

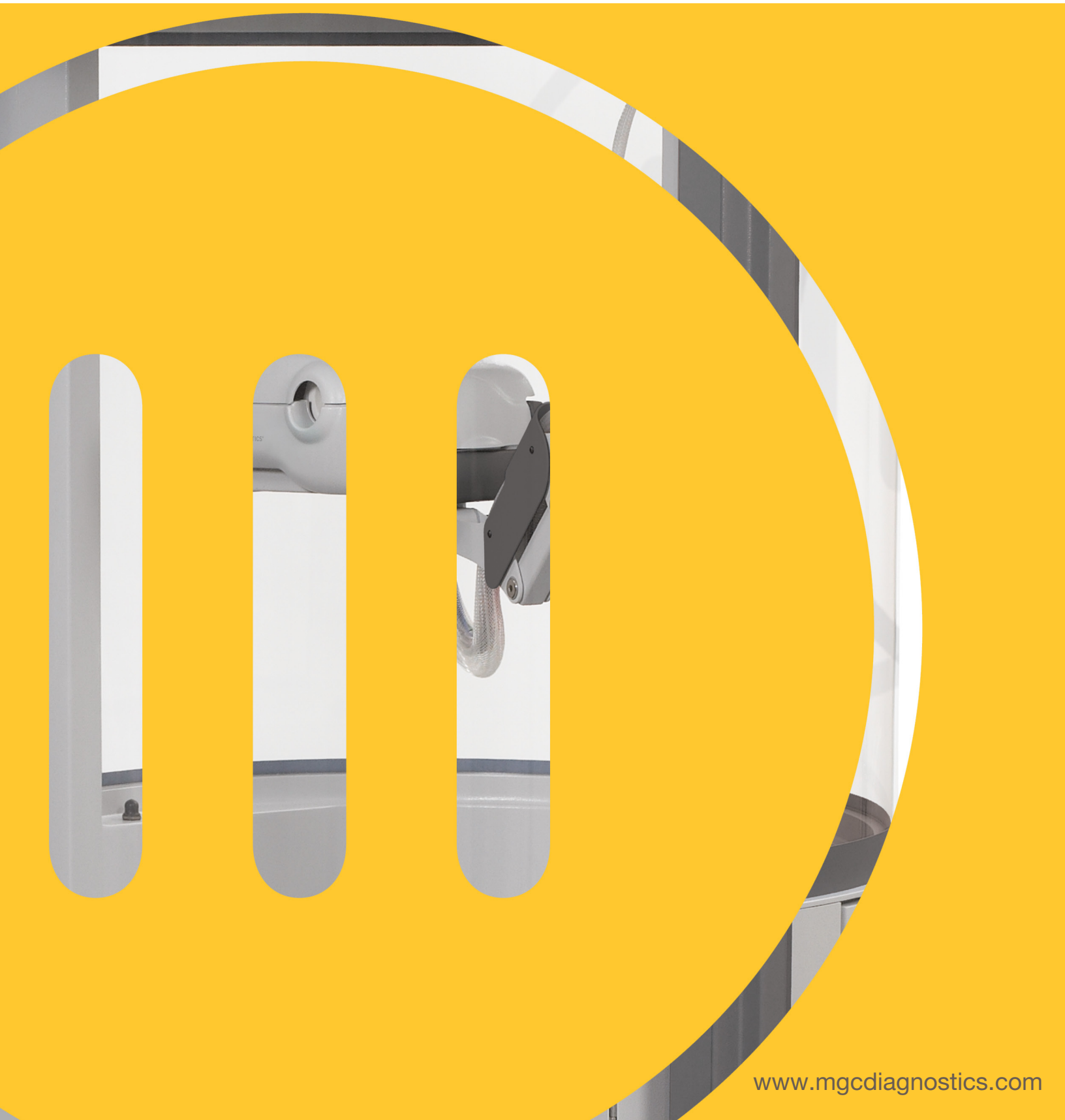
# 2015

## Business Overview

a year of accomplishment



**MGC**  
DIAGNOSTICS®



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# Our Identity



## Based in St. Paul, Minnesota,

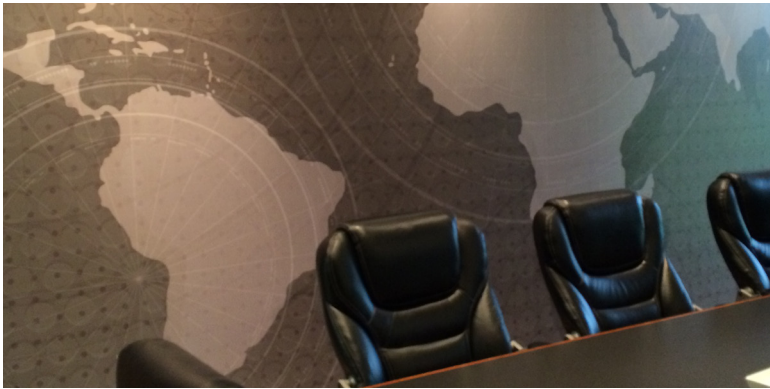
MGC Diagnostics Corporation is a global medical technology company dedicated to cardiorespiratory health solutions. The Company designs, markets and sells non-invasive cardiorespiratory diagnostic products through its Medical Graphics Corporation subsidiary under the MGC Diagnostics brand and trade name and through its Medisoft subsidiary under the Medisoft brand and trade name. Medisoft was acquired on August 1, 2014.

The Company's product portfolio provides solutions for disease detection, integrated care, and wellness across the cardiorespiratory healthcare spectrum. The Company sells its products internationally through

distributors and in the United States through a direct sales force targeting specialists located in hospitals, university-based medical centers, medical clinics, physician offices, pharmaceutical companies, medical device manufacturers, and clinical research organizations ("CROs").

The Company's cardiorespiratory diagnostic products measure the air flow and respiratory pressures and, in most cases analyze the inhaled and exhaled gases such as oxygen and carbon dioxide. The Company operates in a single industry segment: the research, development, manufacture and marketing of non-invasive cardiorespiratory diagnostic products.

# Shareholder's Letter



## To our Shareholders,

The Board of Directors and the management team of MGC Diagnostics are pleased to report that fiscal 2015, both operationally and financially, was a great year for your Company. We took transformative steps to reposition the Company toward becoming one of the global leaders in the cardiorespiratory diagnostic segment. During the fiscal year management the Board initiated a new Long-Term Strategic Plan to guide the profitable growth of the Company in the coming years. Fiscal 2015 saw the achievement of a number of the tactical goals in the plan, including increased revenue and profitability. We successfully launched a newly redesigned product that was very well received by the market and we entered into a new strategic partnership

