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SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-K

Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the fiscal year ended September 30, 2001

Commission file number 0-23837

SURMODICS, INC.
(Exact Name of Registrant as Specified in Its Charter)

Minnesota	41-1356149
(State of Other Jurisdiction of Incorporation or Organization)	(IRS Employer Identification No.)

9924 West 74th Street
Eden Prairie, Minnesota 55344
(Address of Principal Executive Offices) (Zip Code)

(952) 829-2700
(Registrant's Telephone Number, Including Area Code)

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act: Common Stock, $.05 par value

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 by file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [X] No [ ]

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [ ]

The aggregate market value of the Common Stock held by shareholders other than officers, directors or holders of more than 5% of the outstanding stock of the registrant as of December 14, 2001 was approximately $446 million (based upon the closing sale price of the registrant's Common Stock on such date).

The number of shares of the registrant's Common Stock outstanding as of December 14, 2001 was 16,782,091.

DOCUMENTS INCORPORATED BY REFERENCE

1. Portions of the Registrant's Annual Report to Shareholders for the fiscal year ended September 30, 2001 are incorporated by reference into Part II.

2. Portions of the Registrant's definitive Proxy Statement for the Registrant's 2002 Annual Meeting of Shareholders are incorporated by reference into Part III.

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PART I

ITEM 1. BUSINESS

General

SurModics, Inc. ("SurModics" or the "Company") is a leading provider of surface modification solutions to the medical device industry. The Company's primary focus is the commercialization of its patented PhotoLink process through third-party licensing arrangements. PhotoLink is a versatile, easily applied, light-activated coating technology that modifies medical device surfaces by creating covalent bonds between those surfaces and a variety of chemical agents. Through the PhotoLink process, these chemical agents can impart many performance-enhancing characteristics, such as lubricity, hemocompatibility, infection resistance and drug incorporation, onto the surface of a medical device without materially changing the dimensions or physical properties of the device. The Company believes that medical device manufacturers who utilize the Company's technology are able to significantly improve the performance of their products and, in many cases, differentiate their products in a highly competitive marketplace.

The Company focuses on providing high value-added surface modification solutions to a variety of medical device markets and product categories. Examples of products in the market or under development that incorporate the Company's coating technology include interventional cardiology catheters, vascular stents, interventional neurology catheters, guide wires, shunts, cardiac rhythm management devices, and urological devices. The surface properties created by the PhotoLink technology have greatly reduced treatment times in catheter-based vascular procedures and have shown the potential to enhance the long-term performance of implantable devices by improving infection resistance and promoting host cell attachment, growth and subsequent tissue integration. PhotoLink also has applications in the genomics market. The Company licensed its genomics technology to Motorola Life Sciences in fiscal 2000, which included the rights to a coated glass slide used to orient DNA strands for analysis.

The Company has commercialized its PhotoLink technology through licensing arrangements with medical device manufacturers who apply the coatings to their own products. The Company believes this approach allows it to focus its resources on further development of its technology and expansion of its licensing activities, while leveraging the established manufacturing, sales and marketing capabilities of its licensees. Revenues from these arrangements include license fees, development revenue, minimum royalties, and earned royalties based on a percentage of licensees' product sales. The Company also manufactures and sells the chemical reagents used in the PhotoLink process. The Company also licenses certain diagnostic technology to Abbott Laboratories for use with rapid point-of-care diagnostic tests, such as pregnancy and strep tests. Finally, the Company manufactures and sells coated glass slides to the genomics market (primarily Motorola) and offers a line of stabilization products used to extend the shelf life of immunoassay diagnostic tests.

The Company was organized as a Minnesota corporation in June 1979.

Markets and Need for Surface Modification

Recent trends in healthcare toward improved patient outcomes and reduced costs have resulted in intense competition for the development of medical devices that demonstrate superior product performance, reduced procedure times, improved outcomes and overall cost effectiveness. Medical device manufacturers have attempted to address these competitive pressures by developing innovative medical devices manufactured from a wide variety of synthetic materials, including many new, expensive and exotic materials. In an effort to further differentiate their products through improved product performance, a growing number of medical device manufacturers are turning to the emerging field of surface modification technology. Surface modification enables device manufacturers to provide medical devices with desired surface characteristics including improved lubricity, hemocompatibility and infection resistance, as well as the ability to deliver drugs and promote cell growth and tissue integration.

Surface modification has been used to improve medical devices in many different industry segments. The table below identifies several of these market segments and the surface properties the Company believes are desired by each segment.

Market Segment Served	Desired Surface Property and Examples of Applications
Interventional cardiology and vascular access	*Lubricity*: catheters, guide wires *Hemocompatibility*: vascular stents, catheters, guide wires, distal protection devices *Therapeutic drug incorporation and release*: vascular stents, catheters *Infection resistance*: catheters, implantable ports
Cardiac rhythm management	*Lubricity*: pacemaker and defibrillator leads, electrophysiology devices *Hemocompatibility*: electrophysiology devices
Cardiothoracic surgery	*Infection resistance*: heart valves *Hemocompatibility*: minimally invasive bypass devices, vascular grafts, ventricular assist devices *Cell growth and tissue integration*: heart valves, vascular grafts
Interventional neurology and neurosurgery	*Lubricity*: catheters, guide wires *Infection resistance*: catheters, shunts
Urology and gynecology	*Lubricity*: urinary catheters, incontinence devices, ureteral stents, fertility devices *Infection resistance*: urinary catheters, incontinence devices, ureteral stents, fertility devices, penile implants
Orthopedics	*Cell growth and tissue integration*: bone and cartilage regeneration

In addition to the above-identified market segments, the Company’s technology is also very relevant in genomics applications. During fiscal 1999, SurModics launched its 3D-Link Activated Slide to the genomics market. This coated glass slide was used by genomics researchers to prepare

microarrays for DNA analysis. During fiscal 2000, SurModics formed a partnership with Motorola Life Sciences. In addition to providing Motorola exclusive rights to the Company's genomics technology, the agreement calls for collaborative research on further technology advances.

The PhotoLink Solution

PhotoLink is a versatile, easily applied, light-activated coating technology that modifies medical device surfaces by creating covalent bonds between those surfaces and a variety of chemical agents. The PhotoLink solution to surface modification involves the utilization of proprietary, light sensitive (photochemical) reagents. These reagents can consist of advanced polymers or active biomolecules having desired surface characteristics and an attached light-reactive chemical compound (photogroup). When the reagent is exposed to a direct light source, typically ultraviolet light, a photochemical reaction creates a covalent bond between the photogroup and the surface of the medical device, thereby imparting the desired property to the surface. A covalent bond is a very strong chemical bond which results from the sharing of electrons between carbon molecules of the substrate and the applied coating.

SurModics' proprietary PhotoLink reagents work directly on most polymer-based (e.g., plastic) and biological substrates (latex rubber, cellulose, tissue and natural fibers). Metal and glass substrates generally require pretreating with polymers to make a carbon-molecule available for bonding prior to the application of the PhotoLink reagents. The reagents are easily applied to a clean material surface by dipping, spraying, roll coating, ink jetting or brushing. SurModics continues to develop proprietary photochemical reagents providing new product features while expanding the number and type of substrates on which the reagents can be applied.

The Company believes that its proprietary PhotoLink process provides its licensees with a number of benefits.

- *Flexibility.* PhotoLink coatings can be applied to many different kinds of surfaces and can immobilize a variety of chemical, pharmaceutical and biological agents, which allows licensees to be innovative in the design of their products without significantly changing the dimensions or physical properties of the device.

- *Variety of Surface Properties.* The PhotoLink process can be tailored to provide SurModics' licensees with the ability to improve the performance of their devices by choosing the specific coating properties desired for particular applications. The PhotoLink technology also provides the medical device manufacturer with the ability to combine multiple surface-enhancing characteristics on the same device.

- *Ease of Use.* The PhotoLink coating process is a relatively simple process that does not require expensive special equipment or the use of hazardous materials, and does not subject the coated products to harsh chemical, pressure or temperature conditions. Further, PhotoLink coatings are compatible with all the generally accepted sterilization processes, so the surface attributes are not lost when the medical device is sterilized prior to usage.

Surface Properties

SurModics' coating technology has been used by manufacturers of pacemaker leads, drug infusion catheters, laser and balloon angioplasty catheters, urinary drainage catheters, vascular closure devices, wound drains, guide wires, stent delivery catheters, angiography catheters, ureteral stents and

hydrocephalic shunts, among other devices. The PhotoLink process can be used to provide medical device manufacturers with the following surface properties to improve product performance:

- *Lubricity.* Low friction or lubricious coatings reduce the force and time required for insertion, navigation and removal of devices in vascular, neurological and urogenital applications. Lubricity also reduces tissue irritation and damage caused by products such as catheters, guide wires and endoscopy devices. Based on Company and licensee testing, when compared to uncoated surfaces, the PhotoLink process has reduced the friction on surfaces by as much as 95%, depending on the substrate being coated.

