

SURMODICS INC  
Form 10-Q  
August 11, 2008

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D. C. 20549  
FORM 10-Q**

**(Mark One)**

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the quarterly period ended June 30, 2008**

**or**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission File Number: 0-23837**

**SurModics, Inc.**

(Exact name of registrant as specified in its Charter)

MINNESOTA

(State of incorporation)

41-1356149

(I.R.S. Employer Identification No.)

9924 West 74th Street

Eden Prairie, Minnesota 55344

(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (952) 829-2700

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Exchange Act Rule 12b-2).

Yes  No

The number of shares of the registrant's common stock, \$.05 par value per share, outstanding as of July 31, 2008 was 18,073,323.

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## Item 1. Financial Statements

**SurModics, Inc. and Subsidiaries**  
 Condensed Consolidated Balance Sheets  
 (unaudited)

<i>(In thousands, except share and per share data)</i>	<b>June 30, 2008</b>	<b>September 30, 2007</b>
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents	\$ 13,658	\$ 13,812
Short-term investments	10,612	12,496
Accounts receivable, net of allowance for doubtful accounts of \$40 as of June 30, 2008 and September 30, 2007	24,736	16,138
Inventories	2,973	2,497
Deferred tax asset	1,127	1,116
Income taxes receivable	509	
Prepays and other	1,290	1,836
 Total current assets	 54,905	 47,895
Property and equipment, net	34,461	19,738
Restricted cash	1,640	
Long-term investments	45,748	43,917
Deferred tax asset	12,820	5,908
Intangible assets, net	16,402	18,399
Goodwill	18,053	15,686
Other assets	11,224	19,788
 Total assets	 \$ 195,253	 \$ 171,331
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities		
Accounts payable	\$ 2,330	\$ 2,541
Accrued liabilities	4,650	4,187
Accrued income taxes payable		6,227
Deferred revenue	6,025	5,586
Other current liabilities	278	1,311
 Total current liabilities	 13,283	 19,852
Deferred revenue, less current portion	33,251	20,305
Other long-term liabilities	3,281	252
 Total liabilities	 49,815	 40,409
Stockholders Equity		
Series A preferred stock \$ .05 par value, 450,000 shares authorized; no shares issued and outstanding		

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Common stock \$.05 par value, 45,000,000 shares authorized; 18,197,179 and 18,164,980 shares issued and outstanding	910	909
Additional paid-in capital	78,853	76,670
Accumulated other comprehensive (loss) income	(1,577)	1,723
Retained earnings	67,252	51,620
Total stockholders equity	145,438	130,922
Total liabilities and stockholders equity	\$ 195,253	\$ 171,331

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

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**SurModics, Inc. and Subsidiaries**  
Condensed Consolidated Statements of Income  
(unaudited)

	Three Months Ended		Nine Months Ended	
	June 30,		June 30,	
<i>(In thousands, except per share data)</i>	2008	2007	2008	2007
Revenue				
Royalties and license fees	\$ 13,587	\$ 13,416	\$ 40,574	\$ 39,664
Product sales	4,447	2,947	14,354	9,054
Research and development	6,242	1,399	18,884	3,147
Total revenue	24,276	17,762	73,812	51,865
Operating costs and expenses				
Product costs	1,773	1,217	5,902	3,396
Research and development	10,511	6,200	30,415	17,124
Selling, general and administrative	4,808	2,827	15,559	7,633
Total operating costs and expenses	17,092	10,244	51,876	28,153
Income from operations	7,184	7,518	21,936	23,712
Other income				
Investment income	677	1,211	2,681	3,731
Other income (loss)	(51)	(10)	849	(29)
Other income	626	1,201	3,530	3,702
Income before income taxes	7,810	8,719	25,466	27,414
Income tax provision	(3,010)	(3,132)	(9,913)	(10,161)
Net income	\$ 4,800	\$ 5,587	\$ 15,553	\$ 17,253
Basic net income per share	\$ 0.27	\$ 0.31	\$ 0.86	\$ 0.95
Diluted net income per share	\$ 0.26	\$ 0.31	\$ 0.85	\$ 0.95
Weighted average shares outstanding				
Basic	18,073	17,815	18,058	18,116
Dilutive effect of outstanding stock options	249	153	315	133
Diluted	18,322	17,968	18,373	18,249

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

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**SurModics, Inc. and Subsidiaries**  
Condensed Consolidated Statements of Cash Flows  
(unaudited)

