

2016 Business Overview

a year of growth



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Our Identity



Based in St. Paul, Minnesota,

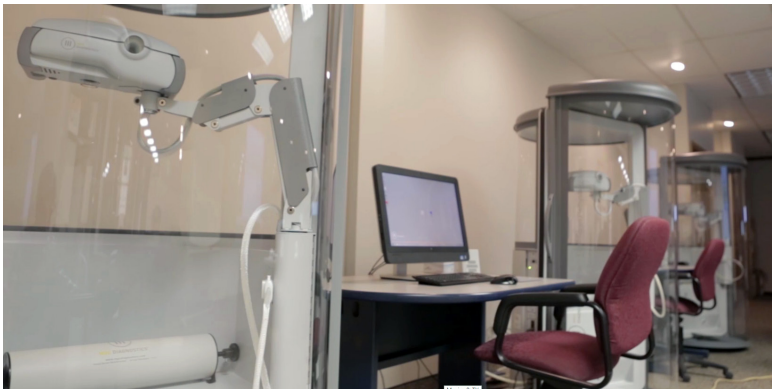
MGC Diagnostics Corporation is a global medical technology company dedicated to cardiorespiratory health solutions. The Company designs, markets and sells non-invasive cardiorespiratory diagnostic products through its Medical Graphics Corporation subsidiary under the MGC Diagnostics brand and trade name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



To Our Valued Shareholders,

Fiscal 2016 was a milestone year for MGC Diagnostics as we achieved record revenue. Our domestic Medical Graphics business continued on the growth trajectory of recent years and our European-based Medisoft business ended the year significantly better positioned for improved operational and financial results in the coming years. Our success this year was driven by the execution of our Long-Range Plan. We remain focused on becoming a global leader in cardiorespiratory diagnostics. Our vision is to provide our customers with state-of-the-art cardiorespiratory diagnostic solutions, deliver unmatched service and support and exceed our customers' needs in the most effective manner possible.

We are very pleased with the operating performance of our business for the fourth quarter and full fiscal year. Our domestic sales team generated record setting, double-digit revenue growth from strong competitive

account conversions and existing customer upgrades. Fourth quarter and fiscal 2016 domestic revenue from equipment sales grew 22.1% and 21.9% respectively, compared to the same periods last year. During the fourth quarter, Medisoft's revenue increased 14%. We have stabilized the business and set a course for improved operating performance.

For the fiscal year, we converted 89 domestic competitive accounts generating \$5.6 million in revenue, compared to 66 wins and \$3.1 million in revenue for fiscal 2015. That translates into a 79% increase in new customer revenue versus fiscal 2015. Our continued success in growing competitive conversion revenue is the result of strategic initiatives implemented in the Long-Range Strategic Plan that we adopted in September 2015. We believe that the cornerstones of our Plan, "Understanding the Customer" and "Innovation

+22.1%

RECORD REVENUE GROWTH

Fourth quarter and fiscal 2016 domestic revenue from equipment sales grew 22.1% compared 2015.

+79%

MGC NEW CUSTOMER REVENUE

Our Medical Graphics (MGC) subsidiary converted 89 domestic competitive accounts generating \$5.6 million in revenue, compared to 66 wins and \$3.1 million in 2015.

+14%

MGC INTERNATIONAL REVENUE

During the fourth quarter, Medisoft's revenue increased 14%. We have stabilized the business and set a course for improved operating performance.



Driven R&D", allow us to anticipate the unmet needs of the market and deliver products and services which support new customers when selecting MGC Diagnostics as their vendor of choice. The successful redesign of the Ultima Series has proven to be a viable upgrade pathway, allowing us to retain and expand our installed base with new customers. Additionally, our core value to provide "Unmatched Service and Support" is valued as superior when compared to services provided by our competitors. Remaining singularly focused on the cardiorespiratory diagnostic market will continue to serve us well as we compete in the coming years.

Our recurring revenue initiatives continue to gain traction. This year we will expand our internal sales team and increase our UltraCare™ service offerings and domestic supplies revenues. The extended service attachment rate for domestic sales during the fiscal 2016

fourth quarter was 38%, compared to 21% for fiscal 2015 fourth quarter and the overall fiscal 2015 average of 32%. Deferred revenue, which consists of extended service contracts, grew 23% to \$8.2 million for the 2016 fourth quarter compared to \$6.7 million at the end of last year's fourth quarter.

Our steadfast conviction to Medisoft has resulted in a stable business, now positioned for growth. During the second half of fiscal 2016, we launched several initiatives aimed at growing Medisoft and leveraging our international opportunities. During the fourth quarter, these strategies began to pay off as revenues for the quarter increased 17% versus the fourth quarter last year. It is important to note that Medisoft's products are beginning to win competitive tenders and are displacing entrenched competitors similar to our domestic success. While tackling integration challenges,

our team at Medisoft made great progress and is looking forward to improved international operational and financial results.

With Medisoft gaining traction in the second half of fiscal 2016, we have increasing expectations for overall growth in our international business. Coupled with a strong domestic outlook and a renewed sense of our ability to compete internationally, we are increasingly confident about the prospects for MGC Diagnostics in fiscal year 2017 and beyond.

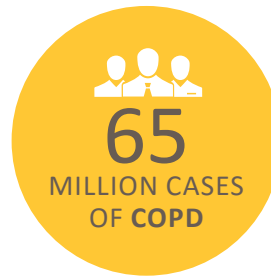
We are firmly committed to providing our customers with a portfolio of state-of-the-art respiratory diagnostic products and services. With the creation of our Scientific Advisory Committee last July, and by collecting valuable information from new customers gained through competitive conversions, MGC Diagnostics is benefiting from strategic “Voice of the Customer” input. This information is instrumental as we develop new product offerings based on current market demands.



