INTEGRA LIFESCIENCES HOLDINGS CORP
Form 8-K
December 21, 2004

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 8-K

CURRENT REPORT
Pursuant to Section 13 or 15(d) of
the Securities Exchange Act of 1934

Date of Report (date of earliest event reported): December 17, 2004

INTEGRA LIFESCIENCES HOLDINGS CORPORATION

(Exact name of Registrant as specified in its charter)

Delaware	0-26224	51-0317849
(State or other jurisdiction of incorporation or organization)	(Commission File Number)	(I.R.S. Employer Identification No.)

311 Enterprise Drive
Plainsboro, NJ 08536
(Address of principal executive offices) (Zip Code)

(609) 275-0500 (Registrant's telephone number, including area code)

Not Applicable
(Former name or former address, if changed since last report)

ITEM 5.02. DEPARTURE OF DIRECTORS OF PRINCIPAL OFFICERS; ELECTION OF DIRECTORS; APPOINTMENT OF PRINCIPAL OFFICERS.

(d) On December 17, 2004, Integra LifeSciences Holdings Corporation (the "Company") appointed Anne M. VanLent, age 56, as a director of the Company. The press release issued by the Company announcing this appointment is attached as Exhibit 99.1 to this report.

Ms. VanLent has been Executive Vice President and Chief Financial Officer of Barrier Therapeutics, Inc., a pharmaceutical company that develops dermatology products, since May 2002. Prior to joining Barrier Therapeutics, Ms. VanLent served as a principal of the Technology Compass Group, LLC, a healthcare/technology consulting firm, since she founded it in October 2001. From July 1997 to October 2001, she was the Executive Vice President--Portfolio Management for Sarnoff Corporation, a multidisciplinary research and development firm. Ms. VanLent also currently serves as a director of Penwest Pharmaceuticals

Co., a Nasdaq-listed company.

ITEM 9.01. Financial Statements and Exhibits.

(c) Exhibits.

Exhibit Number	Description of Exhibit
99.1	Press release issued December 20, 2004

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the Registrant has duly caused this report to be signed on its behalf by the undersigned, hereunto duly authorized.

INTEGRA LIFESCIENCES HOLDINGS CORPORATION

Date: December 21, 2004

By: /s/ Stuart M. Essig

Stuart M. Essig
President and Chief Executive Officer

Exhibit Index

Exhibit Number	Description of Exhibit
99.1	Press release issued December 20, 2004

Exhibit 99.1

News Release

Contacts:
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Integra LifeSciences Holdings Corporation Appoints
Anne M. VanLent to its Board of Directors

Plainsboro, NJ / December 20, 2004/ -- Integra LifeSciences Holdings Corporation (Nasdaq: IART) today announced that effective immediately it has increased the size of its Board of Directors to seven and appointed Anne M. VanLent to fill the newly created vacancy. Ms. VanLent was also appointed to the Audit Committee.

Ms. VanLent currently serves as Executive Vice President and Chief Financial Officer of Barrier Therapeutics, Inc., a publicly traded pharmaceutical company located in Princeton, New Jersey that develops prescription dermatology products, a post she has held since the company's founding in May 2002.

Richard Caruso, Chairman of Integra's Board of Directors stated: "I am pleased that Anne has agreed to join our Board of Directors. Anne is a seasoned senior executive with extensive financial and governance expertise. Her broad interests in healthcare and financial matters make her a great addition to the Board."

"I look forward to working with Stuart Essig, the Board, and the entire team at Integra. I am enthusiastic about this new position as a Director and look forward to contributing to Integra's mission of becoming a leader in medical devices used in neurosurgery, reconstructive surgery and general surgery. I believe Integra is well positioned to continue its technological leadership," said Ms. VanLent.

Commenting on Ms. VanLent's appointment to the Board, Stuart Essig, Integra's President and Chief Executive Officer stated: "Anne's management experience and leadership skills in the pharmaceutical industry are an excellent fit with Integra's mission of bringing innovative medical technology to the market. I look forward to Anne's future contributions to Integra's strategic development."

Prior to joining Barrier Therapeutics, Ms. VanLent served as a principal of the Technology Compass Group, LLC, a healthcare and technology consulting firm she founded in October 2001. From July 1997 to October 2001, she was the Executive Vice President of Portfolio Management for Sarnoff Corporation, a multidisciplinary research and development firm. There she directed Sarnoff's venture spin-off process and was in charge of all patent and licensing activities. Previously, she held senior management positions or consulted for a number of private and public emerging growth healthcare companies. Ms. VanLent also currently serves as a Director and Chair of the Audit Committee of Penwest Pharmaceuticals Co. (NASDAQ: PPCO). She also served as a Director of i-STAT Corporation; a publicly- traded medical device company, prior to its sale to Abbott Laboratories earlier this year. She holds a BS degree in Physics from Mount Holyoke College.

Integra LifeSciences Holdings Corporation is a diversified medical technology company that develops, manufactures, and markets medical devices for use in a

variety of applications. The primary applications for our products are neuro-trauma and neurosurgery, plastic and reconstructive surgery and general surgery. Integra is a leader in applying the principles of biotechnology to medical devices that improve patients' quality of life. Our corporate headquarters are in Plainsboro, New Jersey, and we have manufacturing and research facilities located throughout the world. We have approximately 1,200 employees. Please visit our website at (http://www.Integra-LS.com).

This news release contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements include, but are not limited to, statements concerning expectations for future financial results, including revenues, gross margins and earnings, development of products and formation of strategic alliances. Such forward-looking statements involve risks and uncertainties that could cause actual results to differ materially from predicted or expected results. In addition, the economic, competitive, governmental, technological and other factors identified under the heading "Factors That May Affect Our Future Performance" included in the Business section of Integra's Annual Report on Form 10-K for the year ended December 31, 2003 and information contained in subsequent filings with the Securities and Exchange Commission could affect actual results.

Source: Integra LifeSciences Holdings Corporation

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Total Liabilities
13,190 49,222
Commitments and Contingencies (Note 9)

Stockholders Equity

Series A preferred stock $.05 par value, 450,000 shares authorized;

no shares issued and outstanding

Common stock $.05 par value, 45,000,000 shares authorized; 17,471,472

and 18,030,270 shares issued and outstanding
874 901
Additional paid-in capital
66,005 74,573
Accumulated other comprehensive income (loss)
1,504 (107)
Retained earnings
103,989 66,439
Total Stockholders Equity
172,372 141,806
Total Liabilities and Stockholders Equity
$ 185,562 $ 191,028

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

Table of Contents

SurModics, Inc. and Subsidiaries

Consolidated Statements of Income
For the Years Ended September 30

	2009	2008	2007
	(In thousands, except net income per share)		
Revenue			
Royalties and license fees	$ 75,464	$ 51,788	$ 52,679
Product sales	19,333	20,052	13,543
Research and development	26,737	25,211	6,942
Total revenue	121,534	97,051	73,164
Operating Costs and Expenses			
Product	7,508	8,476	5,584
Customer research and development	13,183	19,187	5,840
Other research and development	21,179	21,311	22,625
Selling, general and administrative	17,200	20,816	13,643
Purchased in-process research and development	3,200		15,573
Restructuring charges	1,763		
Total operating costs and expenses	64,033	69,790	63,265
Income from Operations	57,501	27,261	9,899
Other Income (Loss)			
Investment income, net	1,839	3,329	4,844
Impairment loss on investment		(4,314)	
Other income (loss), net	184	616	(75)
Other income (loss), net	2,023	(369)	4,769
Income Before Income Taxes	59,524	26,892	14,668
Income Tax Provision	(21,974)	(12,153)	(11,321)
Net Income	$ 37,550	$ 14,739	$ 3,347
Basic net income per share	$ 2.15	$ 0.82	$ 0.19
Diluted net income per share	$ 2.15	$ 0.80	$ 0.18
Weighted Average Shares Outstanding			
Basic	17,435	18,026	18,033
Dilutive effect of outstanding stock options	34	304	184
Diluted	17,469	18,330	18,217

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

Table of Contents

SurModics, Inc. and Subsidiaries

Consolidated Statements of Stockholders Equity
For the Years Ended September 30, 2009, 2008 and 2007