- *Hemocompatibility.* Hemocompatible coatings help reduce adverse reactions that may be created when a device is inserted into the body and comes in contact with blood. Heparin has been used for decades as an injectable drug to reduce blood clotting in patients. SurModics can immobilize heparin on the surface of medical devices thereby inhibiting blood clotting on the device surface, minimizing patient risk and enhancing the performance of the device. PhotoLink heparin coatings have been shown in Company and licensee testing to reduce blood clotting by greater than 90% compared to uncoated surfaces. SurModics has also developed synthetic, non-biological coatings that provide medical device surfaces with improved blood compatibility.

- *Infection Resistance.* Antimicrobial coatings are advantageous for most implantable medical devices where risk of infection is a concern. PhotoLink technology can apply passive coatings which significantly reduce bacterial adhesion to the device or active coatings incorporating antimicrobial agents which kill bacteria around the device. Testing by the Company has demonstrated that a PhotoLink coating can reduce the adherence of microorganisms to biomaterial surfaces by 99% depending on the base material of the device. In addition, when compared to uncoated products, the PhotoLink process has been shown to increase the uptake of antimicrobial agents applied to the device just prior to implantation and prolong the release of these agents.

- *Drug Incorporation*. PhotoLink technology can be used to create reservoirs to entrap drugs on the surface of medical devices. These drugs can then be released from the surface on a controlled basis by tailoring the polymers, by adjusting the extent of crosslinking, or by using a barrier coating to control diffusion.

- *Stent Coating.* SurModics provides coatings that address the two fundamental challenges of coronary stents, restenosis (progressive narrowing of vessels due to tissue growth) and thrombosis (blood clot formation which abruptly obstructs blood flow). To address restenosis, SurModics has developed proprietary polymer coating reagents and application methods, that do not require light activation, to create durable stent coatings which serve as reservoirs for therapeutic drugs. The drugs can then be released from the coating on a controlled basis. When a stent with this drug coating is implanted in a patient, the drug diffuses out from the surface of the stent into the blood vessel wall where it can act to inhibit tissue growth, thereby reducing the occurrence of restenosis. Johnson & Johnson’s Cordis division is testing this coating in human clinical trials and has reported excellent results to-date in Europe. SurModics also has developed blood compatible coatings (containing heparin, for example) that are bound to the surfaces of stents to inhibit thrombosis that can occur as blood flows over the stent surface. The hemocompatible coating is designed to remain bound to the surface providing protection

from thrombosis until the natural healing process covers the stent with a thin layer of tissue, eliminating the exposure of the stent to flowing blood.

- *Wettability*. PhotoLink hydrophilic coatings have been shown in tests by the Company and its licensees to accelerate liquid flow rates on normally hydrophobic (water repelling) materials by 75%. Some rapid point-of-care diagnostic tests, such as home monitoring or physician monitoring of glucose levels in diabetics, are currently done by pricking a patient's finger and placing a drop of blood onto a polymer strip which is then inserted into a blood glucose reader. The Company believes that the time it takes for the blood to flow up the strip to provide a readout can be dramatically reduced and the consistency can be greatly improved with PhotoLink technology.

- *Tissue Engineering*. Studies have shown that attachment of extracellular matrix proteins and peptides onto surfaces of implantable medical devices improves host cell attachment, growth and subsequent tissue integration. Company studies have shown that biomedical devices (such as vascular grafts and ocular implants) coated with photoreactive collagen and other proteins have improved attachment, growth of cells and acceptance by surrounding tissues. In addition, the Company is also using its PhotoLink technology to produce three-dimensional scaffolds to promote bone regeneration.

- *Biomolecule Immobilization*. During a DNA gene analysis, typically hundreds of different probes need to be placed in a pattern on a surface, called a DNA microarray. These microarrays are used by the pharmaceutical industry to screen for new drugs, by genome mappers to sequence unknown portions of the human genome, or by diagnostic companies to search a patient sample for disease causing bacteria or viruses. However, DNA does not readily adhere to most surfaces. The Company has demonstrated a versatile method for the immobilization of DNA on various surfaces which led to the Motorola contract signed in fiscal 2000.

Current Licensing Arrangements

The Company has commercialized its technology through licensing arrangements with medical device manufacturers who apply the PhotoLink coatings to their own products in their own facility. The Company believes this approach allows it to focus its resources on further developing its technology and expanding its licensing activities, while leveraging the established manufacturing, sales and marketing capabilities of its licensees for the marketing of the specific medical device utilizing the PhotoLink technology. The Company's licensing agreements are designed to allow manufacturers to incorporate the process into their own manufacturing processes so they can control production and quality without the need to send product outside their facility.

The licensing process begins with the medical device manufacturer specifying the surface characteristics it desires. Because each surface is unique, the Company routinely conducts a feasibility study at no charge to the customer to qualify each new potential product application. Generally this involves no more than 16 hours of effort by SurModics' personnel. Once the feasibility has been proven, the customer typically funds further development by SurModics to optimize the coating formulation to meet the customer's technical needs. Once the customer is satisfied with the performance of the coating, a license agreement is executed granting the licensee the rights to use the technology. SurModics' technical personnel are then available to provide assistance in the transfer of the PhotoLink technology into the licensee's manufacturing process. Such services can include further coating optimization, process control and trouble shooting which are billable to the licensee. The Company also manufactures

and sells the chemical reagents used by all licensees in the coating process, thus creating another source of revenue. The company often supports its customers by providing coating assistance for parts required in human clinical trials. However, the customer generally performs all coating work internally once the product has been approved and is being sold on the market.

The term of a license agreement is generally for a period of 15 years or the life of SurModics' patents, whichever is longer, although an agreement may be terminated for any reason upon prior written notice, typically required at least 90 days before termination. The worldwide license can be either exclusive or nonexclusive for a particular medical device, but over 90% of the Company's licensed applications are nonexclusive. SurModics requires the payment of a non-refundable license fee which has historically ranged from $25,000 to $1,000,000 and quarterly "earned" royalties on the sales of products incorporating SurModics' technology. The royalty rates on most contracts are in the 2% to 4% range, but there are certain contracts with lower and higher rates. The amount of the license fee and the royalty rate are based on various factors including whether the arrangement is exclusive or nonexclusive, the perceived value of the coating application to the device and the size of the potential market. Certain nonrefundable license and research and development fees are recoverable by the licensees as offsets against a percentage of future earned royalties. Most of SurModics' agreements also incorporate a minimum royalty to be paid by the licensee. In most cases, payment of these minimum royalties will not commence until several months after the execution of an agreement for a particular application. On a quarterly basis, a client will pay the greater of earned or minimum royalties to SurModics. The earned royalties are always paid on a quarter-lag basis, based on the client's actual sales of coated products in the prior quarter.

Other Products

Stabilization Products

Although the primary focus of the Company is the development and marketing of its PhotoLink technology, the Company also markets stabilization products for use by manufacturers of immunoassay diagnostic tests. SurModics' StabilCoat and StabilZyme Stabilizers are designed to maintain the activity of biological components of the immunoassays, resulting in a longer shelf life. These products offer SurModics' customers the benefit of product differentiation and improvement while providing the ultimate end users the benefit of a faster test with fewer steps and fewer errors.

Diagnostic Formats

SurModics also licensed a format for *in vitro* diagnostic tests developed during the early years of the Company. This format has found broad application in the expanding area of rapid point-of-care diagnostic testing, such as pregnancy and strep tests, and generated $3.3 million of royalty revenue to the Company in fiscal 2001 pursuant to a license agreement with Abbott Laboratories. Although this revenue is expected to grow in the future with the increased sales of licensed products, limited additional research and development is being undertaken in this area.

Industrial Applications

While it is not the Company's primary focus, SurModics occasionally pursues industrial applications for its PhotoLink technology. The Company only pursues those applications that are perceived to be high value applications in a market that is not considered to be price sensitive. To date, revenue associated with industrial applications has been immaterial and is not expected to be significant in the foreseeable future.

Research and Development

SurModics' research and development personnel support the sales and marketing staff in performing feasibility studies, providing technical assistance to potential licensees, optimizing the coating methodologies for specific licensee applications, assisting in training licensees and integrating the Company's technology and know-how into licensee manufacturing processes. In addition, these personnel work to enhance and expand the PhotoLink technology through the development of new reagents and new applications.

As medical devices become more sophisticated and complex, the Company believes the need for surface properties will grow. The Company intends to continue its development efforts to expand its PhotoLink technology to provide additional optimized surface properties to meet these needs. The Company's technical strategy is to target selected coating characteristics for further development, in order to facilitate and shorten the license cycle. The Company continues to perform research into applications for future products both on its own and in conjunction with some of its licensees. Some of the research and development projects currently being worked on include coatings for site-specific drug release, bone and cartilage repair, enhanced tissue growth, long-term blood compatibility and DNA immobilization methods. In addition to expanding the number of medical applications that may use PhotoLink technology, the Company is working on improving the coating process for metals, developing a process for coating the interior diameter of medical devices and developing coatings activated with sources other than UV light.