<i>(In thousands)</i>	Nine Months Ended June 30,	
	2008	2007
<b>Operating Activities:</b>		
Net income	\$ 15,553	\$ 17,253
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	4,501	2,923
(Gain) loss on equity method investments and sales of investments	(807)	29
Amortization of premium (discount) on investments	36	(1,354)
Stock-based compensation	7,181	5,035
Deferred taxes	(4,339)	(106)
Excess tax benefits from exercise of stock options	(936)	
Loss on disposals of property and equipment	65	370
Change in operating assets and liabilities:		
Accounts receivable	(8,598)	4,033
Inventories	(476)	(307)
Accounts payable and accrued liabilities	(369)	(701)
Income taxes	(3,945)	(2,393)
Deferred revenue	13,151	(683)
Prepays and other	1,583	(502)
<b>Net cash provided by operating activities</b>	<b>22,600</b>	<b>23,597</b>
<b>Investing Activities:</b>		
Purchases of property and equipment	(16,849)	(2,018)
Purchases of available-for-sale investments	(13,601)	(131,971)
Sales/maturities of available-for-sale investments	21,459	146,208
Purchases of held-to-maturity investments	(6,485)	
Business acquisitions	(2,996)	
Purchase of licenses and patents	(1,225)	(1,224)
Investment in other strategic assets	(2,513)	(2,147)
Collection of notes receivable	5,870	395
Cash restricted for land purchase	(1,640)	
Other investing activities	(229)	
<b>Net cash (used in) provided by investing activities</b>	<b>(18,209)</b>	<b>9,243</b>
<b>Financing Activities:</b>		
Excess tax benefits from exercise of stock options	936	
Issuance of common stock	2,955	2,399
Repurchase of common stock	(6,717)	(35,030)
Purchase of common stock to fund employee taxes	(1,495)	
Repayment of notes payable	(224)	
<b>Net cash used in financing activities</b>	<b>(4,545)</b>	<b>(32,631)</b>

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Net change in cash and cash equivalents:	(154)	209
Cash and cash equivalents		
Beginning of period	13,812	3,751
End of period	\$ 13,658	\$ 3,960

Supplemental Information:

Cash paid for income taxes	\$ 18,093	\$ 12,606
Noncash transaction acquisition of property, plant, and equipment on account	\$ 469	\$ 330

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



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**SurModics, Inc. and Subsidiaries**  
**Notes to Condensed Consolidated Financial Statements**  
**Period Ended June 30, 2008**  
**(Unaudited)**

**(1) Basis of Presentation**

The accompanying unaudited interim condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America and reflect all adjustments, consisting solely of normal recurring adjustments, needed to fairly present the financial results for the periods presented. These financial statements include some amounts that are based on management's best estimates and judgments. These estimates may be adjusted as more information becomes available, and any adjustment could be significant. The impact of any change in estimates is included in the determination of earnings in the period in which the change in estimate is identified. The results of operations for the three-month and nine-month periods ended June 30, 2008 are not necessarily indicative of the results that may be expected for the entire 2008 fiscal year.

In July 2007, the Company acquired Brookwood Pharmaceuticals, Inc. ( Brookwood ), from Southern Research Institute, for \$40 million in cash at closing and up to an additional \$22 million in cash upon the successful achievement of specified milestones. In the second quarter of fiscal 2008, a milestone was achieved and \$2 million of additional purchase price was recorded as an increase to goodwill with payment of the liability made in the third quarter. Brookwood specializes in proprietary injectable microparticles and implants to provide sustained delivery of drugs being developed by leading pharmaceutical, biotechnology and medical device clients. This acquisition is helping the Company broaden its technology offerings to customers, diversifying the range of markets in which the Company participates, expanding the Company's customer base, and enhancing the pipeline of potential revenue generating opportunities.

In August 2007, the Company acquired BioFX Laboratories, Inc. ( BioFX ), a leading provider of substrates to the *in vitro* diagnostics industry, for \$11.3 million in cash at closing and up to an additional \$11.4 million in cash upon the successful achievement of specified revenue targets. In the first quarter of fiscal 2008, a milestone was achieved and \$1.1 million of additional purchase price was recorded as an increase to goodwill with payment of the liability made in the third quarter. BioFX is a leading manufacturer of substrates, a critical component of diagnostic test kits used to detect and signal that a certain chemical reaction has taken place. The acquisition of BioFX is broadening the Company's product portfolio in the *in vitro* diagnostics market.

The operating results for the Brookwood and BioFX businesses are included in the consolidated results of operations from the dates of acquisition.

In accordance with the rules and regulations of the United States Securities and Exchange Commission, the Company has omitted footnote disclosures that would substantially duplicate the disclosures contained in the audited consolidated financial statements of the Company. These unaudited condensed consolidated financial statements should be read together with the audited consolidated financial statements for the year ended September 30, 2007, and footnotes thereto included in the Company's Form 10-K as filed with the United States Securities and Exchange Commission on December 14, 2007.