	Common Stock		Additional Paid-in	Accumulated Other Comprehensive Income	Retained	Total Stockholders
	Shares	Amount	Capital	(Loss)	Earnings	Equity
			(In thousands)			
Balance September 30, 2006	18,830	$ 942	$ 96,281	$ (293)	$ 48,273	$ 145,203
Components of comprehensive income, net of tax:						
Net income					3,347	3,347
Unrealized holding gains on available-for-sale securities arising during the period				1,999		1,999
Add reclassification for losses included in net income, net of tax benefit of $10				17		17
Comprehensive income						5,363
Issuance of common stock	14	1	457			458
Common stock repurchased	(1,008)	(50)	(34,980)			(35,030)
Common stock options exercised, net	217	11	4,778			4,789
Purchase of common stock to pay employee taxes	112	5	(379)			(374)
Excess tax benefit from exercise of stock options			466			466
Stock-based compensation			10,312			10,312
Other			(265)			(265)
Balance September 30, 2007	18,165	909	76,670	1,723	51,620	130,922
Components of comprehensive income, net of tax:						
Net income					14,739	14,739
Unrealized holding losses on available-for-sale securities arising during the period				(5,882)		(5,882)
Add reclassification for losses included in net income, net of tax provision of $167				4,052		4,052
Comprehensive income						12,909

Issuance of common stock	16	1	516			517
Common stock repurchased	(342)	(17)	(13,954)			(13,971)
Common stock options exercised, net	114	4	2,514			2,518
Purchase of common stock to pay employee taxes	77	4	(1,678)			(1,674)
Excess tax benefit from exercise of stock options			1,081			1,081
Stock-based compensation			9,652			9,652
Other			(228)			(228)
Accounting change for income taxes					80	80
Balance September 30, 2008	18,030	901	74,573	(107)	66,439	141,806
Components of comprehensive income, net of tax:						
Net income					37,550	37,550
Unrealized holding gains on available-for-sale securities arising during the period				2,123		2,123
Add reclassification for gains included in net income, net of tax provision of $299				(512)		(512)
Comprehensive income						39,161
Issuance of common stock	40	2	611			613
Common stock repurchased	(624)	(31)	(14,967)			(14,998)
Common stock options exercised, net	15	1	65			66
Purchase of common stock to pay employee taxes	10	1	(569)			(568)
Excess tax benefit from exercise of stock options			(366)			(366)
Stock-based compensation			6,853			6,853
Other			(195)			(195)
Balance September 30, 2009	17,471	$ 874	$ 66,005	$ 1,504	$ 103,989	$ 172,372

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

Table of Contents

SurModics, Inc. and Subsidiaries

Consolidated Statements of Cash Flows
For the Years Ended September 30

	2009	2008	2007
		(In thousands)	
Operating Activities			
Net income	$ 37,550	$ 14,739	$ 3,347
Adjustments to reconcile net income to net cash provided by operating activities			
Depreciation and amortization	5,912	6,071	4,214
(Gain) loss on equity method investments and sales of investments	(103)	415	75
Amortization of premium (discount) on investments	139	70	(1,388)
Impairment loss on investment		4,314	
Stock-based compensation	6,853	9,652	10,312
Purchased in-process research & development	3,200		15,573
Restructuring charges	1,763		
Deferred tax	8,229	(3,428)	(9,434)
Excess tax benefit from exercise of stock options	366	(1,081)	(466)
Loss on disposals of property and equipment	291	78	379
Other	(250)		
Change in operating assets and liabilities:			
Accounts receivable	3,269	1,548	1,940
Inventories	(679)	(154)	(850)
Accounts payable and accrued liabilities	(2,387)	(264)	2,594
Income taxes	2,656	(5,003)	5,501
Deferred revenue	(36,050)	11,452	19,166
Prepaids and other	562	1,413	(248)
Net cash provided by operating activities	31,321	39,822	50,715
Investing Activities			
Purchases of property and equipment	(29,364)	(23,866)	(3,626)
Sales of property and equipment		32	37
Purchases of available-for-sale investments	(33,568)	(22,857)	(136,498)
Sales/maturities of available-for-sale investments	55,263	29,258	185,075
Purchases of held-to-maturity investments		(6,485)	
Investment in other strategic assets	(2,500)	(2,562)	(5,749)
Purchase of licenses and patents	(631)	(2,452)	(1,355)
Acquisitions, net of cash acquired	(8,585)	(3,219)	(49,112)
Repayment of notes receivable		5,870	530
Other investing activities	(187)	(228)	(265)
Net cash used in investing activities	(19,572)	(26,509)	(10,963)
Financing Activities			

Excess tax benefit from exercise of stock options	(366)	1,081	466
Issuance of common stock	679	3,037	5,247
Repurchase of common stock	(14,998)	(13,971)	(35,030)
Purchase of common stock to pay employee taxes	(568)	(1,674)	(374)
Repayment of notes payable	(236)	(222)	
Net cash used in financing activities	(15,489)	(11,749)	(29,691)
Net change in cash and cash equivalents	(3,740)	1,564	10,061
Cash and Cash Equivalents			
Beginning of year	15,376	13,812	3,751
End of year	$ 11,636	$ 15,376	$ 13,812
Supplemental Information			
Cash paid for income taxes	$ 11,285	$ 21,058	$ 14,930
Noncash transaction acquisition of property, plant, and equipment on account	$ 1,247	$ 1,745	$ 252
Noncash transaction acquisition of intangibles on account	$ 210	$	$

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

Table of Contents

SurModics, Inc. and Subsidiaries

Notes to Consolidated Financial Statements
September 30, 2009 and 2008

1. Description

SurModics, Inc. and subsidiaries (the Company) develops, manufactures and markets innovative drug delivery and surface modification technologies for the healthcare industry. The Company s revenue is derived from three primary sources: (1) royalties and license fees from licensing its patented drug delivery and surface modification technologies and *in vitro* diagnostic formats to customers; (2) the sale of polymers and reagent chemicals to licensees; substrates, antigens and stabilization products to the diagnostics industry; microarray slides to the diagnostic and biomedical research markets; and (3) research and development fees generated on projects for customers.

Basis of Presentation

The consolidated financial statements include all accounts and wholly owned subsidiaries, and have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). All significant inter-company transactions have been eliminated.

Subsequent Events

Subsequent events have been evaluated through December 11, 2009, the date the financial statements were issued.

On October 5, 2009, the Company entered into a license and development agreement with F. Hoffmann-La Roche, Ltd. (Roche) and Genentech, Inc., a wholly owned member of the Roche Group (Genentech), associated with the Company s proprietary biodegradable microparticles drug delivery system. SurModics received an up front licensing fee of $3.5 million, could be eligible to receive up to approximately $200 million in fees and milestone payments in the event of the successful development and commercialization of multiple products, and will be paid for development work done on these products. Roche and Genentech will have the right to obtain manufacturing services from SurModics. In the event a commercial product is developed, the Company will also receive royalties on sales of such products.

2. Summary of Significant Accounting Policies

Cash and Cash Equivalents

Cash and cash equivalents consist of financial instruments with original maturities of three months or less and are stated at cost which approximates fair value.

Investments

Investments consist principally of U.S. government and government agency obligations and mortgage-backed securities and are classified as available-for-sale or held-to-maturity at September 30, 2009 and 2008. Available-for-sale investments are reported at fair value with unrealized gains and losses net of tax excluded from operations and reported as a separate component of stockholders equity, except for other-than-temporary impairments, which are reported as a charge to current operations. A loss would be recognized when there is an other-than-temporary impairment in the fair value of any individual security classified as available-for-sale, with the

associated net unrealized loss reclassified out of accumulated other comprehensive income with a corresponding adjustment to other income (loss). This adjustment results in a new cost basis for the investment. Investments that management has the intent and ability to hold to maturity are classified as held-to-maturity and reported at amortized cost. If there is an other-than-temporary impairment in the fair value of any individual security classified as held-to-maturity, the Company will write down the security to fair value with a corresponding adjustment to other income (loss). Interest on debt securities, including amortization of premiums and accretion of discounts, is

Table of Contents

SurModics, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Continued)

included in other income (loss). Realized gains and losses from the sales of debt securities, which are included in other income (loss), are determined using the specific identification method.

The original cost, unrealized holding gains and losses, and fair value of available-for-sale investments as of September 30 were as follows *(in thousands):*

	2009			
	Original Cost	Unrealized Gains	Unrealized Losses	Fair Value
U.S. government obligations	$ 10,837	$ 253	$	$ 11,090
Mortgage-backed securities	7,938	177	(106)	8,009
Municipal bonds	7,210	232		7,442
Asset-backed securities	2,334	65	(143)	2,256
Corporate bonds	1,181	3		1,184
Total	$ 29,500	$ 730	$ (249)	$ 29,981

	2008			
	Original Cost	Unrealized Gains	Unrealized Losses	Fair Value
U.S. government obligations	$ 18,440	$ 91	$ (87)	$ 18,444
Mortgage-backed securities	10,147	46	(179)	10,014
Municipal bonds	11,022	153	(3)	11,172
Asset-backed securities	6,193	2	(171)	6,024
Corporate bonds	4,582	8	(33)	4,557
Total	$ 50,384	$ 300	$ (473)	$ 50,211

The original cost and fair value of investments by contractual maturity at September 30, 2009 were as follows *(in thousands):*

	Original Cost	Fair Value
Debt securities due within:		
One year	$ 6,830	$ 6,911
One to five years	14,297	14,749
Five years or more	8,373	8,321

Total	$ 29,500	$ 29,981

The following table summarizes sales of available-for-sale securities for the years ended September 30, 2009, 2008 and 2007 *(in thousands):*

	2009	2008	2007
Proceeds from sales	$ 55,263	$ 29,258	$ 185,075
Gross realized gains	$ 823	$ 454	$ 7
Gross realized losses	$ (12)	$ (26)	$ (34)

At September 30, 2009, the amortized cost and fair market value of held-to-maturity debt securities were $6.3 million and $6.4 million, respectively. Investments in securities designated as held-to-maturity consist of tax-exempt municipal bonds and have maturity dates ranging between three months and three years from September 30, 2009. At September 30, 2008, the amortized cost and fair market value of held-to-maturity debt securities were $6.4 million and $6.3 million, respectively.