in Japan to expand our global footprint. We are now better positioned to compete more aggressively on a global basis and to gain greater market share. We are pleased with the results of fiscal 2015.

For the full year revenue increased 24.9% to \$37.5 million compared to \$30.0 million in fiscal 2014. We generated operating income of \$1.6 million, compared to an operating loss of (\$811,000). Net income for the fiscal year was \$4.0 million, or \$0.94 per diluted share, compared to a net loss of (\$1.2) million, or a loss of \$(0.28) per diluted share in fiscal 2014. Net income for fiscal 2015 included a \$3.5 million tax benefit, or \$0.84 per diluted share, stemming from

+24.9%

**RECORD REVENUE**

Full year revenue increased 24.9% to \$37.5 million in fiscal 2015 compared to \$30.0 million in fiscal 2014.

+11.3%

**MGC DOMESTIC GROWTH**

Our Medical Graphics (MGC) subsidiary led the way with revenue growth in the U.S. of 11.3% to 26.3 million - the best since fiscal year 2007.

+13.2%

**MGC INTERNATIONAL REVENUE**

MGC International revenue grew 13.2% to \$5.7 million, driven by stronger sales in Europe and the Asia/Pacific region.



the recognition of deferred tax assets, of which \$3.1 million came from the partial reversal of the valuation allowance on the Company's U.S. deferred tax assets. Gross margin for the fiscal year was 51.6% with Medical Graphics delivering 54.1% and Medisoftware reporting 36.7%. From an operational standpoint our Medical Graphics subsidiary led the way with revenue growth in the U.S. of 11.3% to \$26.3 million – the best since fiscal year 2007. Medical Graphics' International revenue grew 13.2% to \$5.7 million, driven by stronger sales in Europe and the Asia/Pacific region. We enter the new fiscal year with a Medical Graphics' domestic backlog of \$2.3 million – also the best since 2007 – setting the stage for improved performance in fiscal 2016.

