | $ – |
| Deferred: | | | |
| Federal | **(4,494,000)** | (10,758,000) | – |
| State | **(304,000)** | (768,000) | – |
| | **(4,798,000)** | (11,526,000) | – |
| Total income tax benefit | **$(4,555,000)** | $(11,526,000) | $ – |

Deferred tax assets and liabilities as of July 31, 2003 and 2002 are described in the table that follows.

| | 2003 | 2002 |
|---|---|---|
| Current assets: | | |
| Allowance for doubtful accounts and returns | **$ 255,000** | $ 271,000 |
| Inventory | **272,000** | 188,000 |
| Employee compensation and benefits | **148,000** | 126,000 |
| Other | **131,000** | 61,000 |
| | **806,000** | 646,000 |
| Valuation allowance | **–** | – |
| Net | **$ 806,000** | $ 646,000 |
| | | |
| Long-term assets (liabilities): | | |
| Net operating losses | **$16,760,000** | $ 19,219,000 |
| Amortization of patents | **591,000** | 532,000 |
| Tax credits | **2,619,000** | 2,421,000 |
| Depreciation | **(132,000)** | (31,000) |
| | **19,838,000** | 22,141,000 |
| Valuation allowance | **(740,000)** | (10,518,000) |
| Net | **$19,098,000** | $ 11,623,000 |

The effective income tax rate differed from the U.S. federal statutory rate for each of the three years ended July 31, 2003, 2002 and 2001 as follows:

| | 2003 | 2002 | 2001 |
|---|---|---|---|
| Tax expense (benefit) on income (loss) from continuing operations computed at statutory rate of 35% | **$ 4,204,000** | $ 2,190,000 | $(1,157,000) |
| Change in valuation allowance | **(9,778,000)** | (13,713,000) | 1,047,000 |
| Change in valuation allowance related to disqualified stock options | **952,000** | – | – |
| Other | **67,000** | (3,000) | 110,000 |
| Total income tax benefit | **$(4,555,000)** | $(11,526,000) | $ – |

Deferred tax benefit of $2,777,000 and $743,000 in 2003 and 2002, respectively, relate to disqualified stock options which is recorded directly in equity.

## note 5

**Common Stock**

***Private Placement Offerings*** In March 2000, in conjunction with a private placement offering, the Company issued 1,594,049 shares of its common stock to various investors and received $15,000,000 in gross proceeds. The Company incurred issuance costs of $981,488. In addition, the Company issued 318,810 warrants to purchase shares of its common stock. The exercise price is $12.67 per share. These warrants expire in March 2004.

In May and June 1999, in conjunction with a private placement offering, the Company issued 827,852 shares of its common stock to various investors and received $7,000,000 in gross proceeds. The Company incurred issuance costs of $300,000. In addition, the Company issued 124,178 warrants to purchase shares of its common stock. The exercise price is $11.43 per share for 106,509 warrants and $11.69 per share for 17,669 warrants. These warrants expired in May and June 2003.

***Common Stock Repurchased*** During the first quarter of fiscal 2003, the Company's Board of Directors authorized its initial share repurchase program of $4,000,000. During fiscal 2003, in open market transactions, the Company repurchased 246,900 shares of its common stock, at an average price of approximately $16.18 per share, thereby completing the $4,000,000 authorization. In July 2003, the Company's Board of Directors authorized the repurchase of up to an additional $4,000,000 of its common shares from time to time, in open market transactions. This additional repurchase authorization expires in July 2004. The purpose of this program is to offset dilution from current equity incentive programs.

***Stock Options*** In December 1999, the Company established the 1999 Stock Compensation Plan (the 1999 Plan), which replaced the 1992 Stock Compensation Plan (the 1992 Plan). Although the 1992 Plan remains in effect for options outstanding, no new options may be granted under this plan.

The 1999 Plan authorizes awards of the following type of equity-based compensation: incentive stock options, nonqualified stock options, stock appreciation rights, restricted stock, deferred stock, annual grants of stock options to directors, stock options to directors in lieu of compensation for services rendered as directors, and other stock-based awards valued in whole or in part by reference to stock of the Company. No incentive stock options may be granted on or after December 16, 2009, nor shall such options remain valid beyond ten years following the date of grant.

The total number of shares of stock reserved and available for distribution under the 1999 Plan originally was 2,000,000 shares, all of which may be issued as incentive stock options. The total number of shares of stock reserved and available for distribution under the 1999 Plan is being increased annually beginning on August 1, 2000 by 2% of the number of shares of the Company's common stock outstanding on July 31 of the prior fiscal year.