Table of Contents

SurModics, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Continued)

Inventories

Inventories are principally stated at the lower of cost or market using the specific identification method and include direct labor, materials and overhead. Inventories consisted of the following as of September 30 *(in thousands):*

	2009	2008
Raw materials	$ 1,287	$ 1,308
Finished products	2,043	1,343
Total	$ 3,330	$ 2,651

Property and Equipment

Property and equipment are stated at cost and are depreciated using the straight-line method over 1 to 32 years, the estimated useful lives of the assets. The Company recorded depreciation expense of $3.8 million, $3.1 million and $2.2 million for the years ended September 30, 2009, 2008 and 2007, respectively.

The September 30, 2009 and 2008 balances in construction-in-progress include the cost of enhancing the capabilities of the Company s Eden Prairie, Minnesota and Birmingham, Alabama facilities. As assets are placed in service, construction-in-progress is transferred to the specific property and equipment categories and depreciated over the estimated useful lives of the assets.

In April 2008, the Company acquired a 286,000 square foot facility situated on 42 acres in Birmingham, Alabama for $12.2 million. The Company has been renovating the existing facility to accommodate research and development, clinical manufacturing and commercial manufacturing of drug delivery products for pharmaceutical and biotechnology customers. The building is currently classified as construction-in-progress until renovation and remodeling is completed. The value of the land associated with the purchase is classified as part of the total land carrying value.

In August 2008, the Company acquired approximately five acres of undeveloped land adjacent to its headquarters in Eden Prairie, Minnesota for $3.6 million. The value of the land purchase is classified as part of the total land carrying value.

Property and equipment consisted of the following components as of September 30 *(in thousands):*

	Useful Life (In years)	2009	2008
Land		$ 7,409	$ 7,409
Laboratory fixtures and equipment	3 to 12	19,549	15,767

Building and improvements	1 to 32	15,911	15,025
Office furniture and equipment	3 to 10	4,550	4,156
Construction-in-progress		40,210	16,931
Less accumulated depreciation		(20,714)	(17,391)
Property and equipment, net		$ 66,915	$ 41,897

Other Assets

Other assets consist principally of strategic investments. In fiscal 2009, the balance in other assets increased primarily as a result of an investment in a medical technology company and an increase in the value of the Company s investment in OctoPlus N.V. (OctoPlus).

Table of Contents

SurModics, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Continued)

In January 2005, the Company made an initial equity investment of approximately $3.9 million in OctoPlus, a company based in the Netherlands active in the development of pharmaceutical formulations incorporating novel biodegradable polymers. Subsequent investments brought the Company s total investment to $6.0 million. In October 2006, OctoPlus common stock began trading on an international exchange following an initial public offering of its common stock. With a readily determinable fair market value, the Company now treats the investment in OctoPlus as an available-for-sale investment rather than a cost method investment. Available-for-sale investments are reported at fair value with unrealized gains and losses reported as a separate component of stockholders equity, except for other-than-temporary impairments, which are reported as a charge to current operations, recorded in the other income (loss) section of the consolidated statements of income, and result in a new cost basis for the investment. As of September 30, 2009, the investment in OctoPlus represented an ownership interest of less than 10%. The Company recorded no realized gain or loss related to this investment in fiscal 2009. The Company recognized an impairment loss on the investment totaling $4.3 million in fiscal 2008 based on a significant decline in the stock price of OctoPlus as a result of market conditions. The cost basis in the Company s investment in OctoPlus is $1.7 million.

Beginning in May 2005, the Company has invested $1.2 million in ThermopeutiX, Inc. (ThermopeutiX), a California-based early stage company developing novel medical devices for the treatment of vascular and neurovascular diseases. In addition to the investment, SurModics has licensed its hydrophilic and hemocompatible coating technologies to ThermopeutiX for use with its devices. The Company s investment in ThermopeutiX, which is accounted for under the cost method, represents an ownership interest of less than 20%.

The Company has invested a total of $5.2 million in Novocell, Inc. (Novocell), a privately-held California-based biotechnology firm that is developing a unique treatment for diabetes using coated islet cells, the cells that produce insulin in the human body. In fiscal 2006, the Company determined its investment in Novocell was impaired and that the impairment was other-than-temporary. Accordingly, the Company recorded an impairment loss of $4.7 million. The balance of the investment, $559,000, which is accounted for under the cost method, represents less than a 5% ownership interest.

In July 2007, the Company made equity investments in Paragon Intellectual Properties, LLC (Paragon) and Apollo Therapeutics, LLC (Apollo), a Paragon subsidiary, totaling $3.5 million. SurModics made an additional equity investment in fiscal 2008 totaling $2.5 million, based upon successful completion of specified development milestones. In addition to the investments, the Company has licensed its Finale^{tm} prohealing coating technology and provides development services on a time and materials basis to Apollo. In October 2008, Paragon announced that it had restructured, moving from a limited liability company with seven subsidiaries to a single C-corporation named Nexeon MedSystems, Inc. (Nexeon). SurModics continued to account for the investments in Paragon and Apollo under the equity method in the first quarter of fiscal 2009, as both entities report results to us on a one-quarter lag. Commencing with the second quarter of fiscal 2009, SurModics accounted for the investment in Nexeon under the cost method as the Company s ownership level is less than 20%. The Company made an additional investment of $500,000 in Nexeon in fiscal 2009.

In August 2009, the Company invested $2.0 million in a medical technology company. The Company s investment is accounted for under the cost method, as the Company s ownership interest is less than 20%. This investment is included in the category titled Other in the table below.

Table of Contents

SurModics, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Continued)

Other assets consisted of the following components as of September 30 *(in thousands):*

	2009	2008
Investment in OctoPlus	$ 3,700	$ 1,714
Investment in Nexeon MedSystems	5,651	5,388
Investment in ThermopeutiX	1,185	1,185
Investment in Novocell	559	559
Other	2,162	455
Other assets, net	$ 13,257	$ 9,301

In the years ended September 30, 2009, 2008 and 2007, the Company recognized revenue of $1.4 million, $4.1 million and $909,000, respectively, from activity with companies in which it had a strategic investment.

Intangible Assets

Intangible assets consist principally of acquired patents and technology, customer relationships, licenses, and trademarks. The Company recorded amortization expense of $2.1 million, $3.0 million, and $2.0 million for the years ended September 30, 2009, 2008 and 2007, respectively.

In fiscal 2009, the Company acquired certain assets of PR Pharmaceuticals, Inc., which resulted in an increase to intangible assets. See Note 4 for further information regarding the acquisition.

Intangible assets consisted of the following as of September 30 *(in thousands):*

	Useful Life (In years)	2009	2008
Customer lists	9-11	$ 8,657	$ 7,340
Abbott license	4		7,037
Core technology	8-18	8,330	6,930
Patents and other	2-20	3,076	3,398
Trademarks		600	580
Less accumulated amortization		(3,205)	(8,415)
Intangible assets, net		$ 17,458	$ 16,870

The Abbott license was fully amortized as of September 30, 2009 and the original cost and accumulated amortization have been removed from the 2009 amounts presented. Based on the intangible assets in service as of September 30,

2009, estimated amortization expense for the next five fiscal years is as follows (*in thousands*):

2010	$ 1,627
2011	1,604
2012	1,602
2013	1,602
2014	1,602

Goodwill

Goodwill represents the excess of the cost of the acquired entities over the fair value assigned to the assets purchased and liabilities assumed in connection with the Company s acquisitions (see Note 4 for further information). The carrying amount of goodwill is evaluated annually, and between annual evaluations if events occur or circumstances change indicating that the carrying amount of goodwill may be impaired.

Table of Contents

SurModics, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Continued)

In fiscal 2009 a milestone was achieved associated with the July 2007 acquisition of SurModics Pharmaceuticals, and $3 million of additional purchase price was recorded as an increase to goodwill.