The technical staff of the Company consists of 94 employees, including 13 with Ph.D. degrees, 7 with Masters degrees and over 50 with Bachelor degrees, with expertise in chemistry, biomedical engineering, biology, microbiology, cell biology and biochemistry. The technical staff is organized into five areas of specialization: hydrophilicity, microbiology, hemocompatibility, biochemistry and tissue engineering. In addition, a chemistry group supports the synthesis of new reagents needed by the other five groups.

In fiscal 2001 and 2000, the Company's research and development expenses were $8.0 million and $6.8 million, respectively. A portion of these expenses are billed to customers as the Company performs coating optimization and other development work on their product applications. Research and development revenue was approximately $4.2 million in fiscal 2001 and $2.0 million in fiscal 2000.

Since its founding, the Company has actively participated in the federal government's Small Business Innovative Research ("SBIR") program to fund development efforts. Since 1979, 143 research contracts resulting in revenues of over $26 million have been awarded to SurModics, primarily under the SBIR program. Grant proposals are generally directed toward the commercial strategies of the Company. The Company retains commercial rights to discoveries and technologies resulting from the research and development efforts funded by these grants. Where possible, licensees' products or substrates are used when performing research under the grant; thus the results are often directly applicable to SurModics' licensees. Grant funding has also allowed SurModics to maintain a larger and more technologically diverse employee base than would otherwise be possible.

Patents and Proprietary Rights

The Company has taken steps intended to protect PhotoLink related inventions through a series of patents covering a variety of coating methods, reagents and formulations, as well as particular medical device applications, based on or employing the Company's proprietary photoreactive chemistry. The Company has 26 issued U.S. patents, 25 pending U.S. patent applications, 54 issued foreign patents, and

91 pending foreign patent applications related to its PhotoLink technology. The Company generally files international patent applications (primarily in Australia, Canada, Europe, Japan, and Mexico) in parallel with its U.S. applications. In addition to the patents related to the PhotoLink technology, SurModics has 7 issued U.S. patents, 22 issued foreign patents and 3 pending foreign patent applications related to its diagnostic technology. There can be no assurance that any of the pending patent applications will be allowed.

The Company also relies heavily upon trade secrets and unpatented proprietary technology. The Company seeks to maintain the confidentiality of such information by requiring employees, consultants and other parties to sign confidentiality agreements and by limiting access by parties outside the Company to such information. The Company also does not divulge the detailed chemical structure of its reagent chemical to anyone, including clients. There can be no assurance, however, that these measures will prevent the unauthorized disclosure or use of this information or that others will not be able to independently develop such information. Additionally, there can be no assurance that any agreements regarding confidentiality and non-disclosure will not be breached, or, in the event of any breach, that adequate remedies would be available to the Company.

Marketing and Sales

The Company markets its PhotoLink technology throughout the world using a direct sales force consisting of three licensing managers who focus on specific markets such as cardiology, neurology, urology and orthopedic products. This specialization fosters an in-depth knowledge of the issues faced by SurModics' licensees within these markets such as technology changes, biomaterial changes and the regulatory environment.

Because the sales cycle can take several months from feasibility demonstration to the execution of a license agreement, the Company focuses its sales efforts on potential licensees with established market positions rather than those with only development stage products which may never come to market. Generally, the Company's technology is licensed on a nonexclusive basis to medical device manufacturers for use on specific products. This strategy enables the Company to license its technology to multiple licensees in the same market. SurModics also targets selling new applications to existing licensees. The Company believes the sales cycle is much faster in these situations because the licensee is already familiar with the technology and the general terms of the license have already been negotiated.

As part of its marketing strategy, the Company publishes technical literature on each surface capability of the PhotoLink technology (*i.e.*, lubricity, hemocompatibility, etc.). In addition, the Company exhibits at major trade shows and technical meetings, advertises in trade journals and through its website, and conducts direct mailings to appropriate target markets.

The Company also offers ongoing customer service and technical support throughout a licensee's relationship with SurModics. This service and support begins with a coating feasibility study at no charge to the licensee and also includes additional services such as assistance in the transfer of the technology to the licensee, further coating optimization, process control and trouble shooting, and assistance with FDA submissions for coated product approval. Most of these services are billable to the client.

Competition

Competition in the medical device industry has resulted in an increase in competition in the surface modification market. The Company's PhotoLink technology competes with technologies

developed by Carmeda (a division of Norsk Hydro, Inc.), Specialty Coatings Systems, and STS Biopolymers Inc., among others. In addition, many medical device manufacturers have developed or are engaged in efforts to develop surface modification technologies for use on their own products. Most competitors marketing surface modification to the outside marketplace are divisions of organizations with businesses in addition to surface modification. Overall, the Company believes the worldwide market is very fragmented with no competitor marketing to third parties having more than a 10% market share. Some of the Company's existing and potential competitors (especially medical device manufacturers pursuing coating solutions through their own research and development efforts) have substantially greater financial, technical and marketing resources than the Company.

SurModics attempts to differentiate itself from its competition by providing what it believes is a high value-added solution to surface modification. The Company believes that the primary factors customers consider in choosing a particular surface modification technology are performance, ease of manufacturing, ability to produce multiple properties from a single process, compliance with manufacturing regulations, customer service and pricing. The Company believes that its PhotoLink process competes favorably with respect to these factors, enabling it to charge a premium price. The Company believes that the cost and time required to obtain the necessary regulatory approvals significantly reduces the likelihood of a manufacturer changing the coating process it uses once a device has been approved for sale.

Because a significant portion of the Company's revenue is dependent on the receipt of royalties based on sales of medical devices incorporating PhotoLink coatings, the Company is also affected by competition within the markets for such devices. The Company believes that the intense competition within the medical device markets creates opportunities for the Company's coating technology as medical device manufacturers seek to differentiate their products through new enhancements or to remain competitive with enhancements offered by other manufacturers. Because the Company seeks to license its technology on a non-exclusive basis, the Company may further benefit from competition within the medical device markets by offering its technology to multiple competing manufacturers of a device. However, competition in the medical device markets could also have an adverse effect on the Company. While the Company seeks to license its products to established manufacturers, in certain cases the Company's licensees may compete directly with larger, dominant manufacturers with extensive product lines and greater sales, marketing and distribution capabilities. The Company also is unable to control other factors that may impact commercialization of PhotoLink-coated devices, such as the marketing and sales efforts of its licensees or competitive pricing pressures within the particular device market. There can be no assurance that products coated with the PhotoLink technology will be successfully commercialized by the Company's licensees or that such licensees will otherwise be able to effectively compete.

The primary competition for SurModics' stabilization products is its customers' internally developed formulations. The consolidation of the diagnostic industry increases the availability of internally developed stabilizers to the market. The Company believes that quick market penetration is the best strategy for addressing these threats. As in the coating market, the Company also believes that once its stabilization products are accepted in an FDA-approved diagnostic test, the likelihood of change is reduced because of the cost and time required to qualify a new component. SurModics' marketing strategy for its stabilization products is to develop a strong market presence by offering superior product performance and technical service.

Manufacturing

In accordance with its licensing strategy, the Company does not coat medical devices to be sold by its licensees. The Company does often support its clients by coating for human clinical trials. The Company also manufactures the reagent chemical used in the coating process, allowing it to maintain the quality of the reagents and their proprietary nature, while providing an additional source of revenue. PhotoLink reagents are specialty photoreactive chemicals that are prepared using a proprietary formula in relatively small batch processes (as contrasted with commodity chemicals prepared by large continuous methods). Generally, all PhotoLink reagents share a similar production process: a water soluble polymer is synthesized in a glass reactor; reactive photochemical groups are attached to the polymer; the solution is purified and freeze-dried or spray-dried, thus removing the water and creating a solid; and the reagents are packaged in standard quantities in light- and moisture-proof packaging. The reagents are sold dry, requiring the licensee, in most cases, to simply add water or a water and isopropyl alcohol mix before application. The Company has developed proprietary testing and quality assurance standards for manufacturing the reagents and does not disclose the reagent formulas or manufacturing methods. Although licensees may purchase the requisite chemical reagents from any source, all have elected to purchase them from the Company.

The Company also manufactures its 3D-Link Activated Slides for sale to Motorola. Standard glass slides are cleaned and pretreated in a multiple-step process. The Company applies its proprietary PhotoLink coating in a clean room environment, tests the slides to assure they meet quality standards, and in the final step, packages 24 slides in a box and seals it in moisture-proof packaging.

Finally, the Company also produces its stabilization products. These products are a group of sterile-filtered liquids that generally share a three-step production process. A standard recipe of chemicals is mixed in high purity water, these liquids are sterile-filtered into specific container sizes under aseptic conditions, and the resultant finished goods are bottled and labeled.

The Company maintains multiple sources of supply for the key raw materials used to manufacture its products. The Company does, however, purchase some raw materials from single sources, but it believes that additional sources of supply are readily available.

Although not required to follow Good Manufacturing Practice quality procedures, SurModics does follow such procedures in part to respond to requests of licensees to establish compliance with their criteria. The Company has not yet sought ISO 9001 certification, but may do so in the future.