At July 31, 2003, there were 2,761,253 shares reserved for outstanding options under all plans and 627,586 shares were available for granting of options under the 1999 Plan.

In fiscal 2003, 2002 and 2001, the Company granted 11,648, 7,915 and 40,289 compensatory options, respectively, to its outside directors in lieu of cash payments for directors fees. These options vest six months after date of grant and expire not more than ten years from date of grant. The expense associated with compensatory options to outside directors was approximately $104,000, $67,000 and $89,000 for the years ended July 31, 2003, 2002 and 2001, respectively.

In fiscal 2002 and 2001, the Company granted 1,000 and 13,000 compensatory options, respectively, to various physicians in lieu of cash payments for services. The Company's policy is to treat these options under variable plan accounting in accordance with SFAS No. 123 and related Emerging Issues Task Force guidance. These options were granted under the 1999 Plan and vest ratably over a six-month to a four-year period and expire not more than ten years from date of grant. The expense associated with non-employee options was approximately $16,000, $50,000 and $81,000 for the years ended July 31, 2003, 2002 and 2001, respectively.

A summary of changes in outstanding options for each of the three years ended July 31, 2003 follows:

| | **2003** | 2002 | 2001 |
|---|---|---|---|
| Shares under option at beginning of year | **2,941,974** | 3,246,061 | 1,969,236 |
| Options granted | **441,698** | 295,045 | 1,800,865 |
| Options exercised | **(538,199)** | (379,884) | (72,127) |
| Options canceled | **(84,220)** | (219,248) | (451,913) |
| Shares under option at end of year | **2,761,253** | 2,941,974 | 3,246,061 |
| Shares exercisable at end of year | **1,903,952** | 1,878,695 | 1,009,283 |

Stock option weighted-average exercise prices during fiscal 2003, 2002 and 2001 are summarized below:

| | **2003** | 2002 | 2001 |
|---|---|---|---|
| Outstanding at beginning of year | **$ 8.43** | $ 7.54 | $10.43 |
| Granted | **12.81** | 16.45 | 5.19 |
| Exercised | **7.37** | 7.38 | 6.33 |
| Canceled | **10.51** | 9.09 | 10.27 |
| Outstanding at end of year | **9.36** | 8.43 | 7.54 |

The following table summarizes information concerning options outstanding and exercisable options as of July 31, 2003:

| RANGE OF EXERCISE PRICE | SHARES OUTSTANDING | WEIGHTED-AVERAGE REMAINING CONTRACTUAL LIFE IN YEARS | WEIGHTED-AVERAGE EXERCISE PRICE | SHARES EXERCISABLE | WEIGHTED-AVERAGE EXERCISE PRICE |
|---|---|---|---|---|---|
| $ 1 – 6 | 822,232 | 7.00 | $ 4.43 | 913,850 | $ 4.59 |
| 6 – 12 | 940,544 | 6.43 | 7.63 | 562,299 | 7.77 |
| 12 – 17 | 643,177 | 6.75 | 13.46 | 297,428 | 14.49 |
| 17 – 21 | 355,300 | 6.87 | 17.93 | 130,375 | 18.22 |

In fiscal 1999, the Company granted 1,250 shares of restricted stock to employees under the terms of the 1992 Plan, which vested in fiscal 2001. Approximately $4,000 was accrued to pay the estimated withholding taxes on those shares as management believes that the employees will elect to receive fewer shares in lieu of paying the withholding taxes. In case of termination of the employees, unvested shares are forfeited. Unearned compensation of $10,125 was recorded at the date of grant and was recognized over the vesting period.

In fiscal 2000, the Company granted 1,500 shares of restricted stock to an employee under the terms of the 1992 Plan, which vested in fiscal 2001 and 2,000 shares of restricted stock to an employee under the terms of the 1999 Plan which vested in fiscal 2001. Approximately $15,000 was accrued to pay the estimated withholding taxes on those shares as management believes that the employees will elect to receive fewer shares in lieu of paying the withholding taxes. In case of termination of the employees, unvested shares are forfeited. Unearned compensation of $43,000 was recorded at the date of grant and was recognized over the vesting period.

In fiscal 2001, the Company granted 5,000 shares of restricted stock to an employee under the terms of the 1999 Plan, which vested 2,500 shares each year in fiscal years 2002 and 2003. The fair market value of the restricted shares was approximately $61,000 as of July 31, 2001. Approximately $8,000 was accrued to pay the estimated withholding taxes on those shares as management believes that the employee will elect to receive fewer shares in lieu of paying the withholding taxes. In case of termination of the employee, unvested shares are forfeited. Unearned compensation of approximately $24,000 was recorded at the date of grant and was recognized over the vesting period.