Impairment of Long-Lived Assets

The Company periodically evaluates whether events and circumstances have occurred that may affect the estimated useful life or the recoverability of the remaining balance of long-lived assets, such as property and equipment and investments. If such events or circumstances were to indicate that the carrying amount of these assets would not be recoverable, the Company would estimate the future cash flows expected to result from the use of the assets and their eventual disposition. If the sum of the expected future cash flows (undiscounted and without interest charges) or other measure of fair value were less than the carrying amount of the assets, the Company would recognize an impairment loss reducing the carrying value to fair market value.

Revenue Recognition

In accordance with Securities and Exchange Commission (SEC) guidance, revenue is recognized when all of the following criteria are met: (1) persuasive evidence of an arrangement exists; (2) shipment has occurred or delivery has occurred if the terms specify destination; (3) the sales price is fixed or determinable; and (4) collectability is reasonably assured. However, when there are additional performance requirements, revenue is recognized when all such requirements have been satisfied. Under revenue arrangements with multiple deliverables, the Company recognizes each separable deliverable as it is earned.

The Company s revenue is derived from three primary sources: (1) royalties and license fees from licensing patented drug delivery and surface modification technologies and *in vitro* diagnostic formats to customers; (2) the sale of polymers and reagent chemicals, stabilization products, antigens, substrates and microarray slides to the diagnostics and biomedical research industries; and (3) research and development fees generated on customer projects.

Taxes collected from customers and remitted to governmental authorities are excluded from revenue and amounted to $187,000, $309,000 and $170,000 for the years ended September 30, 2009, 2008 and 2007, respectively.

Royalties & License Fees. The Company licenses technology to third parties and collects royalties. Royalty revenue is generated when a customer sells products incorporating the Company s licensed technologies. Royalty revenue is recognized as licensees report it to the Company, and payment is typically submitted concurrently with the report. Generally, license fees are recognized as revenue when the Company receives payment and the contract price is fixed or determinable. For stand-alone license agreements, up-front license fees are recognized over the term of the related licensing agreement. Minimum royalty fees are recognized in the period earned.

Revenue related to a performance milestone is recognized upon the achievement of the milestone, as defined in the respective agreements and provided the following conditions have been met:

The milestone payment is non-refundable.

The milestone is achieved, involves a significant degree of risk, and was not reasonably assured at the inception of the arrangement.

Accomplishment of the milestone involves substantial effort.

The amount of the milestone payment is commensurate with the related effort and risk.

A reasonable amount of time passes between the initial license payment and the first and subsequent milestone payments.

Table of Contents

SurModics, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Continued)

If these conditions have not been met, the milestone payment is deferred and recognized over the term of the agreement.

Product Sales. Product sales to third parties are recognized at the time of shipment, provided that an order has been received, the price is fixed or determinable, collectability of the resulting receivable is reasonably assured and returns can be reasonably estimated. The Company s sales terms provide no right of return outside of the standard warranty policy. Payment terms are generally set at 30-45 days.

Research and Development. The Company performs third party research and development activities, which are typically provided on a time and materials basis. Generally, revenue for research and development is recorded as performance progresses under the applicable contract.

Arrangements with multiple deliverables. Arrangements such as license and development agreements are analyzed to determine whether the deliverables, which often include a license and performance obligations such as research and development, can be separated or whether they must be accounted for as a single unit of accounting in accordance with accounting guidance. The Company recognizes up-front license payments under these agreements over the economic life of the technology licensed. If the fair value of the undelivered performance obligations can be determined, such obligations would then be accounted for separately. If the license is considered to either (i) not have stand-alone value or (ii) have stand-alone value but the fair value of any of the undelivered performance obligations cannot be determined, the arrangement would then be accounted for as a single unit of accounting, and the license payments and payments for performance obligations would be recognized as revenue over the estimated period of when the performance obligations are performed, or the economic life of the technology licensed to the customer. When the Company determines that an arrangement should be accounted for as a single unit of accounting, it recognizes the related revenue based on a time-based accounting model. Revenue associated with arrangements with multiple deliverables totaled $45.3 million, $4.2 million and $0.3 million in fiscal 2009, 2008 and 2007, respectively. The fiscal 2009 revenue associated with multiple deliverable arrangements is reflected in royalties and license fees revenue ($37.6 million) and in research and development revenue ($7.7 million) in the consolidated statements of income.

Merck Agreement. On June 27, 2007 the Company announced a license and research collaboration agreement with Merck & Co., Inc. (Merck). The agreement called for SurModics and Merck to pursue the joint development and commercialization of SurModics I-vation sustained drug delivery system with TA (triamcinolone acetonide), and other products combining certain of Merck s proprietary drug compounds and the I-vation system for the treatment of serious retinal diseases. Under the terms of the agreement, Merck led and funded development and commercialization activities. SurModics received an up-front license fee of $20 million in fiscal 2007 and additional license fees totaling $11 million in fiscal 2008. In addition, the Company was paid for its activities in researching and developing the combination products. Research and development fees totaling $5.8 million were billed in fiscal 2008. The Company recognized out-of-pocket reimbursements, totaling $1.6 million in fiscal 2008, as revenue in the period since the related costs were incurred when commensurate value was transferred to Merck in exchange for the reimbursement received.

The Company recognized revenue from the up-front license fee, additional license fees and research and development fees over the economic life of the technology licensed to Merck, which was 16 years.

In September 2008, following a strategic review of Merck s business and product development portfolio, Merck gave notice to SurModics of its intent to terminate the collaborative research and license agreement as well as the supply agreement entered into in June 2007. The termination was effective December 2008. The Company recognized all remaining deferred revenue related to the Merck agreement, totaling $34.8 million, as revenue in fiscal 2009. The Company also recognized a $9 million milestone payment from Merck associated with the termination of the triamcinolone acetonide development program in fiscal 2009. As of September 30, 2009, there were no deferred revenue amounts from Merck, compared with $34.8 million of license fees and research and development fees in deferred revenue as of September 30, 2008.

Table of Contents

SurModics, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Continued)

Deferred Revenue

Amounts received prior to satisfying the above revenue recognition criteria are recorded as deferred revenue in the accompanying consolidated balance sheets, with deferred revenue to be recognized beyond one year being classified as non-current deferred revenue. As of September 30, 2009 and 2008, the Company had deferred revenue of $1.5 million and $37.6 million, respectively.

Costs related to products and services delivered are recognized in the period revenue is recognized except for services related to the Merck agreement, which were recognized as incurred. Customer advances are accounted for as a liability until all criteria for revenue recognition have been met.

Research and Development Costs

Research and development costs are expensed as incurred. Some research and development costs are related to third party contracts, and the related revenue is recognized as described in Revenue Recognition above. The research and development costs are presented in the consolidated statements of income in two categories; those associated with customer related projects and those associated with other research and development costs.

Costs associated with customer related research and development include specific project direct labor costs and material expenses as well as an allocation of overhead costs based on direct labor dollars.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Ultimate results could differ from those estimates.

New Accounting Pronouncements

In October 2009, the Financial Accounting Standards Board (FASB) issued an update to authoritative accounting guidance to address the accounting for multiple-deliverable arrangements. This accounting update enables vendors to account for products and services (deliverables) separately rather than as a combined unit. This authoritative guidance establishes the accounting and reporting for arrangements under which the vendor will perform multiple revenue-generating activities. The amendments to the authoritative guidance establish a selling price hierarchy for determining the selling price of a deliverable. The selling price used for each deliverable will be based on vendor-specific objective evidence if available, third-party evidence if vendor-specific objective evidence is not available, or estimated selling price if neither vendor-specific objective evidence nor third-party evidence is available. The authoritative guidance also expands the disclosures related to multiple-deliverable revenue arrangements and in the year of adoption requires additional disclosures following previous authoritative guidance. The authoritative guidance is effective for the Company beginning in fiscal 2011 with early adoption permitted. The Company expects to early adopt this authoritative guidance in the first quarter of fiscal 2010 and is currently evaluating the impact on the consolidated financial statements.

In June 2009, the FASB issued authoritative guidance to eliminate the historical GAAP hierarchy and establish only two levels of GAAP, authoritative and nonauthoritative. When launched on July 1, 2009, the FASB Accounting Standards Codification (ASC) became the single source of authoritative, nongovernmental GAAP, except for rules and interpretive releases of the Securities and Exchange Commission (SEC), which are sources of authoritative GAAP for SEC registrants. All other nongrandfathered, non-SEC accounting literature not included in the ASC became nonauthoritative. The subsequent issuances of new standards will be in the form of Accounting Standards Updates that will be included in the ASC. This authoritative guidance was effective for financial statements for interim or annual reporting periods ended after September 15, 2009. The Company adopted the new codification in

Table of Contents

SurModics, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Continued)

the fourth quarter of fiscal 2009. As the codification was not intended to change or alter existing GAAP, it did not have any impact on the Company s consolidated financial statements.