Our Belgium-based Medisoftware subsidiary continued its successful transition as we more fully integrated their operations, and we installed a new management team to improve operational and financial performance. With the appointment of Frederic Gavage as Managing Director, we now have in place a strong team prepared to strengthen the Medisoftware brand. Medisoftware has a strong reputation for innovation and has produced leading-edge products for the European markets. We will leverage that reputation with a focused sales strategy and expect to drive improved overall operational and financial results in fiscal 2016 and beyond. We believe Medisoftware is a more stable business today and we are confident that MGCD's acquisition of Medisoftware

provides the company with a significant step in our strategy to become a leading global supplier of cardiorespiratory diagnostics solutions.

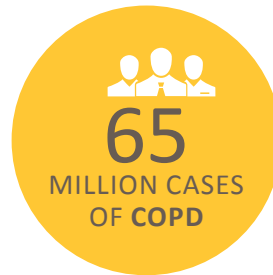
Our singular focus in cardiorespiratory diagnostics reflects our total dedication to solve our customer's challenges in the most cost effective manner possible, and to devise solutions for their future opportunities. We are dedicated to providing unmatched service and support, relentlessly make improvements to our technology and products and to anticipate the future needs of our customers. This is the "new" MGC Diagnostics.



***"Our singular focus in cardiorespiratory diagnostics reflects our total dedication to solve our customer's challenges...This is the "new" MGC Diagnostics."***

The cardiorespiratory segment that we compete in is large and continues to grow. According to the World Health Organization and the American Journal of Respiratory Critical Care:

- 65 million people have chronic obstructive pulmonary disease ("COPD"), accounting for 5% of all deaths globally, and estimated to be increasing by greater than 30% in the next 10 years to become the third leading cause of death worldwide;
- 300 million people have asthma, projected to increase to 400 million by 2025 - asthma is the most common disease in children;
- 130 million adults have sleep apnea, 1 in 5 adults have undiagnosed mild sleep apnea and 1 in 15 adults have undiagnosed severe sleep apnea;



- 10% of patients with COPD and obstructive sleep apnea ("OSA") will have overlapping disease;
- 15-25% of patients with COPD and asthma will have overlapping disease;
- Patients with severe asthma are 32 times more likely to develop COPD than those with mild asthma.

Additionally, the continued aging of the U.S. population, as well as that of other developed nations around the world, represents a significant opportunity for medical device manufacturers that can provide equipment with the appropriate feature sets that maximize the effectiveness of healthcare providers to treat these conditions and for patients to participate in managing their care. We recognize this opportunity and all of us at MGC Diagnostics are dedicated to becoming a leading solutions provider in this segment.

We also recognize that we operate in an industry segment with long equipment replacement cycles – typically 7 to 10 years in length. To grow our business in the coming years it will be necessary to convert our competitor's customers to MGC Diagnostics customers along with accelerating the upgrade rate of our installed base. To do that we must offer products at a reasonable price point that allow our customers, existing and new, to effectively treat their cardiorespiratory patients at a price point they can increase in the years to come.



afford. We are continuously improving our competitive position to do that. In fiscal 2015 we won a total of 66 competitive conversions that contributed \$3.0 million in revenue, compared to 48 competitive conversions and \$2.9 million in revenue for fiscal 2014. We expect that the number of conversions, and revenue generated from those conversions, will begin to

Another way that we can grow our business is to strike partnerships in selected international markets with leading distributors. In November 2015 we entered into a multi-year partnership agreement with Pacific

Medico Co., Ltd., of Tokyo, Japan, to exclusively market MGC Diagnostics' CCM Express indirect calorimeter system in Japan. The CCM Express is an advanced technology designed for use with patients in critical

care environments requiring mechanical ventilation.

The CCM Express brings advanced technology to the physician, scientist and clinician challenged with providing care to critically ill patients where commonly used predictive equations often include errors in the prescription of nutritional therapies. With the Japanese medical device market continuing to experience positive growth, entering this market is a significant step in expanding the global footprint of MGC Diagnostics. We are excited with the possibilities of this partnership. We will look to replicate this type of agreement in other international markets.