**(2) New Accounting Pronouncements**

In September 2006, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Accounting Standards ( SFAS ) No. 157, *Fair Value Measurements* ( SFAS No. 157 ). This statement establishes a framework for measuring fair value and requires enhanced disclosures about fair value measurements. SFAS No. 157 applies to fair value measurements required by existing accounting pronouncements and does not require any new fair value measurements. SFAS No. 157 is effective for the Company in fiscal 2009. FASB Staff Position No. FAS 157-2 provides a deferral of SFAS No. 157 provisions for non-financial assets and liabilities until fiscal 2010. The Company has not determined the impact, if any, the adoption of this statement will have on its consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* ( SFAS No. 159 ). SFAS No. 159 permits entities to choose to measure many financial assets and financial liabilities at fair value. Unrealized gains and losses on items for which the fair value option has been elected will be reported in earnings. SFAS No. 159 is effective for



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the Company in fiscal 2009. The Company is currently evaluating the impact of SFAS No. 159 on its consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141(R), *Business Combinations* ( SFAS No. 141(R) ), 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. SFAS No. 141(R) is effective for the Company in fiscal 2010. Earlier adoption is prohibited and once adopted SFAS No. 141(R) will impact recognition and measurement of future business combinations.

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) 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 components (*in thousands*) :

	<b>June 30, 2008</b>	<b>September 30, 2007</b>
Raw materials	\$ 1,363	\$ 1,241
Finished products	1,610	1,256
Total	\$ 2,973	\$ 2,497

**(4) Restricted Cash**

The Company has entered into an agreement to purchase an undeveloped parcel of land, as described in Note 12. To secure the performance of its obligations under the purchase agreement, the Company delivered a standby letter of credit in the amount of \$1.6 million. This letter of credit is fully collateralized by restricted cash that the Company deposited with the issuing institution.

**(5) Other Assets**

Other assets consist principally of strategic investments. The Company accounts for its strategic investments under the cost method, except for its investments in Paragon Intellectual Properties, LLC ( Paragon ), Paragon's subsidiary, Apollo Therapeutics, LLC, and Brookwood's investment in Aeon Bioscience, Inc. (included in the Other category in the table below), which are accounted for under the equity method. In addition, the investment in OctoPlus is accounted for as an available-for-sale investment, which is reported at fair value with unrealized gains and losses reported as a separate component of stockholders' equity. Other assets consisted of the following (*in thousands*):

	<b>June 30, 2008</b>	<b>September 30, 2007</b>
Investment in OctoPlus	\$ 3,421	\$ 8,762
Long-term portion of note receivable		5,158
Investment in Paragon and subsidiary	5,626	3,632
Investment in ThermopeutiX	1,185	1,185
Investment in Novocell	559	559
Other	433	492
Total other assets	\$ 11,224	\$ 19,788

The Company recognized revenue of \$510,000 and \$210,000 for the three-month periods ended June 30, 2008 and 2007, respectively, and recognized revenue of \$3.0 million and \$335,000 for the nine-month periods ended June 30,

2008 and 2007, respectively, from activity with companies in which it had a strategic investment.

In September 2005, the Company entered into an agreement to sell a contract manufacturing facility and 27 acres of land located in Bloomington, Minnesota. The terms of the sale agreement included a \$100,000 cash down payment and a note receivable of \$6.9 million, which was collateralized by the property. The terms of the note called for monthly installment payments of principal and interest at 6% with the remaining amount due and payable in September 2010. On January 14, 2008, the outstanding balance (including principal and accrued interest) of \$5.8 million was repaid to the Company in its entirety.

**Table of Contents****(6) Intangible Assets**

Intangible assets consist principally of acquired patents and technology, customer relationships, licenses, and trademarks. The Company recorded amortization expense related to intangible assets of \$742,000, and \$443,000 for the three months ended June 30, 2008 and 2007, respectively. The Company recorded amortization expense related to intangible assets of \$2,223,000, and \$1,337,000 for the nine months ended June 30, 2008 and 2007, respectively.

In September 2004, the Company made a commitment to purchase for \$7.0 million certain additional sublicense rights and the accompanying future royalty revenue streams under certain sublicenses through an amendment to the Company's diagnostic format patent license with Abbott Laboratories. Prior to such amendment, the Company was receiving only a portion of the royalties under such sublicenses. The first \$5.0 million installment was paid in fiscal 2005, and an additional \$1.0 million installment was paid in fiscal 2007. The remaining \$1.0 million installment was paid in the third quarter of fiscal 2008.