In April 2008, the FASB issued authoritative accounting guidance which amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of intangible assets under goodwill and other intangible asset accounting. The authoritative guidance is intended to improve the consistency between the useful life of a recognized intangible asset under goodwill and intangible asset accounting and the period of the expected cash flows used to measure the fair value of the asset under business combination accounting and other GAAP. The authoritative guidance is effective for the Company in fiscal 2010, with early adoption prohibited. The Company does not expect the adoption of the authoritative guidance to have a material impact on its consolidated financial statements.

In December 2007, the FASB issued authoritative accounting guidance which establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in an acquiree, including the recognition and measurement of goodwill acquired in a business combination. The authoritative guidance is effective for the Company in fiscal 2010 and once adopted will impact recognition and measurement of future business combinations.

In September 2006, the FASB issued authoritative accounting guidance associated with fair value measurements. This guidance defines fair value, establishes a consistent framework for measuring fair value, gives guidance regarding methods used for measuring fair value and expands disclosures about fair value measurements. These provisions were implemented in fiscal 2009. See Note 3 for additional information regarding fair value measurements. However, in February 2008, the FASB issued guidance which delayed the effective date from fiscal 2009 to fiscal 2010 for all nonfinancial assets and liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). The Company is currently evaluating the potential impact of the authoritative guidance for which the effective date was delayed until fiscal 2010 on its consolidated financial statements.

No other new accounting pronouncement issued or effective has had, or is expected to have, a material impact on the Company s consolidated financial statements.

3. Fair Value Measurements

Effective October 1, 2008, the Company adopted new accounting guidance on fair value measurements. The new guidance defines fair value, establishes a framework for measuring fair value under GAAP, and expands disclosures about fair value measurements. The guidance is applicable for all financial assets and liabilities and for all nonfinancial assets and liabilities recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). Fair value is defined as the exchange price that would be received from selling an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants at the measurement date. When determining the fair value measurements for assets and liabilities required or permitted to be recorded at fair value, the Company considers the principal or most advantageous market in which it would transact and also considers assumptions that market participants would use when pricing the asset or liability, such as inherent risk, transfer restrictions and risk of nonperformance.

Fair Value Hierarchy

New accounting guidance on fair value measurements requires that assets and liabilities carried at fair value be classified and disclosed in one of the following three categories:

Level 1 Quoted (unadjusted) prices in active markets for identical assets or liabilities.

Table of Contents

SurModics, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Continued)

The Company s Level 1 asset consists of its investment in OctoPlus (see Note 2 for further information). The fair market value of this investment is based on the quoted price of OctoPlus shares as traded on the Amsterdam Stock Exchange.

Level 2 Observable inputs other than quoted prices included in Level 1, such as quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the asset or liability.

The Company s Level 2 assets consist of money market funds, U.S. Treasury securities, corporate bonds, municipal bonds, U.S. agency securities, agency and municipal securities and certain asset-backed securities and mortgage-backed securities. Fair market values for these assets are based on quoted vendor prices and broker pricing where all significant inputs are observable.

Level 3 Unobservable inputs to the valuation methodology that are supported by little or no market activity and that are significant to the measurement of the fair value of the assets or liabilities. Level 3 assets and liabilities include those whose fair value measurements are determined using pricing models, discounted cash flow methodologies or similar valuation techniques, as well as significant management judgment or estimation.

The Company s Level 3 assets include a U.S. government agency security and certain asset-backed and mortgage-backed securities. The fair market values of these investments were determined by broker pricing where not all significant inputs were observable.

In valuing assets and liabilities, the Company is required to maximize the use of quoted market prices and minimize the use of unobservable inputs.

We did not significantly change our valuation techniques from prior periods.

Assets and Liabilities Measured at Fair Value on a Recurring Basis

In instances where the inputs used to measure fair value fall into different levels of the fair value hierarchy, the fair value measurement has been determined based on the lowest level input that is significant to the fair value measurement in its entirety. The Company s assessment of the significance of a particular item to the fair value measurement in its entirety requires judgment, including the consideration of inputs specific to the asset or liability. The following table presents information about the Company s financial assets and liabilities measured at fair value on a recurring basis as of September 30, 2009 *(in thousands)*:

	Quoted Prices in Active Markets for Identical Instruments	**Significant Other Observable Inputs**	**Significant Unobservable Inputs**	**Total Fair Value as of September 30,**

	(Level 1)	(Level 2)	(Level 3)	2009
Assets:				
Cash equivalents	$	$ 9,108	$	$ 9,108
Short-term investments		6,911		6,911
Long-term investments		21,867	1,203	23,070
Other assets	3,700			3,700
Total assets measured at fair value	$ 3,700	$ 37,886	$ 1,203	$ 42,789

Short-term and long-term investments disclosed in the consolidated balance sheets include held-to-maturity investments totaling $6.3 million as of September 30, 2009 and 2008. Held-to-maturity investments are carried at an amortized cost.

Table of Contents

SurModics, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Continued)

Changes in Level 3 Instruments Measured at Fair Value on a Recurring Basis

The following table is a reconciliation of financial assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) *(in thousands)*:

	2009
Balance, beginning of year	$ 264
Total realized and unrealized gains included in other comprehensive income	25
Purchases, sales and maturities, net	339
Transfer in (out) of Level 3	575
Balance, end of year	$ 1,203

As of September 30, 2009, marketable securities measured at fair value using Level 3 inputs was comprised of $36,000 of a U.S. government agency security, $73,000 of a mortgage-backed security and $1,094,000 of asset-backed securities within the Company s available-for-sale investment portfolio. These securities were measured using observable market data and Level 3 inputs as a result of the lack of market activity and liquidity. The fair value of these securities was based on the Company s assessment of the underlying collateral and the creditworthiness of the issuer of the securities.

Assets and Liabilities Measured at Fair Value on a Non-Recurring Basis

The Company s investments in non-marketable securities of private companies are accounted for using the cost or equity method. These investments as well as held-to-maturity securities are measured at fair value on a non-recurring basis when they are deemed to be other-than-temporarily impaired. In determining whether a decline in value of non-marketable equity investments in private companies has occurred and is other-than-temporary, an assessment is made by considering available evidence, including the general market conditions in the investee s industry, the investee s product development status and subsequent rounds of financing and the related valuation and/or the Company s participation in such financings. The Company also assesses the investee s ability to meet business milestones and the financial condition and near-term prospects of the individual investee, including the rate at which the investee is using its cash and the investee s potential need for additional funding at a possibly lower valuation. The valuation methodology for determining the decline in value of non-marketable equity securities is based on inputs that require management judgment and are Level 3 inputs.

4. Acquisitions

PR Pharmaceuticals, Inc. On November 4, 2008, the Company s SurModics Pharmaceuticals, Inc. (formerly known as Brookwood Pharmaceuticals, Inc.) subsidiary entered into an asset purchase agreement with PR Pharmaceuticals, Inc. (PR Pharma), whereby it acquired certain contracts and assets of PR Pharma for $5.6 million consisting of $2.9 million in cash on the closing date, additional consideration of $2.4 million upon successful achievement of specified milestones and $0.3 million in transaction costs. PR Pharma is eligible to receive up to an additional

$3.6 million in cash upon the successful achievement of milestones for contract signing and invoicing, successful patent issuances and product development. Management believes this acquisition strengthens the Company s portfolio of drug delivery technologies for the pharmaceutical and biotechnology industries. The purchase price was allocated as follows as of November 4, 2008 *(in thousands)*:

Core technology	$ 1,400
Customer relationships	900
In-process research and development	3,200
Trade names	20
Non-compete agreements	50
Total purchase price	$ 5,570

Table of Contents

SurModics, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Continued)

The acquired developed technology is being amortized on a straight-line basis over 18 years, customer relationships are being amortized over 9 years, and non-compete agreements are being amortized over 2 years. The trade names have a life of less than one year and were fully amortized in fiscal 2009. As part of the acquisition, the Company recognized fair value associated with in-process research and development (IPR&D) of $3.2 million. The IPR&D was expensed on the date of acquisition and relates to polymer-based drug delivery systems. The value assigned to IPR&D is related to projects for which the related products have not achieved commercial feasibility and have no future alternative use. The amount of purchase price allocated to IPR&D was based on estimating the future cash flows of each project and discounting the net cash flows back to their present values. The discount rate used was determined at the time of acquisition in accordance with accepted valuation methods. These methodologies include consideration of the risk of the project not achieving commercial feasibility. The research efforts ranged from 5% to 50% complete at the date of acquisition. The Company used the Relief from Royalty valuation method to assess the fair value of the projects with a risk-adjusted discount rate of 25%. The Company determined the method was appropriate based on the nature of the projects and future cash flow streams. The research and development work performed is billed to customers, in most cases, using standard commercial billing rates which include a reasonable markup. Accordingly, the Company has no fixed cost obligations to carry projects forward. There have been no significant changes to the development plans for the acquired incomplete projects. Significant net cash inflows would commence with the commercial launch of customer products that are covered by the intellectual property rights and related agreements acquired from PR Pharma.