Government Regulation

Although PhotoLink technology itself is not directly regulated by the FDA, the medical devices incorporating this technology are subject to FDA regulation. The burden of demonstrating safety and efficacy of such medical devices, the ultimate criteria applied by the FDA, rests with the Company’s licensees (the medical device manufacturers). Medical products incorporating the PhotoLink technology may generally be marketed only after 510(k) or PMA applications have been submitted and approved by the FDA, which process can take anywhere from six months for a 510(k) application, to two or three years for a PMA application. These applications are prepared by the manufacturer and contain results of extensive laboratory toxicity, mutagenicity and clinical evaluations on animals and humans conducted by the manufacturer.

The Company maintains confidential Device Master Files at the FDA regarding the nature, chemical structure and biocompatibility of the PhotoLink reagents. Although the Company’s licensees

do not have access to these files, the licensees may, with the permission of the Company, reference these files in any medical device submission to the FDA. This process allows the FDA to understand in confidence the details of the PhotoLink technology without the Company having to share this highly confidential information with its licensees.

Recent U.S. legislation allows device manufacturers, prior to obtaining FDA approval to market a medical device in the U.S., to manufacture the device in the U.S. and export it for sale in international markets. This generally allows SurModics to realize earned royalties sooner. However, sales of medical devices outside the U.S. are subject to international requirements that vary from country to country. The time required to obtain approval for sale internationally may be longer or shorter than that required by the FDA.

Employees

As of December 1, 2001, SurModics had 143 employees of whom 77 were engaged in technical and 17 in manufacturing positions, with the remainder in sales, marketing, quality or administrative positions. Of SurModics' employees, 14 hold Ph.D. degrees and 14 hold Masters degrees. The Company is not a party to any collective bargaining agreements and believes that its employee relations are good.

Management believes that the future success of the Company will depend in part on its ability to attract and retain qualified technical, management and marketing personnel. Such experienced personnel are in high demand, and the Company must compete for their services with other firms which may be able to offer more favorable benefits.

ITEM 2. PROPERTIES

In May 1999, SurModics purchased the land and building it currently occupies in Eden Prairie, Minnesota for approximately $3.2 million. The building has approximately 64,000 square feet of space. In June 2001, the Company purchased real property for approximately $2.5 million for potential future expansion. The Company now intends to sell this property and expand into a different location. Subsequent to year-end, the Company purchased a 135,000 square foot facility on 27 acres of land in Bloomington, Minnesota for approximately $7.1 million and intends to move its operations into this facility in early 2003. The purchases of these properties were internally funded and remain unencumbered. The Company believes that projected capacity of the manufacturing area is adequate to service the needs of its licensees for the foreseeable future.

ITEM 3. LEGAL PROCEEDINGS

The Company is not a party to nor is any of its property subject to any material pending legal proceedings.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

There were no matters submitted to a vote of security holders during the fourth quarter of fiscal 2001.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

(a) The information required by Item 5 relating to the Company's Common Stock and other shareholder matters is incorporated herein by reference to the section entitled "Stock Listing and Price History" which appears on page 33 of the Company's 2001 Annual Report to Shareholders.

(b) The Company made no sales of unregistered securities during the quarter-ended 9/30/2001.

ITEM 6. SELECTED FINANCIAL DATA

The selected consolidated financial data presented below for the five fiscal years ended September 30 is derived from the audited financial statements. The financial data set forth below should be read in conjunction with the Company's consolidated financial statements and "Management's Discussion and Analysis of Financial Condition and Results of Operation" contained in Item 7.

	Fiscal Year				
(Dollars in thousands, except per share data)	2001	2000	1999	1998	1997
Income Statement Data:					
Total revenues	$ 22,693	$ 18,279	$ 13,494	$ 9,779	$ 7,583
Operating income	7,566	5,333	2,419	948	37
Net income	5,109	4,240	4,360*	1,637	236
Diluted net income per share	.29	.25	.27*	.12	.02
Pro forma amounts assuming the accounting change was applied retroactively:					
Net income	6,814	3,669	4,199*	1,633	136
Diluted net income per share	.38	.22	.26*	.12	.01
Balance Sheet Data:					
Cash and short-term investments	$ 14,840	$ 17,357	$ 5,922	$ 4,870	$ 1,948
Total assets	60,583	50,749	31,958	24,305	6,450
Retained earnings (accumulated deficit)	7,186	2,077	(2,163)	(6,523)	(8,160)
Total stockholders' equity	55,700	48,303	29,719	22,698	5,102
Pro forma amounts assuming the accounting change was applied retroactively:					
Retained earnings (accumulated deficit)	7,186	372	(3,297)	(7,496)	(9,129)
Total stockholders' equity	55,700	46,598	28,585	21,725	4,133

*****Net income for the year ended September 30, 1999 includes the reversal of an income tax valuation reserve totaling $2,074,000. To make the results comparable between years, excluding the income tax reversal would result in net income of $2,286,000 and diluted earnings per share of $0.14.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

The Section entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations" in the 2001 Annual Report to Shareholders is incorporated herein by reference.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

SurModics' investment policy requires investments with high credit quality issuers and limits the amount of credit exposure to any one issuer. The Company's investments principally consist of U.S. government and government agency obligations and investment-grade, interest-bearing corporate debt securities with varying maturity dates, the majority of which are five years or less. Because of the credit criteria of the Company's investment policies, the primary market risk associated with these investments is interest rate risk. SurModics does not use derivative financial instruments to manage interest rate risk or to speculate on future changes in interest rates. A 10% increase in interest rates would result in an approximate $350,000 decrease in the fair value of the Company's available-for-sale securities as of September 30, 2001, but no material impact on the results of operations or cash flows. Management believes that a reasonable change in raw material prices would not have a material impact on future earnings or cash flows because the Company's inventory exposure is not material.

Although the Company conducts business in foreign countries, its international operations consist primarily of sales of reagent and stabilization chemicals. Additionally, all sales transactions are in U.S. dollars. Accordingly, SurModics does not expect to be subject to material foreign currency risk with respect to future costs or cash flows from our foreign sales. To date, the Company has not entered into any foreign currency forward exchange contracts or other derivative financial instruments to hedge the effects of adverse fluctuations in foreign currency exchange.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The balance sheets as of September 30, 2001 and 2000 and the statements of income, stockholders' equity and cash flows for each of the three years in the period ended September 30, 2001 together with the Report of Independent Public Accountants contained on pages 18 through 31 of the Company's Annual Report to Shareholders for the year ended September 30, 2001 are incorporated herein by reference.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT.

The names, ages and positions of the Company's executive officers are as follows:

Name	Age	Position
Dale R. Olseth	71	Chairman and Chief Executive Officer
James C. Powell	52	President and Chief Operating Officer
Stephen C. Hathaway	46	Vice President and Chief Financial Officer
Patrick E. Guire, Ph.D	65	Senior Vice President of Research and Chief Scientific Officer
Walter H. Diers Jr.	50	Vice President of Corporate Development
Marie J. Versen	40	Vice President of Quality Management and Regulatory Compliance

Dale R. Olseth joined the Company in 1986 as its President, Chief Executive Officer and a director of the Company and has served as Chairman since 1988. Mr. Olseth also serves on the Board of Directors of The Toro Company. He served as Chairman or President and Chief Executive Officer of Medtronic, Inc. from 1976 to 1986. From 1971 to 1976, Mr. Olseth served as President and Chief Executive Officer of Tonka Corporation. Mr. Olseth received a B.B.A. degree from the University of Minnesota in 1952 and an M.B.A. degree from Dartmouth College in 1956.

James C. Powell joined the Company in 1987. He became Vice President of Technical Operations in 1992 and was elected President and Chief Operating Officer in 1998. He was employed at Precision-Cosmet Company, Inc., a manufacturer of contact and intraocular lenses, from 1978 until he joined SurModics. Mr. Powell received a B.S. degree in wood sciences from Texas A&M University in 1972 and an M.S. degree in polymer science in 1975 from the University of Washington.

Stephen C. Hathaway joined the Company as its Vice President and Chief Financial Officer in September 1996. Prior to joining SurModics, he served as Director of Finance for Ceridian Employer Services, Ceridian Corporation from 1995 to 1996. Prior to that, Mr. Hathaway was Vice President — Finance & Operations for Wilson Learning Corporation from 1988 to 1995. He also spent ten years with Arthur Andersen LLP. Mr. Hathaway received a B.S. degree in accounting from Miami University in 1977 and became a Certified Public Accountant in 1980.

Patrick E. Guire, Ph.D. is a co-founder of the Company and has served as Senior Vice President of Research and Chief Scientific Officer and a director since 1980. Dr. Guire is responsible for the research affairs of the Company. Prior to founding SurModics, Dr. Guire was employed by Kallestad Laboratories, Inc. as a senior scientist from 1978 to 1979 and was a researcher at the Midwest Research Institute, Inc. in Kansas City, Missouri from 1972 to 1978. He received a B.S. degree in Chemistry from the University of Arkansas, Fayetteville in 1958 and a Ph.D. in biochemistry from the University of Illinois in 1963.