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

	Useful life (in years)	June 30, 2008	September 30, 2007
Customer lists	9-11	\$ 7,340	\$ 7,340
Abbott license	4	7,037	7,037
Core technology	8-18	6,930	6,933
Patents and other	7-20	2,217	1,988
Trademarks		580	580
Less accumulated amortization of intangible assets		(7,702)	(5,479)
Intangible assets, net		\$ 16,402	\$ 18,399

Based on the intangible assets in service as of June 30, 2008, estimated amortization expense for each of the next five years ending June 30 is as follows (*in thousands*):

2009	\$2,134
2010	1,299
2011	1,299
2012	1,299
2013	1,299

**(7) Stock-based Compensation**

The Company's stock-based compensation expenses were as follows (*in thousands*):

	Three months ended June 30,		Nine months ended June 30,	
	2008	2007	2008	2007
Product costs	\$ 44	\$ 27	\$ 131	\$ 79
Research and development	867	1,322	2,743	2,729
Selling, general and administrative	919	816	4,307	2,227
Total	\$ 1,830	\$ 2,165	\$ 7,181	\$ 5,035

As of June 30, 2008, approximately \$16.7 million of total unrecognized compensation costs related to non-vested awards is expected to be recognized over a weighted average period of approximately 2.1 years.

**Table of Contents***Stock Option Plans*

The Company accounts for stock-based compensation in accordance with SFAS No. 123(R), *Share Based Payment* ( SFAS 123(R) ), which requires all share-based payments, including grants of stock options, to be recognized in the income statement as an operating expense, based on their fair values, over the requisite service period.

The Company uses the Black-Scholes option pricing model to determine the weighted average fair value of options. The weighted average per-share fair values of options granted during the three-month periods ended June 30, 2008 and 2007 were \$13.72 and \$16.41, respectively. The weighted average per-share fair values of options granted during the nine-month periods ended June 30, 2008 and 2007 were \$18.46 and \$16.55, respectively. The assumptions used as inputs in the model were as follows:

	Three months ended		Nine months ended	
	June 30,		June 30,	
	2008	2007	2008	2007
Risk-free interest rates	2.9%	4.6%	3.2%	4.6%
Expected life (years)	4.1	5.0	5.1	5.7
Expected volatility	33.9%	40.9%	39.7%	48.7%
Dividend yield	0%	0%	0%	0%

The risk-free interest rate assumption was based on yields for U.S. Treasury bonds with maturities similar to those of the expected term of the award. The expected life of options granted is determined based on the Company's experience. Expected volatility is based on the Company's stock price movement over a period approximating the expected term. 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 is based on historical experience.

The Company's Incentive Stock Options ( ISO ) are granted at an exercise price of at least 100% of the fair market value of the common stock of the Company ( 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. ISO's 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 ( NQSO ) are granted at fair market value on the date of grant. NQSO's expire in 7 to 10 years or upon termination of employment or service as a Board member. Board member options are 20% immediately vested with the remainder exercisable at rates of 20% per year commencing one year after date of grant. Employee options are exercisable at rates of 20% per year from the date of grant, or ranging from 20% to 33% per year commencing one year after the date of grant depending on the particular award granted.

*Restricted Stock Awards*

The Company has entered into restricted stock agreements with certain key employees, covering the issuance of Common Stock ( Restricted Stock ). Under SFAS No.123(R), 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. The stock-based compensation table above includes Restricted Stock expenses of \$474,000 and \$1,680,000 for the three-month and nine-month periods ended June 30, 2008, respectively, and \$292,000 and \$848,000 for the three-month and nine-month periods ended June 30, 2007, respectively.

*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 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. For the three-month and nine-month periods ended June 30, 2008, the Company recognized \$867,000 and \$1,175,000 and associated with the fair value of performance share awards vested or expected to vest, respectively. For the three-month and nine-month periods ended June 30, 2007, the Company recognized \$667,000 and \$805,000 of stock-based compensation expense related to these awards, respectively. The stock-based compensation table above includes the Performance Share expenses.



**Table of Contents***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 that are 85% of the average closing price as defined in the Stock Purchase Plan. As of June 30, 2008 and 2007, there were \$211,000 and \$184,000 of employee contributions, respectively, included in accrued liabilities in the accompanying condensed consolidated balance sheets. Stock compensation expense recognized related to the Stock Purchase Plan for three-month periods ended June 30, 2008 and 2007 totaled \$58,000 and \$38,000, respectively. Stock compensation expense recognized related to the Stock Purchase Plan for the nine-month periods ended June 30, 2008 and 2007 totaled \$141,000 and \$118,000, respectively. The stock-based compensation table above includes the Stock Purchase Plan expenses.