SurModics Pharmaceuticals, Inc. On July 31, 2007, the Company entered into a stock purchase agreement with Southern Research Institute (SRI) whereby it acquired 100% of the capital stock of SurModics Pharmaceuticals, Inc. (formerly Brookwood Pharmaceuticals, Inc.) (SurModics Pharmaceuticals) held by SRI for $42.3 million consisting of $40 million in cash on the closing date and $2.3 million in transaction costs. SRI could receive up to an additional $22 million in cash upon the successful achievement of specified milestones. In fiscal 2009, a milestone was achieved and $3 million of additional purchase price was recorded as an increase to goodwill. In fiscal 2008, a milestone was achieved and $2 million of additional purchase price was recorded as an increase to goodwill. SurModics Pharmaceuticals is a drug delivery company based in Birmingham, Alabama that provides proprietary polymer-based technologies to companies developing pharmaceutical products. SurModics Pharmaceuticals, a wholly owned subsidiary of SurModics, operates as a separate business unit. Management believes this acquisition strengthens SurModics portfolio of drug delivery technologies for the pharmaceutical and biotechnology industries in particular. Operating results of SurModics Pharmaceuticals have been included in the Company s consolidated financial statements since August 1, 2007.

As part of the acquisition, the Company recognized IPR&D of $15.6 million. The IPR&D was expensed on the date of acquisition and relates to polymer-based drug delivery systems. The value assigned to IPR&D is related to projects for which the related products have not received commercial feasibility and have no future alternative use. The amount of purchase price allocated to IPR&D was based on estimating the future cash flows of each project and discounting the net cash flows back to their present values.

BioFX Laboratories, Inc. On August 13, 2007, the Company acquired 100% of the capital stock of BioFX Laboratories, Inc. (BioFX), a provider of substrates to the *in vitro* diagnostics industry, for $11.6 million, $11.3 million of which was in cash paid to the sellers and $300,000 in transaction costs. The Company is also required to pay up to an additional $11.4 million in cash upon the successful achievement of specified revenue targets. In fiscal 2008, a milestone was achieved and $1.1 million of additional purchase price was recorded as an increase to goodwill.

The sellers are still eligible to receive up to $7.6 million in additional consideration. BioFX is a wholly owned subsidiary of SurModics, and operates within the In Vitro Technologies business unit. Management believes the acquisition enhances the Company s technological position in the *in vitro* diagnostics market. Operating results of BioFX have been included in the Company s consolidated financial statements since August 14, 2007.

Table of Contents

SurModics, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Continued)

The following *pro forma* consolidated condensed financial results of operations for the 2007 fiscal year, are presented as if the SurModics Pharmaceuticals and BioFX acquisitions had been completed at the beginning of fiscal 2007 (*in thousands*).

Pro forma revenue	$ 89,708
Pro forma income from operations	$ 28,034
Pro forma net income	$ 17,735
Pro forma basic earnings per share	$ 0.98
Pro forma diluted earnings per shares	$ 0.98

5. Revolving Credit Facility

In February 2009, the Company entered into a two-year $25.0 million unsecured revolving credit facility. Borrowings under the credit facility, if any, will bear interest at a benchmark rate plus an applicable margin based upon the Company s funded debt to EBITDA ratio. In connection with the credit facility, the Company is required to maintain certain financial and nonfinancial covenants. As of September 30, 2009, the Company had no debt outstanding under this credit facility and was in compliance with all covenants.

6. Stockholders Equity

The Company has stock-based compensation plans under which it grants stock options and restricted stock awards. Accounting guidance requires all share-based payments to be recognized as an operating expense, based on their fair values, over the requisite service period. The Company s stock-based compensation expenses for the years ended September 30 were allocated as follows *(in thousands):*

	2009	2008	2007
Product	$ 87	$ 161	$ 96
Research and development	3,621	3,793	5,188
Selling, general and administrative	3,145	5,698	5,028
Total	$ 6,853	$ 9,652	$ 10,312

As of September 30, 2009, approximately $8.7 million of total unrecognized compensation costs related to non-vested awards is expected to be recognized over a weighted average period of approximately 2.6 years. The unrecognized compensation costs include $2.8 million associated with performance share awards that are currently not anticipated to be fully expensed because the performance conditions are not expected to be met.

Stock Option Plans

The Company uses the Black-Scholes option pricing model to determine the weighted average grant date fair value of stock options granted. The weighted average per share fair value of stock options granted during fiscal 2009, 2008 and 2007 was $8.95, $14.85, and $17.42, respectively. The assumptions used as inputs in the model for the years ended September 30 were as follows:

	2009	**2008**	**2007**
Risk-free interest rates	2.30%	2.80%	4.50%
Expected life	4.8 years	4.6 years	5.4 years
Expected volatility	40%	37%	45%
Dividend yield	0%	0%	0%

The risk-free interest rate assumption was based on the U.S. Treasury s rates for U.S. Treasury zero-coupon bonds with maturities similar to those of the expected term of the award. The expected life of options granted is

Table of Contents

SurModics, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Continued)

determined based on the Company s experience. Expected volatility is based on the Company s stock price movement. Based on management s judgment, dividend rates are expected to be zero for the expected life of the options. The Company also estimates forfeitures of options granted, which are based on historical experience.

The Company s Incentive Stock Options (ISO) are granted at a price of at least 100% of the fair market value of the Common Stock on the date of the grant or 110% with respect to optionees who own more than 10% of the total combined voting power of all classes of stock. ISOs expire in seven years or upon termination of employment and are exercisable at a rate of 20% per year commencing one year after the date of grant. Nonqualified stock options are granted at fair market value on the date of grant. Nonqualified options expire in 7 to 10 years or upon termination of employment or service as a Board member. Nonqualified options granted prior to May 2008 generally become exercisable with respect to 20% of the shares on each of the first five anniversaries following the grant date such that the entire option is fully vested five years after date of grant, and nonqualified options granted subsequent to May 2008 generally become exercisable with respect to 25% on each of the first four anniversaries following the grant date such that the entire option is fully vested four years after the grant date. The Company has authorized 2,400,000 shares for grant under the 2003 Equity Incentive Plan of which 51,000 remain available for future awards. In September 2009, the Company granted 29,066 performance share awards to officers under the 2003 Equity Incentive Plan and 229,552 stock options to officers under the 2009 Equity Incentive Plan. The 2009 Equity Incentive Plan is subject to shareholder approval at the February 2010 Annual Meeting of Shareholders. As of September 30, 2009, the aggregate intrinsic value of the option shares outstanding and option shares exercisable was $0.7 million and $0.6 million, respectively. At September 30, 2009, the average remaining contractual life of options outstanding and options exercisable was 4.3 and 3.2 years, respectively. The intrinsic value of options exercised during fiscal 2009, 2008 and 2007 was $235,000, $2.9 million and $4.4 million, respectively.

	Number of Shares	Weighted Average Exercise Price
Outstanding at September 30, 2006	1,510,780	$ 29.69
Granted	166,400	37.85
Exercised	(253,060)	25.82
Forfeited	(22,700)	33.71
Outstanding at September 30, 2007	1,401,420	31.29
Granted	392,917	41.86
Exercised	(163,297)	27.45
Forfeited	(108,250)	33.59
Outstanding at September 30, 2008	1,522,790	34.26
Granted	268,700	24.06
Exercised	(17,600)	8.82
Forfeited	(104,320)	35.33
Outstanding at September 30, 2009	1,669,570	$ 32.82

Exercisable at September 30, 2009	902,589	$	32.07

Restricted Stock Awards

The Company has entered into restricted stock agreements with certain key employees, covering the issuance of Common Stock (Restricted Stock). Under accounting guidance these shares are considered to be non-vested shares. The Restricted Stock will be released to the key employees if they are employed by the Company at the end of the vesting period. Compensation has been recognized for the estimated fair value of the 100,895 common shares awarded and is being charged to income over the vesting term. The stock-based compensation table includes the

Table of Contents

SurModics, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Continued)

Restricted Stock expenses recognized related to these awards, which totaled $1.8 million, $2.2 million and $1.2 million during fiscal 2009, 2008 and 2007, respectively.