In fiscal 2002, the Company granted 2,124 shares of restricted stock to the Board of Directors under the terms of the 1999 Plan, which vested in 2002. The fair market value of the restricted shares was approximately $21,000 as of July 31, 2002. Approximately $13,000 was accrued to pay the estimated withholding taxes on those shares as management believes that the Board of Directors will elect to receive fewer shares in lieu of paying the withholding taxes. In case of termination of the Board of Directors, unvested shares are forfeited. Unearned compensation of $36,000 was recorded at the date of grant and was recognized over the vesting period.

In fiscal 2003, the Company granted 2,010 shares of restricted stock to the Board of Directors under the terms of the 1999 Plan, which vest in twelve months. The fair market value of the restricted shares was approximately $34,000 as of July 31, 2003. In case of termination of the Board of Directors, unvested shares are forfeited. Unearned compensation of $36,000 was recorded at the date of grant and is being recognized over the vesting period.

In fiscal 2003, 2002 and 2001, total compensation expense of approximately $40,000, $40,000 and $26,000, respectively, were recognized on these restricted stock grants.

***Stock Warrants*** Stock purchase warrants held by unrelated parties representing the right to purchase 26,400 shares of the Company's common stock at $8.52 a share were outstanding as of July 31, 2003. These warrants do not have an expiration date and must be exercised if the market value of the Company's common stock exceeds $22.73 per share for any sixty consecutive calendar days.

In July 1998, the Company issued to various investors 110,640 common stock purchase warrants in conjunction with a private placement of convertible debentures and are exercisable into common stock at $15.58 per share. These warrants expired on July 15, 2002.

In May and June 1999, the Company issued 106,509 and 17,669 warrants, respectively, to various investors in conjunction with the Company's private placement offering. These warrants are exercisable into common stock at $11.43 and $11.69, respectively. During fiscal 2003 and 2002, 101,278 and 19,150 of these warrants were exercised, respectively. The remaining unexercised warrants of 3,750 expired in May 2003.

In March 2000, the Company issued 318,810 warrants to various investors in conjunction with the Company's private placement offering. These warrants expire in March 2004 and are exercisable into common stock at $12.67. During fiscal 2003 and 2002, 83,046 and 13,984 of these warrants were exercised. As of July 31, 2003, the remaining 221,780 warrants were outstanding and unexercised.

A summary of changes in outstanding warrants for each of the three years ended July 31 follows:

| | **2003** | 2002 | 2001 |
|---|---|---|---|
| Warrants outstanding at beginning of year | **436,254** | 580,028 | 580,028 |
| Warrants issued | **–** | – | – |
| Warrants exercised | **(184,324)** | (33,134) | – |
| Warrants expired | **(3,750)** | (110,640) | – |
| Warrants outstanding at end of year | **248,180** | 436,254 | 580,028 |

***Employee Stock Purchase Plan*** The Employee Stock Purchase Plan, effective January 1, 1991, enables eligible employees, through payroll deduction, to purchase the Company's common stock at the end of each calendar year. The purchase price is the lower of 85% of the fair market value of the stock on the first or last day of the calendar year. The Company issued 25,267 shares in fiscal 2003, 63,242 shares in fiscal 2002, and 52,493 shares in fiscal 2001 under this Plan.

## note 6

**Accrued Warranty Costs**

The Company estimates the amount of warranty claims on sold product that may be incurred based on current and historical data. The actual warranty expense could differ from the estimates made by the Company based on product performance. A summary of changes in the Company's product warranty liability of each of the three years ended July 31 follows:

| | **2003** | 2002 | 2001 |
|---|---|---|---|
| Accrued warranty costs at beginning of year | **$ 123,000** | $ 123,000 | $ 114,000 |
| Payments made for warranty costs | **(226,200)** | (130,700) | (223,600) |
| Accrual for product costs | **249,700** | 130,700 | 232,600 |
| Accrued warranty costs at end of year | **$ 146,500** | $ 123,000 | $ 123,000 |

## note 7

**401(k) Plan**

The Company has an employees' savings and profit sharing plan for all qualified employees who have completed six months of service. Company contributions are made at the discretion of the Board of Directors subject to the maximum amount allowed under the Internal Revenue Code. Contributions for the years ended July 31, 2003, 2002 and 2001 were $303,766, $276,196 and $250,179, respectively.

## note 8

**Related Party Transactions**

A Director of the Company at times performs outside legal services for the Company. During fiscal 2002 and 2001, the amount of these services was approximately $2,000 and $74,000, respectively.