Walter H. Diers, Jr. joined the Company in 1988 and currently serves as Vice President of Corporate Development. He served as a consultant to several small, high technology companies from 1984 until he joined SurModics. Prior to that, he was the Controller of the Laserdyne division of Data

Card Corporation. Mr. Diers received a B.S. degree in economics and a B.S. degree in business in 1977 and an M.B.A. degree in finance in 1979 from the University of Minnesota.

Marie J. Versen joined the Company in 1987, and in 1996 became its Vice President of Quality Management and Regulatory Compliance. She was previously employed at Precision-Cosmet Company, Inc. from 1983 to 1986. Ms. Versen received a B.S. degree in chemical engineering from the University of Minnesota in 1983.

The executive officers of the Company are elected by and serve at the discretion of the Board of Directors.

The information required by Item 9 relating to directors and compliance with Section 16(a) of the Securities Exchange Act of 1934 is incorporated herein by reference to the sections entitled “Election of Directors” and “Section 16(a) Beneficial Ownership Reporting Compliance” which appear in the Company’s definitive proxy statement for its 2002 Annual Meeting of Shareholders.

ITEM 11. EXECUTIVE COMPENSATION

The information required by Item 11 is incorporated herein by reference to the section entitled “Executive Compensation” which appears in the Company’s definitive Proxy Statement for its 2002 Annual Meeting of Shareholders.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The information required by Item 12 is incorporated herein by reference to the sections entitled “Principal Shareholders” and Management Shareholdings” which appear in the Company’s definitive Proxy Statement for its 2002 Annual Meeting of Shareholders.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

None.

PART IV

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K

(a) Exhibits. See “Exhibit Index” on the page following signatures.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

SURMODICS, INC.
("Registrant")

Dated: December 21, 2001 By: /s/ Dale R. Olseth

Dale R. Olseth
Chairman and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been signed below by the following persons on behalf of the Registrant, in the capacities, and on the dates indicated.

(Power of Attorney)

Each person whose signature appears below constitutes and appoints DALE R. OLSETH and STEPHEN C. HATHAWAY as his true and lawful attorneys-in-fact and agents, each acting alone, with full power of substitution and resubstitution, for him and in his name, place and stead, in any and all capacities, to sign any or all amendments to this Annual Report on Form 10-K and to file the same, with all exhibits thereto, and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys-in-fact and agents, each acting alone, full power and authority to do and perform each and every act and thing requisite and necessary to be done in and about the premises, as fully to all intents and purposes as he might or could do in person, hereby ratifying and confirming all said attorneys-in-fact and agents, each acting alone, or his substitute or substitutes, may lawfully do or cause to be done by virtue thereof.

Signature	Title	Date
/s/ Dale R. Olseth Dale R. Olseth	Chairman, Chief Executive Officer and Director (Chief Executive Officer)	December 21, 2001
/s/ Stephen C. Hathaway Stephen C. Hathaway	Vice President and Chief Financial Officer (Chief Financial and Accounting Officer)	December 21, 2001
/s/ Donald S. Fredrickson Donald S. Fredrickson, M.D.	Director	December 18, 2001
/s/ James J Grierson James J. Grierson	Director	December 18, 2001

Signature	Title	Date
/s/ Patrick E. Guire	Director	December 21, 2001
Patrick E. Guire		
/s/ Kenneth H. Keller	Director	December 17, 2001
Kenneth H. Keller		
/s/ David A. Koch	Director	December 19, 2001
David A. Koch		
/s/ Kendrick B. Melrose	Director	December 17, 2001
Kendrick B. Melrose		
/s/ John A. Meslow	Director	December 18, 2001
John A. Meslow		

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

EXHIBIT INDEX TO FORM 10-K

For the Fiscal Year Ended September 30, 2001

SURMODICS, INC.

Exhibit	
3.1	Restated Articles of Incorporation, as amended—incorporated by reference to Exhibit 3.1 to the Company's Quarterly Report on Form 10-QSB for the quarter ended December 31, 1999, SEC. File No. 0-23837
3.2	Bylaws, as amended to date—incorporated by reference to Exhibit 3.1 to the Company's Quarterly Report on Form 10-QSB for the quarter ended December 31, 1998, SEC. File No. 0-23837.
10.1*	Company's Incentive 1987 Stock Option Plan, including specimen of Incentive Stock Option Agreement—incorporated by reference to Exhibit 10.2 to the Company's Registration Statement on form SB-2, Reg. No. 333-43217
10.2*	Company's Incentive 1997 Stock Option Plan, including specimen of Incentive Stock Option Agreement—incorporated by reference to Exhibit 10.3 to the Company's Registration Statement on form SB-2, Reg. No. 333-43217
10.3*	Form of Restricted Stock Agreement—incorporated by reference to Exhibit 10.4 to the Company's Registration Statement on form SB-2, Reg. No. 333-43217
10.4*	Form of Non-qualified Stock Option Agreement—incorporated by reference to Exhibit 10.5 to the Company's Registration Statement on form SB-2, Reg. No. 333-43217
10.5	Form of License Agreement—incorporated by reference to Exhibit 10.6 to the Company's Registration Statement on form SB-2, Reg. No. 333-43217
10.6	License Agreement with Abbott Laboratories dated November 20, 1990, as amended—incorporated by reference to Exhibit 10.7 to the Company's Registration Statement on form SB-2, Reg. No. 333-43217
10.7	Purchase and Sale Agreement dated March 31, 1999 between the Company and Prairie View Jack Ltd.—incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-QSB for the quarter ended March 31, 1999, SEC. File No. 0-23837.
10.8*	SurModics, Inc. Executive Income Continuation Plan—incorporated by reference to Exhibit 10 to the Company's Quarterly Report on Form 10-QSB for the quarter ended June 30, 1999, SEC. File No. 0-23837.
13	Portions of Annual Report to Shareholders for the fiscal year ended September 30, 2001 incorporated by reference in this Form 10-K.
23	Consent of Arthur Andersen LLP
24	Power of Attorney (included on signature page of this Form 10-K)

*Management contract or compensatory plan or arrangement

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

GENERAL

SurModics is a leading provider of surface modification solutions to medical device manufacturers. The Company's revenues are derived from four primary sources: fees from licensing its patented technology to customers; royalties received from licensees; the sale of photoreactive chemical compounds to licensees, stabilization products to the diagnostics industry and coated glass slides to the genomics market; and research and development fees generated on projects for commercial customers and government grants.

Fiscal 2001 was another record year for SurModics. Total revenue increased 24% to $22.7 million from $18.3 million in fiscal 2000. PhotoLink-related revenue increased 31% to a record $15.9 million from $12.1 million in 2000. All PhotoLink categories showed double-digit growth, but commercial development revenue was especially strong.

Commercial development revenue jumped to $3.6 million from $1.4 million in 2000, a 152% increase. PhotoLink royalties increased 15% to $7.8 million and reagent sales, those chemicals used by licensees in the coating process, increased 10% to $2.6 million. Operating income rose 42% to $7.6 million from $5.3 million in fiscal 2000. Net income was $5.1 million, or $.29 per diluted share, compared to $4.2 million, or $.25 per diluted share, in fiscal 2000. Fiscal 2001 results included a charge of $1.7 million, or $.09 per diluted share, for the cumulative effect of a change in accounting principle related to the adoption of the SEC's Staff Accounting Bulletin No. 101.

RESULTS OF OPERATIONS

YEARS ENDED SEPTEMBER 30, 2001 AND 2000

Revenue. The Company's revenue was $22.7 million in fiscal 2001, an increase of 24% over fiscal 2000. The revenue components were as follows:

(Dollars in thousands)	Fiscal 2001	Fiscal 2000	Increase (Decrease)	% Increase (Decrease)
PhotoLink revenue:				
Royalties	$7,781	$6,763	$1,018	15%
License fees	1,794	1,470	324	22%
Reagent sales	2,638	2,393	245	10%
Commercial development	3,648	1,445	2,203	152%
Total PhotoLink revenue	15,861	12,071	3,790	31%
Diagnostic royalties	3,253	2,917	336	12%
Stabilization & other products	3,047	2,687	360	13%
Government research	532	604	(72)	(12%)
Total revenue	$22,693	$18,279	$4,414	24%

The revenue growth in fiscal 2001 was mostly due to a 31% increase in total PhotoLink revenue, especially commercial development and royalty revenue. An increase in customer-funded development activity resulted in a 152% rise in commercial development revenue. The two largest components of this were collaborative work performed with Johnson & Johnson's Cordis division on its drug-coated stent and

Motorola Life Sciences on genomics projects. A single customer accounted for approximately 66% of the commercial development revenue in 2001 and 63% in fiscal 2000. PhotoLink royalties increased 15% due to sales growth of previously introduced coated products by licensees, new coated products introduced in 2001, and increased minimum royalties. The top 10 product applications accounted for 84% of the PhotoLink royalties received in fiscal 2001. SurModics' clients now have 57 coated products on the market compared to 47 one year ago.