**(8) Comprehensive Income**

The components of comprehensive income are as follows (*in thousands*):

	Three months ended		Nine months ended	
	June 30,		June 30,	
	2008	2007	2008	2007
Net income	\$ 4,800	\$ 5,587	\$ 15,553	\$ 17,253
Other comprehensive income:				
Unrealized holding (losses) gains on available-for-sale securities arising during the period, net of tax	(1,575)	(173)	(2,457)	2,668
Adjustment for realized (gains) losses included in net income, net of tax	(39)	6	(843)	18
Comprehensive income	\$ 3,186	\$ 5,420	\$ 12,253	\$ 19,939

**(9) Income Taxes**

The Company adopted the provisions of FASB Interpretation No. 48 ( FIN 48 ) *Accounting for Uncertainty in Income Taxes - An Interpretation of FASB Statement No. 109*, on October 1, 2007. Upon adoption of FIN 48, the Company recorded a net \$79,000 benefit related to taxes, which was recorded as an increase to the October 1, 2007 beginning retained earnings balance. As of the adoption date, the Company has gross unrecognized tax benefits of \$1.1 million and if recognized, this total amount would impact the effective tax rate. At adoption, the Company classified \$160,000 of the gross unrecognized tax benefits as a current liability, reflecting the amount the Company expects to pay during the next twelve months in connection with certain amended tax returns filed by the Company. As of June 30, 2008 the current liability has been reduced to zero. The remaining liability for unrecognized tax benefits has been classified as non-current, as no payments are expected to be made in the next twelve months. The Company does not anticipate any other significant increases or decreases in unrecognized tax benefits within twelve months of adoption of FIN 48. Interest and penalties related to unrecognized tax benefits are recorded in income tax expense. As of October 1, 2007, a gross balance of \$445,000 of interest and penalties had been accrued related to the unrecognized tax benefits balance. There have been no material changes to this amount as of June 30, 2008.

The Company files tax returns, including returns for its subsidiaries, in the United States federal jurisdiction and in various state jurisdictions. Uncertain tax positions are related to tax years that remain subject to examination. As of the date of the adoption, U.S. tax returns for fiscal years ended September 30, 2005, 2006, and 2007 remained subject to examination by federal tax authorities. Tax returns for state and local jurisdictions for fiscal years ended September 30, 2003 through 2007 remain subject to examination by state and local tax authorities.

**(10) 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 how to allocate resources and in assessing performance.





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SurModics manages its business on the basis of the operating segments noted in the table below, which are comprised of the Company's seven business units. The three operating segments are aggregated into one reportable segment. The Drug Delivery operating segment consists of three business units: (1) the Drug Delivery business unit, which is responsible for technologies dedicated to site specific delivery of drugs; (2) the Ophthalmology business unit, which is dedicated to 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 Brookwood Pharmaceuticals business unit, which provides proprietary polymer-based technologies to companies developing improved pharmaceutical products. The Hydrophilic and Other operating segment consists of three business units: (1) the Hydrophilic Technologies business unit, which focuses on enhancing medical devices with advanced lubricious coatings that facilitate their placement and maneuverability in the body; (2) the Regenerative Technologies business unit, which is developing platforms intended to augment or replace tissue/organ function (e.g., cell encapsulation applications), or to modify medical devices to facilitate tissue/organ recovery through natural repair mechanisms (e.g., hemo/biocompatible or prohealing coatings); and (3) the Orthopedics business unit, which is committed to innovative solutions for orthopedics patients using proven SurModics technologies, and creating new technology solutions to existing patient care gaps in the orthopedics field. The In Vitro operating segment consists of the In Vitro Technologies (formerly Diagnostics and Drug Discovery) business unit, which includes the Company's genomics slide technologies, stabilization products, antigens and substrates for immunoassay diagnostics tests, its *in vitro* diagnostic format technology and its synthetic ECM cell culture products.

Each operating segment 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 accounting policies for segment reporting are the same as for the Company as a whole. The table below presents revenue from the three operating segments for the three-month and nine-month periods in fiscal 2008 and 2007, respectively (*in thousands*):

	Three months ended		Nine months ended	
	June 30,		June 30,	
	2008	2007	2008	2007
Operating segment:				
Drug Delivery	\$ 10,674	\$ 5,772	\$ 33,397	\$ 18,607
Hydrophilic and Other	7,899	6,897	23,714	18,720
In Vitro	5,703	5,093	16,701	14,538