## note 9

**Commitments and Contingencies**

The Company's medical products operation is conducted from a leased facility under an operating lease which expires in fiscal 2006. The lease can be canceled by either party with notice and payment of a termination fee.

The Company is also leasing a sales office under an operating lease that expires in 2005. The future annual rentals on this operating lease are approximately $16,000 per year through 2005.

Total rental expense charged to operations was approximately $262,000, $261,000, and $258,000 for the years ended July 31, 2003, 2002, and 2001, respectively.

Future minimum payments under the non-cancelable operating leases at July 31, 2003 were:

| YEAR ENDED JULY 31 | AMOUNT |
|---|---|
| 2004 | $258,000 |
| 2005 | 258,000 |
| 2006 | 242,000 |
| Total minimum lease payments | $758,000 |

## note 10

**Segment and Geographic Information and Concentration of Credit Risk**

The Company's operations are in one business segment; the design, manufacture and distribution of cardiovascular and vascular medical devices. The Company evaluates revenue performance based on the worldwide revenues of each major product line and profitability based on an enterprise-wide basis due to shared infrastructures to make operating and strategic decisions.

Total revenues from sales in the United States and outside the United States for each of the three years ended July 31, 2003, 2002 and 2001 are as follows:

| | **2003** | 2002 | 2001 |
|---|---|---|---|
| United States | **$56,212,396** | $42,032,901 | $29,628,777 |
| Outside the United States | **1,215,313** | 437,792 | 371,770 |
| Total revenues | **$57,427,709** | $42,470,693 | $30,000,547 |

In fiscal 2003, 2002, and 2001 there were no individual customers with sales exceeding 10% of total revenues.

## note 11

**Selected Quarterly Financial Data** (Unaudited)

| FISCAL YEAR ENDED JULY 31, 2003 | FIRST QUARTER | SECOND QUARTER | THIRD QUARTER | FOURTH QUARTER |
|---|---|---|---|---|
| Products sales | **$12,681,903** | **$14,321,660** | **$14,625,124** | **$15,799,022** |
| Gross profit | **9,293,205** | **10,467,899** | **11,044,344** | **12,112,197** |
| Income – before income taxes | **2,439,654** | **3,418,166** | **2,921,530** | **3,233,410** |
| Income tax (provisions) benefit | **(915,000)** | **(1,282,000)** | **(1,097,000)** | **7,849,000** |
| Net income – after income taxes | **1,524,654** | **2,136,166** | **1,824,530** | **11,082,410**[1] |
| Income per common share – before income taxes | | | | |
| Basic | **$ 0.14** | **$ 0.20** | **$ 0.17** | **$ 0.18** |
| Diluted | **0.13** | **0.18** | **0.15** | **0.17** |
| Income tax (provisions) benefit | | | | |
| Basic | **$ (0.05)** | **$ (0.08)** | **$ (0.07)** | **$ 0.44** |
| Diluted | **(0.05)** | **(0.07)** | **(0.05)** | **0.41** |
| Net income per common share – after income taxes | | | | |
| Basic | **$ 0.09** | **$ 0.12** | **$ 0.10** | **$ 0.62** |
| Diluted | **0.08** | **0.11** | **0.10** | **0.58** |

[1] Fourth Quarter 2003 Net Income reflects a reduction of valuation allowance of $9,778,000.

| FISCAL YEAR ENDED JULY 31, 2002 | | | | |
|---|---|---|---|---|
| Products sales | $ 9,585,268 | $10,223,788 | $10,755,468 | $11,906,169 |
| Gross profit | 6,585,286 | 7,013,293 | 7,601,264 | 8,581,015 |
| Income – before income taxes | 938,528 | 1,625,349 | 1,686,922 | 2,004,924 |
| Income tax benefit | – | – | – | 11,526,000 |
| Net income – after income taxes | 938,528 | 1,625,349 | 1,686,922 | 13,530,924[2] |
| Income per common share – before income taxes | | | | |
| Basic | $ 0.06 | $ 0.10 | $ 0.10 | $ 0.12 |
| Diluted | 0.05 | 0.09 | 0.09 | 0.11 |
| Income tax benefit | | | | |
| Basic | $ – | $ – | $ – | $ 0.66 |
| Diluted | – | – | – | 0.63 |
| Net income per common share – after income taxes | | | | |
| Basic | $ 0.06 | $ 0.10 | $ 0.10 | $ 0.78 |
| Diluted | 0.05 | 0.09 | 0.09 | 0.74 |

[2] Fourth Quarter 2002 Net Income reflects a reduction of valuation allowance of $13,713,000.