Reagent sales increased 10% due to additional coated products on the market and increased production of previously introduced devices by PhotoLink clients. A single customer purchased 38% of the reagents sold during fiscal 2001, down from 55% in fiscal 2000. More importantly, reagent sales to all other customers increased 53% between years. During fiscal 2001, SurModics signed 10 new license agreements resulting in a 22% increase in license fee revenue to $1.8 million. Included in both years were $1.0 million in license fees from Motorola Life Sciences. The Company now has license agreements with 50 companies covering over 100 product applications.

In total, non-PhotoLink revenue sources increased 10% in fiscal 2001. Diagnostic royalties increased 12%, most of which was due to proceeds from patent infringement settlements. Sales of stabilization and other products grew 13% between years. A 31% decrease in stabilization chemical sales was more than offset by a 141% increase in sales of 3D-Link Activated Slides; however, slide sales were down in the fourth quarter. Finally, revenue from government grants decreased 12% as the Company continues to de-emphasize its reliance on the government to fund its research projects.

In fiscal 2002, management expects revenue growth in the 20 to 25% range. A significant event impacting this rate of growth will be the timing of Johnson & Johnson's launch of its drug-coated stent. If European regulatory approval is received around April 1, 2002, SurModics will receive royalties in only the fourth quarter of fiscal 2002. If European approval is received sooner, royalties will also be generated in the third quarter. Royalties will also be positively impacted by the 12 new coated products that clients are expected to launch in fiscal 2002. Several of these products have the potential to generate significant annual royalties. With respect to license revenue, the implementation of SAB 101 will require license fees to be deferred and recognized over an average of 15 years.

Revenue will fluctuate from quarter to quarter depending on, among other factors: success by clients in selling coated medical devices; the timing of introductions of coated products by clients; the number and size of development projects that are entered into; the number of new license agreements that are finalized; one significant contract that generates lower royalty rates as the client's sales increase; and the impact of most medical device clients generating lower sales during the summer months, which results in relatively lower royalty revenue to SurModics in the first quarter of each fiscal year.

Product costs. The Company's product costs were $2.4 million for fiscal 2001, an increase of $500,000, or 28%, over fiscal 2000. Overall product margins averaged 57%, a decrease from 63% in fiscal 2000. Reagent margins increased in 2001, while stabilization and slide margins declined. A portion of this decrease was due to a 15% reduction in stabilization product pricing. In addition, the Company completed additional manufacturing capacity in the first quarter, which added to certain of the overhead cost allocations. In fiscal 2002, management expects overall product margins to improve by one or two percentage points.

Research and development expense. Research and development expense was $8.0 million for fiscal 2001, an increase of $1.2 million, or 18%, over fiscal 2000. Most of this increase was due to compensation and benefit expenses associated with the technical personnel hired by the Company during the year. In addition, the Company incurred increased legal fees associated with patents and increased depreciation from the full-year impact of the build-out of additional lab space in the prior year. In fiscal 2002, management

expects research and development expenses to increase 18 to 20% over fiscal 2001, as the Company continues to invest in expanding its coating technology.

Sales and marketing expense. Sales and marketing expense was $1.7 million for fiscal 2001, an increase of $125,000, or 8%, over fiscal 2000. Increased compensation and benefit expenses, travel, and consulting fees were partially offset by a decrease in recruiting costs associated with sales and marketing positions filled in the last quarter of fiscal 2000. In fiscal 2002, management expects sales and marketing expenses to increase in a similar range to fiscal 2001.

General and administrative expense. General and administrative expense was $3.0 million for fiscal 2001, an increase of $300,000, or 12%, over fiscal 2000. The increase was primarily due to higher compensation and benefit costs, increased professional fees and higher utility costs. In addition, the Company expanded its operation within the current facility, eliminating tenant rental income that previously offset a portion of operating costs. In fiscal 2002, management expects general and administrative expenses to increase 8 to 10% over fiscal 2001.

Other income, net. The Company's net other income was $3.1 million for fiscal 2001, an increase of $1.6 million, or 116%, over fiscal 2000. Interest earned on the Company's investments amounted to $2.3 million, an increase of 66% from fiscal 2000. The increase was due to the additional $7.8 million of cash provided by operating activities during the year, and the full year impact of the $13.0 million in proceeds from the issuance of Common Stock in the fourth quarter of fiscal 2000. The remaining $701,000 of net other income represented capital gains on investment sales to take advantage of an expiring tax capital loss carryforward. In fiscal 2002, management expects other income to decrease significantly due to a lower interest rate environment and, now that the tax capital loss has been fully utilized, no need to generate capital gain income for tax purposes.

Income tax expense. The Company's income tax provision was $3.8 million in fiscal year 2001 versus $2.5 million in fiscal 2000. The effective tax rate was 36% in fiscal 2001, a slight decrease from 37% in fiscal 2000 due to the utilization of the capital loss carryforward discussed above.

YEARS ENDED SEPTEMBER 30, 2000 AND 1999

Revenue. The Company's revenue was $18.3 million in fiscal 2000, an increase of 35% over fiscal 1999. The revenue components were as follows:

(Dollars in thousands)	Fiscal 2000	Fiscal 1999	Increase (Decrease)	% Increase (Decrease)
PhotoLink revenue:				
Royalties	$6,763	$3,912	$2,851	73%
License fees	1,470	645	825	128%
Reagent sales	2,393	1,876	517	28%
Commercial development	1,445	1,122	323	29%
Total PhotoLink revenue	12,071	7,555	4,516	60%
Diagnostic royalties	2,917	2,758	159	6%
Stabilization & other products	2,687	2,261	426	19%
Government research	604	920	(316)	(34%)
Total revenue	$18,279	$13,494	$4,785	35%

The revenue growth in fiscal 2000 was largely due to the 60% increase in total PhotoLink revenue between years. PhotoLink royalties increased 73% due primarily to sales growth of previously introduced coated products by licensees. SurModics' clients had 47 coated products on the market. Reagent sales increased 28% due to increased production of coated devices by PhotoLink clients. A single customer purchased 55% of the reagents sold during fiscal 2000, down from 57% in fiscal 1999. More importantly, reagent sales to all other customers increased 32% between years. During fiscal 2000, SurModics signed 10 new license agreements, compared to 14 new agreements executed in fiscal 1999. Revenue from license fees increased 128% from fiscal 1999 due to the receipt of a $1.0 million license fee from Motorola Life Sciences during the fourth quarter of fiscal 2000. Customer-funded development projects to optimize the PhotoLink coatings for each customer's specific application resulted in a 29% increase in commercial development revenue. Approximately 63% of the commercial development revenue resulted from work on a project for a single customer. This same customer accounted for 34% of the commercial development revenue in fiscal 1999.

Non-PhotoLink revenue sources also grew in fiscal 2000; however, this growth was offset by a reduction in government revenue. Diagnostic royalties increased 6% between years. Most of this growth occurred in the first half of the year, as FDA manufacturing issues at the sole licensee impacted royalties in the second half. Sales of stabilization and other products grew 19%. A 9% decrease in stabilization chemical sales was more than offset by large growth in 3D-Link Activated Slides. Stabilization sales suffered from the loss of a single large customer. Finally, revenue from government grants decreased 34% between years, as the Company has de-emphasized its reliance on grants and has internally funded more of its research projects.

Product costs. The Company's product costs were $1.9 million for fiscal 2000, an increase of $400,000, or 26%, over fiscal 1999. Overall product margins averaged 63% during both years. Efficiencies gained through increased sales volumes were offset by additional scrap and labor costs.

Research and development expense. Research and development expense was $6.8 million for fiscal 2000, an increase of $1.5 million, or 30%, over fiscal 1999. Most of this increase was due to compensation and benefit expenses associated with the additional technical personnel hired by the Company during the year. In addition, the Company incurred increased costs due to the build-out of additional lab space within the current facility early in the year and the associated costs to furnish the new space with equipment and supplies.

Sales and marketing expense. Sales and marketing expense was $1.6 million for fiscal 2000, a decrease of $200,000, or 11%, over fiscal 1999. This decrease was due primarily to compensation and benefit expenses associated with unfilled sales and marketing positions throughout the year. Some of these positions were filled during the fourth quarter.

General and administrative expense. General and administrative expense was $2.7 million for fiscal 2000, an increase of $100,000, or 5%, over fiscal 1999. The increase was primarily due to inflation, resulting in higher compensation and benefit costs, and increased legal and professional fees.

Other income, net. The Company's net other income was $1.4 million for fiscal 2000, an increase of $300,000, or 22%, over fiscal 1999. This income primarily represents interest earned on the Company's investments. The level of investments increased due to the $7.4 million of cash provided by operating activities, $13.2 million from the issuance of Common Stock and higher yields due to an increase in interest rates.

Income tax expense. The Company's income tax provision was $2.5 million for fiscal year 2000 versus a $783,000 income tax benefit in fiscal 1999. The Company's effective tax rate was 37% in fiscal

2000. The income tax benefit in fiscal 1999 resulted from the reversal of an income tax valuation allowance of approximately $2.5 million, reducing the Company's tax provision at statutory rates to a net credit of $783,000.