“We are firmly committed to providing our customers with a portfolio of state-of-the-art respiratory diagnostic products and services.”

During the third quarter of fiscal 2016, we strengthened our balance sheet by retiring all of our bank debt. The Company has a strong financial foundation, featuring a clean balance sheet, consistent cash flow generation, a cash balance of approximately \$7.3 million, no long-term debt, deferred revenue of \$8.2 million, and a working capital position of \$11.7 million as of October 31, 2016.

Reflecting on fiscal 2016, it is clear that our domestic equipment business performed at a very high level, and that our international business is poised for growth in the coming years. I want to thank our employees for achieving this result.



We are excited with the opportunities ahead, particularly because we operate in large markets with great potential. 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 increase by more 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;
- 15-25% of patients with COPD and asthma will have overlapping disease.

In the course of reporting our financial results for fiscal 2016, and in conjunction with our auditors, we made difficult, but appropriate decisions to declare goodwill and intangible asset impairments associated with Medisoft. Additionally, we established reserves for our SleepVirtual and Resmon PRO FOT inventories. We acquired these assets in connection with past strategic initiatives to diversify our product portfolio and expand our international footprint. Strategically, we remain dedicated to our Medisoft business and developing the market for the Resmon Pro FOT; however, we determined that sales may take longer than originally planned and that our expected future cash flows from the SleepVirtual assets did not support historical carrying values. The Resmon Pro FOT product received final FDA approval last November and the European

Respiratory Society's Product of "Outstanding Interest Award" in December and we focused our efforts to position this technology in existing and adjacent markets. Despite these charges, we continue to implement strategies to realize the remaining potential of these assets.

The Board of Directors and management recognize our never-ending responsibility to operate this Company in a manner that can drive the value of the investments of our loyal shareholders. As such, the Board recently approved a special cash dividend of \$0.70 per common share. The cash dividend was paid on February 24, 2017 to all shareholders of record as of February 10, 2017. As we have stated previously, if the Board of Directors determines that the Company's capital exceeds the amount necessary to retain sufficient cash and liquid assets to meet its working capital and liquidity needs, and retains a reasonable cushion for contingencies and strategic opportunities, the Board will consider various options for increasing shareholder value. That may include, but will not be limited to, purchasing our own shares in the open market and in privately-negotiated transactions and or paying cash dividends. This special dividend demonstrates the Board's confidence in the Company's continued solid domestic operating performance, consistent cash flow generation and strong balance sheet with no debt as of the end of the fiscal year 2016. This is a special cash dividend and we cannot guarantee any future dividends.

The Board is also undertaking a comprehensive review of the Company's businesses and assets to explore additional opportunities to enhance value for our loyal shareholders. A Special Committee consisting of Board Chairman Mark Sheffert, Vice Chairman Terry Bunge and director Hank Struik will oversee this process. The Board has retained Craig-Hallum Capital Market LLC to advise the Board in this process. We expect this to be

a thorough process and we will report its findings and conclusions at the completion of the review. The Board will consider all reasonable options that can potentially drive sustainable value. We cannot guarantee that any actions will be taken as a direct result of this review, but it is important for management and the Board to clearly understand potential available options to enhance the future value of the Company. We believe that our investors deserve this review at this time to assess opportunities that can increase the value of their investment in MGC Diagnostics Corporation.

Today, we are better positioned to grow our business, both domestically and internationally. The financial condition of the Company is strong with a cash balance at October 31, 2016 of \$7.3 million; no long-term debt; positive working capital of \$11.7 million and positive cash flow of \$4.6 million from operating activities. Our primary objective for fiscal 2017 and beyond is to profitably grow our core cardiopulmonary diagnostic business to enhance shareholder value.

As always, the entire MGC Diagnostics team expresses its sincere appreciation for the confidence and support of our loyal shareholders. We continue to make measurable progress in positioning the Company for sustained growth and profitability. We are dedicated to 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

Long-Range Plan

In 2015 the Board of Directors and the Company's management team 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 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.

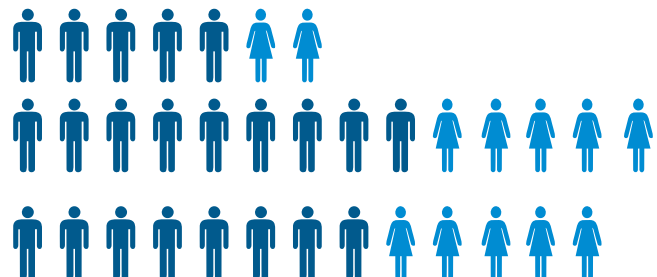
Improving Profitability

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 ("ASP") of our products. Given the nature of our markets, where incremental growth in the coming years will come from converting competitor customers into MGCD 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 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 began 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 the 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.



TO OUR LOYAL SHAREHOLDERS:

Thank you for your continued
confidence and support

Board and Management Team

BOARD OF DIRECTORS

MARK W. SHEFFERT

Director and Chair

JOHN R. BAUDHUIN

Director

WENDY D. LYNCH, PH.D

Director

ROBERT E. MUNZENRIDER

Director

HENDRIK STRUIK

Director

TERRENCE W. BUNGE

Director

OFFICERS AND SENIOR MANAGEMENT

TODD M. AUSTIN

Chief Executive Officer

MATTHEW S. MARGOLIES

President

Get in touch

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