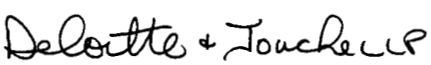
## Independent Auditors' Report

To the Shareholders of Possis Medical, Inc.:

We have audited the accompanying consolidated balance sheets of Possis Medical, Inc. and subsidiaries (the "Company") as of July 31, 2003 and 2002 and the related consolidated statements of operations and comprehensive income (loss), cash flows and changes in shareholders' equity for each of the three years in the period ended July 31, 2003. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits 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 consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Possis Medical, Inc. and subsidiaries as of July 31, 2003 and 2002 and the results of their operations and comprehensive income (loss) and their cash flows for each of the three years in the period ended July 31, 2003, in conformity with accounting principles generally accepted in the United States of America.



Deloitte & Touche LLP
Minneapolis, Minnesota
September 15, 2003

## Board of Directors

**Robert G. Dutcher**
Chairman of the Board
Director since 1993
Chairman, President and
Chief Executive Officer

**Mary K. Brainerd**
Director since 2001
Chief Executive Officer
HealthPartners, Inc.,
Minneapolis, MN

**Seymour J. Mansfield**
Director since 1987
Officer and Shareholder,
Mansfield, Tanick & Cohen, P.A.,
Minneapolis, MN

**William C. Mattison, Jr.**
Director since 1999
Retired. Formerly a Principal of
Gerard, Klauer Mattison & Co., Inc.,
New York, NY

**Whitney A. McFarlin**
Director since 1998
Retired. Former Chairman
of the Board, President and CEO,
Angeion Corporation,
Minneapolis, MN

**Donald C. Wegmiller**
Director since 1987
Chairman, Clark Consulting
HealthCare Group,
Minneapolis, MN

**Rodney A. Young**
Director since 1999
Former Chairman of the Board,
CEO and President,
LecTec Corporation,
Minnetonka, MN

## Officers

**Robert G. Dutcher**
Chairman, President and
Chief Executive Officer

**Eapen Chacko**
Vice President, Finance, Investor
Relations, Public Relations and
Chief Financial Officer

**Irving R. Colacci**
Vice President, Legal Affairs &
Human Resources, General Counsel
and Secretary

**James D. Gustafson**
Vice President, Technology, Product
Development and Quality Systems

**Shawn F. McCarrey**
Vice President, Worldwide Sales

**Robert J. Scott**
Vice President, Manufacturing
and Information Technology

## Corporate Information

**Auditors**
Deloitte & Touche LLP, Minneapolis, MN

**Legal Counsel**
Dorsey & Whitney LLP, Minneapolis, MN

**Transfer Agent**
Wells Fargo Minnesota, N.A.
Shareowner Services
161 North Concord Exchange
P.O. Box 738
South Saint Paul, MN 55075-0738
Phone: (800) 468-9716

**Annual Meeting**
The annual meeting will be held
at the Marriott City Center, 30 South
Seventh Street, Minneapolis, MN
on Wednesday, December 10, 2003
at 4:00 P.M.

**Form 10-K**
A copy of the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission will be provided to shareholders without charge upon written request.

**Investor Information**
Shareholders, security analysts, and investors seeking additional information about the Company should call Investor Relations at 763-780-4555. The following information may be obtained upon request from the Possis Medical Investor Relations Department, 9055 Evergreen Boulevard, N.W. Minneapolis, MN 55433-8003, USA.

- News releases describing significant Company events and sales and earnings results for each quarter and the fiscal year.
- Form 10-K Annual and Form 10-Q Quarterly Reports to the Securities and Exchange Commission detailing Possis' business and financial condition.

News releases and other information can be accessed via the Internet at www.possis.com

**Market for the Registrant's Common Equity and Related Stockholder Matters:**
The Company had 1,383 common shareholders of record at July 31, 2003. The common stock is traded on the Nasdaq Stock Market under the symbol POSS. High and low closing sale prices for each quarter of fiscal years ended July 31, 2003 and 2002 are presented below:

| | 2003 | | 2002 | |
|---|---|---|---|---|
| | HIGH | LOW | HIGH | LOW |
| Quarter: | | | | |
| First | **$12.62** | **$ 9.01** | $14.70 | $ 9.85 |
| Second | **19.63** | **11.49** | 19.00 | 13.00 |
| Third | **20.19** | **14.93** | 21.15 | 14.19 |
| Fourth | **19.79** | **13.57** | 15.10 | 8.91 |



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