LIQUIDITY AND CAPITAL RESOURCES

As of September 30, 2001, the Company had working capital of $17.7 million and cash, cash equivalents and investments totaling $44.4 million. The Company generated positive cash flows from operating activities of $7.8 million in fiscal 2001, $7.4 million in fiscal 2000, and $4.4 million in fiscal 1999. The increase in cash flows in fiscal 2001 was primarily due to the increased net income generated during the year and tax benefits generated from the exercise of employee stock options.

The significant increase in investing activities over the last year was primarily due to the activity in the Company's available-for-sale investment portfolio as managed by an independent investment manager. Due to the desire to fully utilize an expiring tax capital loss carryforward, investing activities increased as certain investments were sold to generate gains and the proceeds were then reinvested.

SurModics' investment policy requires investments with high credit quality issuers and limits the amount of credit exposure to any one issuer. The Company's investments principally consist of U.S. government and government agency obligations and investment-grade, interest-bearing corporate debt securities with varying maturity dates, the majority of which are five years or less. Because of the credit criteria of the Company's investment policies, the primary market risk associated with these investments is interest rate risk. SurModics does not use derivative financial instruments to manage interest rate risk or to speculate on future changes in interest rates. A 10% increase in interest rates would result in an approximate $350,000 decrease in the fair value of the Company's available-for-sale securities as of September 30, 2001, but no material impact on the results of operations or cash flows. Management believes that a reasonable change in raw material prices would not have a material impact on future earnings or cash flows because the Company's inventory exposure is not material. Also, the Company's foreign currency exposure is not significant.

The Company purchased $2.1 million of personal property and equipment in fiscal 2001, and $3.0 million in fiscal 2000. In addition, in June 2001, the Company used $2.5 million to purchase real property for potential future expansion. The property was classified as an other asset at September 30, 2001, as the Company now intends to sell the property and expand into a different location. Subsequent to year-end, the Company purchased a facility on 27 acres of land for approximately $7.1 million and intends to move its operations into this facility towards the end of 2002.

The most significant financing activity over the last three years was the sale of almost 800,000 shares of Common Stock to Motorola, Inc. in a private placement that generated $13.0 million in August 2000. Proceeds from stock option exercises generated an additional $700,000 and $200,000 during fiscal 2001 and 2000, respectively.

As of September 30, 2001, the Company had no debt, nor did it have any credit agreements. The Company believes that its existing capital resources will be adequate to fund SurModics' operations into the foreseeable future.

NEW ACCOUNTING PRONOUNCEMENTS

In December 1999, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 101 ("SAB 101"), "Revenue Recognition in Financial Statements." SAB 101 requires that license and other up-front fees be recognized over the term of the agreement unless the fee is in exchange for products delivered or services performed that represent the culmination of a separate earnings process. The Company adopted SAB 101 effective October 1, 2000. As a result, the Company reported a charge to fiscal 2001 earnings of $1.7 million, net of taxes, or $.09 per diluted share, for the cumulative effect of a change in accounting principle. Had the accounting change been applied retroactively, net income would have decreased by $600,000 to $3.7 million, or $.22 per diluted share, in the year ended September 30, 2000 and decreased by $200,000 to $4.2 million, or $.26 per diluted share, in the year ended September 30, 1999. The Company now has $2.6 million in additional deferred revenue, net of deferred costs, that will be recognized as revenue in the future.

FORWARD-LOOKING STATEMENTS

Certain statements contained in this Annual Report and other written and oral statements made from time to time by the Company do not relate strictly to historical or current facts. As such, they are considered "forward-looking statements" that provide current expectations or forecasts of future events. These forward-looking statements are made pursuant to the safe harbor provisions of the Private Securities Reform Act of 1995. Such statements can be identified by the use of terminology such as "anticipate," "believe," "estimate," "expect," "intend," "may," "could," "possible," "plan," "project," "will," "forecast" and similar words or expressions. The Company's forward-looking statements generally relate to its growth strategy, financial results, product development programs, sales efforts, and the impact of the Motorola and Johnson & Johnson agreements. One must carefully consider forward-looking statements and understand that such statements involve a variety of risks and uncertainties, known and unknown, and may be affected by inaccurate assumptions. Consequently, no forward-looking statement can be guaranteed and actual results may vary materially. The Company undertakes no obligation to update any forward-looking statement.

Although it is not possible to create a comprehensive list of all factors that may cause actual results to differ from the Company's forward-looking statements, such factors include, among others: (i) the trend of consolidation in the medical device industry, resulting in more significant, complex and long-term contracts than in the past and potentially greater pricing pressures; (ii) the Company's ability to attract new licensees and to enter into agreements for additional product applications with existing licensees, and the willingness of potential customers to sign license agreements under the terms offered by the Company; (iii) the success of existing licensees in selling products incorporating SurModics' technology and the timing of new product introductions by licensees; (iv) the difficulties and uncertainties associated with the lengthy and costly new product development and foreign and domestic regulatory approval processes, such as delays, difficulties or failures in achieving acceptable clinical results or obtaining foreign or FDA marketing clearances, which may result in lost market opportunities or postpone or preclude product commercialization by licensees; (v) efficacy or safety concerns with respect to products marketed by SurModics and its licensees, whether scientifically justified or not, that may lead to product recalls, withdrawals or declining sales; (vi) the development of new products or technologies by competitors, technological obsolescence and other changes in competitive factors; and (vii) economic and other factors over which the Company has no control, including changes in inflation and consumer confidence. Investors are advised to consult any further disclosures by the Company on this subject in its filings with the Securities and Exchange Commission.

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To SurModics, Inc.:

We have audited the accompanying balance sheets of SurModics, Inc. (a Minnesota corporation) as of September 30, 2001 and 2000, and the related statements of income, stockholders' equity and cash flows for each of the three years in the period ended September 30, 2001. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of SurModics, Inc. as of September 30, 2001 and 2000, and the results of its operations and its cash flows for each of the three years in the period ended September 30, 2001 in conformity with accounting principles generally accepted in the United States.

As explained in Note 2 to the financial statements, effective October 1, 2000, the Company changed its method of accounting for revenue recognition of license fees.

Arthur Andersen LLP

Minneapolis, Minnesota,

October 23, 2001

SurModics, Inc.
Balance Sheets
As of September 30

(thousands, except share data)	2001	2000
ASSETS		
Current Assets		
Cash and cash equivalents	$ 9,044	$ 1,510
Short-term investments	5,796	15,847
Accounts receivable, net of allowance for doubtful accounts of $40	3,245	1,406
Inventories	724	500
Deferred tax asset	297	912
Prepaids and other	877	911
Total current assets	19,983	21,086
Property and Equipment, net	7,672	7,166
Long-Term Investments	29,565	22,293
Deferred Tax Asset	646	--
Other Assets, net	2,717	204
	$ 60,583	$ 50,749
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities		
Accounts payable	$ 553	$ 379
Accrued liabilities-		
Compensation	874	1,110
Income taxes	356	--
Other	442	474
Deferred revenue	303	433
Total current liabilities	2,528	2,396
Deferred Revenue, less current portion	2,355	50
Total liabilities	4,883	2,446
Commitments and Contingencies (Note 6)		
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 16,760,501 and 16,556,002 shares issued and outstanding	838	828
Additional paid-in capital	47,777	45,740
Unearned compensation	(376)	(289)
Stock purchase notes receivable	--	(7)
Accumulated other comprehensive income (loss)	275	(46)
Retained earnings	7,186	2,077
Total stockholders' equity	55,700	48,303
	$ 60,583	$ 50,749

The accompanying notes are an integral part of these balance sheets.

SurModics, Inc.
Statements of Income
For the Years Ended September 30

(thousands, except net income per share)	2001	2000	1999
Revenue			
Royalties	$ 11,034	$ 9,680	$ 6,670
License fees	1,794	1,470	645
Product sales	5,685	5,080	4,137
Research and development	4,180	2,049	2,042
Total revenue	22,693	18,279	13,494
Operating Costs and Expenses			
Product	2,440	1,903	1,511
Research and development	7,997	6,797	5,248
Sales and marketing	1,698	1,573	1,769
General and administrative	2,992	2,673	2,547
Total operating costs and expenses	15,127	12,946	11,075
Income from Operations	7,566	5,333	2,419
Other Income			
Investment income	2,354	1,418	1,069
Gain (loss) on sale of investments	701	(2)	89
Other income, net	3,055	1,416	1,158
Income Before Income Taxes	10,621	6,749	3,577
Income Tax Provision (Benefit)	3,807	2,509	(783)
Income before cumulative effect of a change in accounting principle	6,814	4,240	4,360
Cumulative effect of a change in accounting principle, net of tax	(1,705)	--	--
Net income	$ 5,109	$ 4,240	$ 4,360
Basic net income per share before cumulative effect of a change in accounting principle	$ .41	$ .27	$ .30
Cumulative effect of a change in accounting principle	(.10)	--	--
Basic net income per share	$ .31	$ .27	$ .30
Diluted net income per share before cumulative effect of a change in accounting principle	$ .38	$ .25	$ .27
Cumulative effect of a change in accounting principle	(.09)	--	--
Diluted net income per share	$ .29	$ .25	$ .27
Weighted Average Shares Outstanding			
Basic	16,692	15,699	14,708
Dilutive effect of outstanding stock options	1,158	1,119	1,376
Diluted	17,850	16,818	16,084
Proforma amounts assuming the accounting change was applied retroactively			
Net income	$ 6,814	$ 3,669	$ 4,199
Basic net income per share	$ 0.41	$ 0.23	$ 0.29
Diluted net income per share	$ 0.38	$ 0.22	$ 0.26