Coming off a strong fiscal year in 2015, we head into fiscal 2016 with great optimism. We believe we have created a sustainable platform from which we can consistently grow, both domestically and

internationally. The financial condition of the Company continues to be strong with cash and cash equivalents of \$6.6 million compared to \$5.7 million at the end of fiscal 2014; positive working capital of \$11.4 million compared to working capital of \$9.9 million at the end of fiscal 2014; and positive cash flow of \$2.2 million from operating activities, compared to \$342,000 generated in the same period last year.

All of us at MGC Diagnostics would like to thank you - our loyal shareholders - for your continued confidence and support. We have weathered some difficult times in recent years, but we are now stronger, better positioned and more focused on growing your business in a manner that can enhance the value of your investment.

Sincerely,



Mark Sheffert  
Chairman of the Board of Directors



Todd Austin  
Chief Executive Officer



TO OUR LOYAL SHAREHOLDERS:  
Thank you for your continued  
confidence and support

**+27%**  
COMPETITIVE  
CONVERSIONS

# Long-Range Plan

In recent months the Board of Directors and the Company's management team have initiated a new Long-Term Strategic Plan focusing on process improvements throughout the enterprise to generate consistent growth and profitability in the coming years. We have a strong transformational vision of how we want MGC Diagnostics to develop and operate in the coming years. Our plan is built around six key initiatives:



## UNDERSTANDING THE CUSTOMER

**PLAN:** Identify target hospitals for our products and services.



## DRIVING REVENUE GROWTH

**PLAN:** Transform MGCD into a company that can grow on a consistent basis year over year.



## IMPROVING PROFITABILITY

**PLAN:** Control the average selling prices of our products by lowering the cost of a number of our current products by reconfiguring the feature sets.



## Understanding the Customer

On a global basis MGC Diagnostics' core customer is the pulmonologist and the hospitals in which they practice. The pulmonologist's primary focus is the diagnosing and treatment of diseases associated with the cardio-respiratory system, primarily chronic obstructive pulmonary disease ("COPD") and asthma.

As MGCD's diagnostic equipment is mainly utilized in hospitals, we have undertaken and concluded a detailed analysis to identify U.S. hospitals that are good targets for our products and services. These target hospitals generally invest in the equipment and staff to effectively treat patients with respiratory diseases. Cross referencing this list against our existing installed base of customers we have identified hospitals that are not currently MGCD customers, and that maintain equipment that we believe is due for replacement, either for age or obsolescence. This information is now being utilized by our sales organization to target specific hospitals for conversion into new customers. We believe we are now devoting the right combination of time, resources and personnel to develop this universe of potential new customers in the coming years.



### INNOVATION DRIVEN R&D

**PLAN:** Identify and utilize external partnerships to assess, design, and develop new products while maintaining MGCD's proprietary technology expertise.



### ORGANIZATIONAL EXCELLENCE

**PLAN:** Align all employees with the goals and objectives of the Company and where people are empowered to contribute to the success of the Company.



### ENHANCING SHAREHOLDER VALUE

**PLAN:** Increase the number of shareholders by aggressively communicating its long-range vision to the broader Wall Street investment community.

### Driving Revenue Growth

As we look into the future, our goal is to transform MGCD into a company that can grow on a consistent basis year over year. We operate in relatively mature markets that grow at low single digit rates. However, our current penetration of these markets, approximately 22% in the U.S. and approximately 7% internationally, provides us with significant capacity in each market to substantially grow our business in the near-term future. With a focus on truly understanding the needs of the markets, we are in a prime position to match our products with new customers in order to provide a value proposition that far exceeds their existing technology.