	Number of Shares	Weighted Average Grant Price
Balance at September 30, 2006	153,000	$ 32.14
Granted	83,027	42.07
Vested	(24,836)	37.87
Forfeited	(5,000)	34.56
Balance at September 30, 2007	206,191	35.89
Granted	12,383	42.18
Vested	(40,336)	38.76
Forfeited	(21,109)	32.83
Balance at September 30, 2008	157,129	36.06
Granted	7,700	23.93
Vested	(59,047)	34.44
Forfeited	(4,887)	41.91
Balance at September 30, 2009	100,895	$ 35.80

Performance Share Awards

The Company has entered into Performance Share agreements with certain key employees, covering the issuance of Common Stock (Performance Shares). The Performance Shares vest upon the achievement of all or a portion of certain performance objectives, which must be achieved during the performance period. Compensation is recognized in each period based on management s best estimate of the achievement level of the grants specified performance objectives and the resulting vesting amounts. In fiscal 2009 the Company reversed expenses previously recognized of $207,000 relating to three-year Performance Shares awarded in May 2008 and one-year Performance Shares awarded in September 2008, which was partially offset by an expense of $164,000 related to the estimated value of Performance Shares awarded to individuals based on likely achievement of specific performance objectives. The Company recorded compensation expense of $1.9 million in fiscal 2008 related to 30,552 one-year Performance Shares and 30,552 three-year Performance Shares awarded in May 2008 and 7,600 Performance Shares that vested for certain individuals that met various specific performance objectives. The Company recorded compensation expense of $4.8 million in fiscal 2007 related to 132,375 Performance Shares. The stock-based compensation table includes the Performance Shares expenses.

1999 Employee Stock Purchase Plan

Under the 1999 Employee Stock Purchase Plan (Stock Purchase Plan), the Company is authorized to issue up to 200,000 shares of Common Stock. All full-time and part-time employees can choose to have up to 10% of their annual compensation withheld to purchase the Company s Common Stock at purchase prices defined within the provisions of the Stock Purchase Plan. As of September 30, 2009 and 2008, there were $276,000 and $355,000 of employee contributions, respectively, included in accrued liabilities in the accompanying consolidated balance sheets. Stock compensation expense recognized related to the Stock Purchase Plan totaled $265,000, $199,000 and $156,000 during fiscal 2009, 2008 and 2007, respectively. The stock-based compensation table includes the Stock Purchase Plan expenses.

Table of Contents

SurModics, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Continued)

7. Restructuring Charges

In November 2008, the Company announced a functional reorganization to allow the Company to better serve its customers and improve its operating performance. As a result of the reorganization, the Company eliminated 15 positions, or approximately five percent of the Company s workforce. These employee terminations occurred across various functions and the reorganization plan was completed by the end of the first quarter of fiscal 2009. The Company also vacated a leased facility in Eden Prairie, Minnesota, consolidating into its owned office and research facility also in Eden Prairie, as part of the reorganization plan.

The Company recorded total restructuring charges of approximately $1.8 million in connection with the reorganization. These pre-tax charges consisted of $0.5 million of severance pay and benefits expenses and $1.3 million of facility-related costs which were recorded in fiscal 2009. The restructuring is expected to result in approximately $2.0 million in annualized cost savings.

The following table summarizes the restructuring accrual activity for fiscal 2009 *(in thousands)*:

	Employee Severance and Benefits	Facility-Related Costs	Total
Balance at September 30, 2008	$	$	$
Accruals during the year	513	1,250	1,763
Cash Payments	(513)	(295)	(808)
Balance at September 30, 2009	$	$ 955	$ 955

The charges above have been shown separately as restructuring charges on the consolidated statements of income. The remaining accrual as of September 30, 2009 relates to facility-related costs that are expected to be paid within the next 15 months. As such, the current portion totaling $0.9 million is recorded as a current liability within other accrued liabilities and the long-term portion totaling $0.1 million is recorded as a long-term liability within other long-term liabilities on the consolidated balance sheets.

8. Income Taxes

The Company accounts for income taxes under the asset and liability method prescribed in accounting guidance. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. A valuation allowance is provided when it is more likely than not that some portion or all of a deferred tax asset will not be realized. The ultimate realization of deferred tax assets depends on the generation of future taxable income during the period in which related temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income and tax planning strategies in this assessment. Deferred tax

assets and liabilities are measured using the enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date of such change.

Table of Contents

SurModics, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Continued)

Income taxes in the accompanying consolidated statements of income for the years ended September 30 are as follows *(in thousands):*

	2009	2008	2007
Current provision:			
Federal	$ 12,257	$ 13,534	$ 19,069
State and foreign	1,362	1,516	1,732
Total current provision	13,619	15,050	20,801
Deferred provision (benefit):			
Federal	7,483	(2,832)	(8,573)
State	872	(65)	(907)
Total deferred provision (benefit)	8,355	(2,897)	(9,480)
Total provision	$ 21,974	$ 12,153	$ 11,321

The reconciliation of the difference between amounts calculated at the statutory federal tax rate for the fiscal years ended September 30 and the Company s effective tax rate is as follows *(in thousands):*

	2009	2008	2007
Amount at statutory federal income tax rate	$ 20,833	$ 9,387	$ 5,067
Change because of the following items:			
State taxes	1,206	715	736
Other	(481)	223	(241)
Stock-based compensation	416	239	262
Valuation allowance		1,589	
Write-off of in-process research and development			5,497
Income tax provision	$ 21,974	$ 12,153	$ 11,321

The components of deferred income taxes consisted of the following as of September 30 and result from differences in the recognition of transactions for income tax and financial reporting purposes *(in thousands):*

	2009	2008
Depreciable assets	$ (2,951)	$ (4,325)

Deferred revenue	261	11,005
Accruals and reserves	526	523
Stock options	5,258	4,397
Impaired asset	3,264	3,318
Unrealized (losses) gains on investments	(962)	66
Other	844	571
Valuation allowance	(3,339)	(3,398)
Total deferred tax asset	2,901	12,157
Less current deferred tax asset	(353)	(1,058)
Noncurrent deferred tax asset	$ 2,548	$ 11,099

In fiscal 2008, the Company recorded a $1.6 million valuation allowance against the potential capital loss created by the impairment of the Company s investment in OctoPlus (see Note 2 for further information). The valuation allowance was recorded because the Company does not currently foresee future capital gains within the

Table of Contents

SurModics, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Continued)

allowable carry forward and carry back periods to offset this capital loss when it was recognized. As such, no tax benefit has been recorded in the consolidated statements of operations.

On October 1, 2007, the Company adopted new accounting guidance on the accounting for uncertainty in income taxes. The adoption of the new guidance resulted in an increase to retained earnings as of October 1, 2007, of $80,000, which was reflected as a cumulative effect of a change in accounting principle, with a corresponding decrease to the net liability for unrecognized tax expenses. Unrecognized tax benefits are the differences between a tax position taken, or expected to be taken in a tax return, and the benefit recognized for accounting purposes pursuant to accounting guidance. A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows *(in thousands):*

	2009	2008
Beginning of fiscal year	$ 1,540	$ 1,120
Increases in tax positions for prior years	273	194
Increases in tax positions for current year	260	237
Settlements with taxing authorities		
Lapse of the statute of limitations	(31)	(11)
End of fiscal year	$ 2,042	$ 1,540

The total amount of unrecognized tax benefits including interest and penalties that, if recognized, would affect the effective tax rate as of September 30, 2009 and 2008, respectively, are $2.0 million and $1.3 million. Currently, the Company does not expect the liability for unrecognized tax benefits to change significantly in the next twelve months with the above balances classified on the consolidated balance sheets as a part of long-term liabilities. Interest and penalties related to unrecognized tax benefits are recorded in income tax expense. As of September 30, 2009 and 2008, a gross balance of $605,000 and $397,000, respectively, has been accrued related to the unrecognized tax benefits balance for interest and penalties.

The Company files tax returns, including returns for its subsidiaries, in the United States (U.S.) federal jurisdiction and in various state jurisdictions. Uncertain tax positions are related to tax years that remain subject to examination. U.S. tax returns for fiscal years ended September 30, 2006, 2007, and 2008 remain subject to examination by federal tax authorities. Tax returns for state and local jurisdictions for fiscal years ended September 30, 2003 through 2008 remain subject to examination by state and local tax authorities.

9. Commitments and Contingencies

Litigation. From time to time, the Company has been, and may become, involved in various legal actions involving its operations, products and technologies, including intellectual property and employment disputes. The outcomes of these legal actions are not within the Company s complete control and may not be known for prolonged periods of time. In some actions, the claimants seek damages, as well as other relief, including injunctions barring the sale of products that are the subject of the lawsuit, which, if granted, could require significant expenditures or result in lost

revenues. The Company records a liability in the consolidated financial statements for these actions when a loss is known or considered probable and the amount can be reasonably estimated. If the reasonable estimate of a known or probable loss is a range, and no amount within the range is a better estimate, the minimum amount of the range is accrued. If a loss is possible but not known or probable, and can be reasonably estimated, the estimated loss or range of loss is disclosed. In most cases, significant judgment is required to estimate the amount and timing of a loss to be recorded.