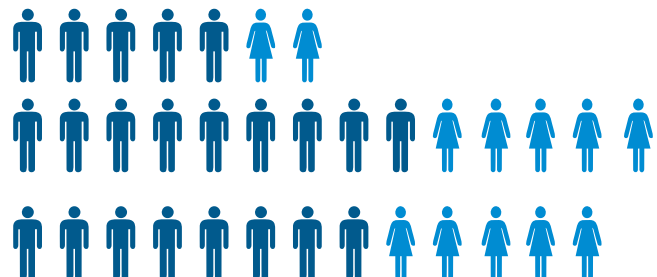
### Improving Profitability

In tandem with driving consistent revenue growth, improving profitability is a key factor in having the financial capability to expand our business while enhancing the value of our shareholders' investments. An important aspect of improving profitability will be controlling the average selling prices ("ASPs") of our products. Given the nature of our markets, where incremental growth in the coming years will come from converting competitor customers into MGC customers, we expect that equipment pricing pressures will be the norm rather than the exception. Understanding that, we are completing several projects targeted at lowering the cost of a number of our current products by reconfiguring the feature sets in a way that we believe will have broad appeal across both domestic and international markets. We are determined to maintain adequate controls to sustain ASP's and the overall margins of the transactions we close.

### Innovation Driven R&D

We continue to develop innovative products with the appropriate function and feature sets, and price points that fit the needs of our hospital customers worldwide. We have engineering teams that develop complex electronic-based medical instrumentation and software at both Medical Graphics and Medisoft. Beginning in fiscal year 2016 we will begin to transition from in-house engineering to identifying and utilizing external partnerships to assess, design, and develop new products while maintaining MGCD's proprietary technology expertise. This will permit us to redeploy our assets and resources to additional business development activities to drive consistent, profitable revenue growth. Bringing new innovative products to market with the appropriate function and feature sets to treat cardiorespiratory patients in the most efficient and cost-effective manner is critical to the future success of MGC Diagnostics.

Employees continue to adapt to changes in market conditions while implementing the changes needed to address the evolving dynamics in our industry.



## Organizational Excellence

We are dedicated to building an organization capable of defining and implementing the plans and actions required to transform MGCD into a consistently growing and profitable business. To accomplish this all employees must be aligned with the goals and objectives of the Company and contribute to a culture where people are empowered and inspired to achieve the overall success of the Company. We are well ahead of the curve in this regard. Our employees continue to successfully adapt to ongoing changes in market conditions while implementing the changes that the Board and management have set forth to address the evolving dynamics in our industry. We are tremendously proud of their accomplishments and we appreciate their individual efforts to constantly improve on the quality products they produce.

## Enhancing Shareholder Value

At the end of the day, MGCD shareholders have the right to expect their investment in the Company to provide a good return. We realize that superior performance is clearly the best way to improve shareholder value. Another way to improve our value is to increase our number of shareholders. Accordingly, the company plans to consistently, and more aggressively, communicate its long-range vision and plans for profitably growing the business to the broader Wall Street investment community. We firmly believe that management being sharply focused on achieving consistent annual revenue growth and profitability, combined with the commitment to expand the visibility of MGCD throughout the Wall Street community, will translate into enhanced value of your Company. In addition, the Board and management will actively seek out opportunities to expand the business through selective partnerships, mergers and acquisitions.

MGCD clearly understands that our shareholders are the owners of the Company and that the Board of Directors serves as their representatives with respect to ensuring the growth and profitability of the Company. Therefore, the Board recently amended the Company's Bylaws to give shareholders (or groups of shareholders) that have owned at least three percent of MGCD's common stock continuously for at least three years the ability to nominate and include in MGCD annual meeting proxy materials (Proxy Access), director nominees constituting up to twenty percent of the members of the Board. This action will make it easier for our long-time shareholders to nominate directors to our board. We are a leader in providing proxy access to our shareholders, but believe it is the right thing to do and gives a greater voice in the governance of the Company to its owners, which it turn should result in greater value.

# Board and Management Team

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## BOARD OF DIRECTORS

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MARK W. SHEFFERT

Director and Chair

JOHN R. BAUDUIN

Director

WENDY D. LYNCH, PH.D

Director

ROBERT E. MUNZENRIDER

Director

HENDRIK STRUIK

Director

TERRENCY W. BUNGE

Director

## OFFICERS AND SENIOR MANAGEMENT

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TODD M. AUSTIN

Chief Executive Officer

MATTHEW S. MARGOLIES

President

WESLEY W. WINNEKINS

Chief Financial Officer and  
Chief Risk Officer

# Get in touch

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