InnoRx, Inc. In January 2005, the Company entered into a merger agreement whereby SurModics acquired all of the assets of InnoRx, Inc. (InnoRx), an early stage company developing drug delivery devices and therapies for the ophthalmology market. SurModics will be required to issue up to approximately 480,059 additional shares of its common stock to the stockholders of InnoRx upon the successful completion of the remaining development and commercial milestones involving InnoRx technology acquired in the transaction.

Table of Contents

SurModics, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Continued)

Alabama Jobs Commitment. In April 2008, the Company purchased a 286,000 square foot facility to support Current Good Manufacturing Practices manufacturing needs of customers and the anticipated growth of the SurModics Pharmaceuticals business. At the same time, SurModics Pharmaceuticals entered into an agreement with various governmental authorities to obtain financial incentives associated with creation of jobs in Alabama. Some of the governmental agencies have recapture rights in connection with the financial incentives if the number of full-time employees are not hired by June 2012, with an extension to June 2013 if circumstances or events occur that are beyond the control of SurModics Pharmaceuticals or could not have been reasonably anticipated by SurModics Pharmaceuticals. As of September 30, 2009, SurModics Pharmaceuticals has received $1.7 million in connection with the agreement, and the Company has recorded the payment in other long-term liabilities.

SRI Litigation. On July 31, 2009, the Company s SurModics Pharmaceuticals business unit was named as a defendant in litigation pending in the circuit court of Jefferson County, Alabama, between SRI and two of SRI s former employees (the Plaintiffs). In the litigation, the Plaintiffs allege that they contributed to or invented certain intellectual property while they were employed at SRI, and pursuant to SRI s policies then in effect, they are entitled to, among other things, a portion of the purchase price consideration paid by the Company to SRI as part the Company s acquisition of Brookwood Pharmaceuticals, Inc., pursuant to a stock purchase agreement made effective on July 31, 2007 (the Stock Purchase Agreement). A trial has not yet been scheduled. Pursuant to the Stock Purchase Agreement, the Company has certain rights of indemnification against losses (including without limitation, damages, expenses and costs) incurred as a result of the litigation. The Company s consolidated financial statements do not include any expenses or liabilities related to the above litigation as the probability of the outcome is currently not determinable and any potential loss is not estimable. The Company believes that it has meritorious defenses to the Plaintiffs claims and will vigorously defend and prosecute this matter.

Operating Leases. The Company leases certain facilities under noncancelable operating lease agreements. Rent expense for the years ended September 30, 2009, 2008 and 2007 was $994,000, $773,000 and $140,000, respectively. Annual commitments pursuant to operating lease agreements are as follows:

Year Ended September 30,	
2010	$ 422,000
2011	177,000
2012	126,000
2013	131,000
2014	33,000
Thereafter	
Total minimum lease payments	$ 889,000

10. Defined Contribution Plans

The Company has a 401(k) retirement and savings plan for the benefit of qualifying employees. The Company has matched 50% of each dollar of the first 6% of the tax deferral elected by each employee. Effective April 1, 2009, the

Company changed its matching contribution to a discretionary approach and the Company ceased matching contributions. Company contributions totaling $243,000, $539,000 and $356,000 have been expensed for the years ended September 30, 2009, 2008 and 2007, respectively. The expense increase in fiscal 2008 principally reflects the addition of employees eligible for this benefit as a result of the SurModics Pharmaceuticals acquisition.

11. Operating Segments

Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker, or decision making group, in deciding

Table of Contents

SurModics, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Continued)

how to allocate resources and in assessing performance. In November 2008, the Company announced it changed its operational structure so that the Company is now organized into four clinically and market focused business units: Cardiovascular, Ophthalmology, SurModics Pharmaceuticals, and In Vitro Technologies. The Company believes that this structure will improve the visibility, marketing and adoption of the Company s broad array of technologies within specific markets and help its customers in the medical device, pharmaceutical and life science industries solve unmet clinical needs. In addition, a new centralized research and development function has been formed to serve the needs of the Company s clinically and market focused business units, other than the SurModics Pharmaceuticals business unit, which continues to maintain certain R&D operations.

The Company manages its business on the basis of the markets noted in the table below, which are comprised of the Company s four business units. Therapeutic contains: (1) the Cardiovascular business unit, which provides drug delivery and surface modification technologies to customers in the cardiovascular market; (2) the Ophthalmology business unit, which is currently focused on the advancement of treatments for eye diseases, such as age-related macular degeneration (AMD) and diabetic macular edema (DME), two of the leading causes of blindness; and (3) the SurModics Pharmaceuticals business unit, which provides proprietary polymer-based drug delivery technologies to companies developing improved pharmaceutical products in cardiovascular, ophthalmology and other clinical markets. Revenue results in Therapeutic are presented below by the clinical market areas in which the Company s customers participate (Cardiovascular, Ophthalmology and Other Markets). Diagnostic contains the In Vitro Technologies business unit, which includes the Company s microarray slide technologies, stabilization products, antigens and substrates for immunoassay diagnostics tests, and its *in vitro* diagnostic format technology.

For fiscal years ended September 30, 2009, 2008 and 2007, the Company s results are aggregated into one reportable segment, as each business unit has similar economic characteristics, technology, manufacturing processes, customers, regulatory environments, and shared infrastructures. The Company manages its expenses on a company-wide basis, as many costs and activities are shared among the business units. The focus of the business units is providing solutions to customers and maximizing financial performance over the long term.

The table below presents revenue from the markets, for the years ended September 30 as follows (*in thousands*):

	2009	2008	2007
Therapeutic			
Cardiovascular	$ 39,841	$ 47,675	$ 46,487
Ophthalmology	52,102	10,252	2,453
Other Markets	13,114	17,875	4,041
Total Therapeutic	105,057	75,802	52,981
Diagnostic	16,477	21,249	20,183
Total revenue	$ 121,534	$ 97,051	$ 73,164

Major Customers

Revenue from customers that equaled or exceeded 10% of total revenue was as follows for the years ended September 30:

	2009	2008	2007
Merck & Company	37%	<10%	**
Johnson & Johnson	11%	20%	33%
Abbott Laboratories	<10%	10%	16%

** - less than one percent

Table of Contents

SurModics, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Continued)

The revenue from the customers listed is derived from all three primary sources: royalties and license fees, product sales, and research and development fees.

Geographic Revenue

Geographic revenue was as follows for the years ended September 30:

	2009	2008	2007
Domestic	84%	79%	81%
Foreign	16%	21%	19%

12. Quarterly Financial Data (Unaudited)

The following is a summary of the unaudited quarterly results for the years ended September 30, 2009, 2008 and 2007 *(in thousands, except per share data).*

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Fiscal 2009				
Revenue	$ 63,216	$ 20,925	$ 18,186	$ 19,207
Income from operations	42,667	6,200	4,661	3,973
Net income	27,085	4,216	3,539	2,710
Net income per share(1):				
Basic	1.53	0.24	0.20	0.16
Diluted	1.53	0.24	0.20	0.16
Fiscal 2008				
Revenue	$ 23,829	$ 25,707	$ 24,276	$ 23,239
Income from operations	7,571	7,181	7,184	5,325
Net income (loss)	5,646	5,107	4,800	(814)
Net income (loss) per share(1):				
Basic	0.31	0.28	0.27	(0.05)
Diluted	0.31	0.28	0.26	(0.05)
Fiscal 2007				
Revenue	$ 16,740	$ 17,362	$ 17,762	$ 21,300
Income (loss) from operations	8,109	8,085	7,518	(13,813)
Net income (loss)	5,992	5,675	5,587	(13,907)
Net income (loss) per share(1):				
Basic	0.32	0.31	0.31	(0.78)
Diluted	0.32	0.31	0.31	(0.78)

(1) The sum of the quarterly earnings per share may not equal the annual earnings per share because of changes in the average shares outstanding.

Table of Contents

SurModics, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Continued)

In the first quarter of fiscal 2009, the Company recorded income that had previously been deferred of $34.8 million associated with the Merck contract termination, a $9 million milestone payment from Merck associated with the termination of the triamcinolone acetonide development program, a $3.2 million charge for in-process research and development acquired in connection with the purchase of certain contracts and assets of PR Pharma, as well as a $1.8 million restructuring charge associated with a functional reorganization.

In the fourth quarter of fiscal 2009, the Company recorded $1.3 million in royalty income in connection with the settlement of previously disclosed litigation involving Abbott Laboratories and Church & Dwight Co, Inc.

In the fourth quarter of fiscal 2008, the Company recorded a $4.3 million non-cash impairment loss on its investment in OctoPlus.

In the fourth quarter of fiscal 2007, the Company recorded a $15.6 million charge for in-process research and development acquired in connection with the purchase of SurModics Pharmaceuticals, Inc.