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

SurModics, Inc.
Statements of Stockholders' Equity
For the Years Ended September 30, 2001, 2000 and 1999
(in thousands)

	Common Stock		Additional	Unearned
	Shares	Amount	Paid-In Capital	Compensation
Balance, September 30, 1998	14,428	$ 721	$ 28,574	$ (170)
Components of comprehensive income, net of tax:				
Net income	--	--	--	--
Unrealized holding losses on available-for-sale securities arising during the period	--	--	--	--
Total comprehensive income				
Common stock options exercised, net	966	48	1,286	--
Tax benefit from exercise of stock options	--	--	1,650	--
Restricted stock activity	17	1	170	(171)
Net loan activity	(7)	--	(56)	--
Amortization of unearned compensation	--	--	--	74
Balance, September 30, 1999	15,404	770	31,624	(267)
Components of comprehensive income, net of tax:				
Net income	--	--	--	--
Unrealized holding gains on available-for-sale securities arising during the period	--	--	--	--
Total comprehensive income				
Issuance of common stock	794	40	12,960	--
Common stock options exercised, net	360	18	220	--
Tax benefit from exercise of stock options	--	--	818	--
Restricted stock activity	(2)	--	118	(118)
Net loan activity	--	--	--	--
Amortization of unearned compensation	--	--	--	96
Balance, September 30, 2000	16,556	828	45,740	(289)
Components of comprehensive income, net of tax:				
Net income	--	--	--	--
Unrealized holding gains on available-for-sale securities arising during the period	--	--	--	--
Less reclassification for gains included in net income	--	--	--	--
Total comprehensive income				
Issuance of common stock	22	1	279	--
Common stock options exercised, net	177	9	168	--
Tax benefit from exercise of stock options	--	--	1,392	--
Restricted stock activity	6	--	198	(198)
Net loan activity	--	--	--	--
Amortization of unearned compensation	--	--	--	111
Balance, September 30, 2001	16,761	$ 838	$ 47,777	$ (376)

SurModics, Inc.
Statements of Stockholders' Equity
For the Years Ended September 30, 2001, 2000 and 1999
(in thousands)

	Stock Purchase Notes Receivable	Accumulated Other Comprehensive Income (Loss)	Retained Earnings (Accumulated Deficit)	Total Stockholders' Equity
Balance, September 30, 1998	$ (182)	$ 278	$ (6,523)	$ 22,698
Components of comprehensive income, net of tax:				
Net income	--	--	4,360	4,360
Unrealized holding losses on available-for-sale securities arising during the period	--	(465)	--	(465)
Total comprehensive income				3,895
Common stock options exercised, net	--	--	--	1,334
Tax benefit from exercise of stock options	--	--	--	1,650
Restricted stock activity	--	--	--	--
Net loan activity	124	--	--	68
Amortization of unearned compensation	--	--	--	74
Balance, September 30, 1999	(58)	(187)	(2,163)	29,719
Components of comprehensive income, net of tax:				
Net income	--	--	4,240	4,240
Unrealized holding gains on available-for-sale securities arising during the period	--	141	--	141
Total comprehensive income				4,381
Issuance of common stock	--	--	--	13,000

Common stock options exercised, net	--	--	--	238
Tax benefit from exercise of stock options	--	--	--	818
Restricted stock activity	--	--	--	--
Net loan activity	51	--	--	51
Amortization of unearned compensation	--	--	--	96
Balance, September 30, 2000	(7)	(46)	2,077	48,303
Components of comprehensive income, net of tax:				
Net income	--	--	5,109	5,109
Unrealized holding gains on available-for-sale securities arising during the period	--	762	--	762
Less reclassification for gains included in net income	--	(441)	--	(441)
Total comprehensive income				5,430
Issuance of common stock	--	--	--	280
Common stock options exercised, net	--	--	--	177
Tax benefit from exercise of stock options	--	--	--	1,392
Restricted stock activity	--	--	--	--
Net loan activity	7	--	--	7
Amortization of unearned compensation	--	--	--	111
Balance, September 30, 2001	$ --	$ 275	$ 7,186	$ 55,700

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

SurModics, Inc.
Statements of Cash Flows
For the Years Ended September 30
(in thousands)

	2001	2000	1999
Operating Activities			
Net income	$ 5,109	$ 4,240	$ 4,360
Adjustments to reconcile net income to net cash provided by operating activities-			
Depreciation and amortization	1,547	1,126	709
Loss (gain) on sale of investments	(701)	2	(89)
Amortization of unearned compensation, net	111	96	74
Tax benefit from exercise of stock options	1,392	818	1,650
Deferred tax provision	(31)	1,553	(2,465)
Cumulative effect of a change in accounting principle, net of tax	1,705	--	--
Change in operating assets and liabilities:			
Accounts receivable	(1,839)	27	(377)
Inventories	(224)	(41)	(79)
Accounts payable and accrued liabilities	(94)	(8)	716
Accrued income taxes	356	--	--
Deferred revenue	470	215	(53)
Prepaids and other	10	(651)	(34)
Net cash provided by operating activities	7,811	7,377	4,412
Investing Activities			
Purchases of property and equipment, net	(2,053)	(2,994)	(4,721)
Purchases of available-for-sale investments	(81,907)	(52,862)	(24,436)
Sales/maturities of available-for-sale investments	85,708	34,725	23,972
Repayment of stock purchase notes receivable	7	51	68
Purchase of other assets	(2,489)	--	3
Net cash used in investing activities	(734)	(21,080)	(5,114)
Financing Activities			
Issuance of common stock, net	457	13,238	1,334
Net cash provided by financing activities	457	13,238	1,334
Net increase (decrease) in cash and cash equivalents	7,534	(465)	632
Cash and Cash Equivalents			
Beginning of year	1,510	1,975	1,343
End of year	$ 9,044	$ 1,510	$ 1,975
Supplemental Information			
Cash paid for taxes	$ 1,232	$ 67	$ 95

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

SurModics, Inc.
Notes to Financial Statements
September 30, 2001 and 2000

1. DESCRIPTION

SurModics, Inc. (the Company) develops, manufactures and markets innovative surface modification solutions to the medical device industry. The Company's revenue is derived from the following: fees from licensing its patented technology to customers; royalties received from licensees; the sale of photoreactive chemical compounds to licensees, stabilization products to the diagnostic industry and coated glass slides to the genomics market; and research and development fees generated on projects for commercial customers and government grants. The Company markets its products through a direct sales force primarily in the United States and certain international markets.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

CASH AND CASH EQUIVALENTS

Cash and cash equivalents consist principally of money market instruments with original maturities of three months or less and are stated at cost which approximates fair value.Cash and cash equivalents consist principally of money market 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 as of September 30, 2001 and 2000. Available-for-sale investments are reported at fair value with unrealized gains and losses 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 and result in a new cost basis for the investment.

The amortized cost, unrealized holding gains and losses, and fair value of investments as of September 30 were as follows (in thousands):

	2001			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
U.S. government obligations	$ 11,210	$ 82	$ (5)	$ 11,287
Mortgage-backed securities	11,204	266	(5)	11,465
Municipal bonds	6,022	254	-	6,276
Corporate bonds	3,268	17	(220)	3,065
Asset-backed securities	3,221	52	(5)	3,268
Total	$ 34,925	$ 671	$ (235)	$ 35,361

	2000			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
U.S. government obligations	$ 14,039	$ 52	$ (74)	$ 14,017
Corporate bonds	9,095	2	(14)	9,083
Mortgage-backed securities	9,003	35	(33)	9,005
Asset-backed securities	3,598	10	(7)	3,601
Municipal bonds	2,451	3	(20)	2,434
Total	$ 38,186	$ 102	$ (148)	$ 38,140

The amortized cost and fair value of investments by contractual maturity at September 30, 2001, were as follows:

	Amortized Cost	Fair Value
Debt securities due within:		
One year	$ 6,010	$ 5,829
One to five years	22,488	22,989
Five years or more	6,427	6,543
Total	$ 34,925	$ 35,361

INVENTORIES

Inventories are 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 as of September 30 (in thousands):

	2001	2000
Raw materials	$269	$197
Finished products	455	303
Total	$724	$500

PROPERTY AND EQUIPMENT

Property and equipment are stated at cost and are depreciated using the straight-line method over 3 to 20 years, the estimated useful lives of the assets. Upon completion, construction-in-progress will begin depreciation over the estimated useful lives of the assets. Property and equipment consisted of the following components as of September 30 (in thousands):

	2001	2000	Useful life(in years)
Laboratory fixtures and equipment	$ 5,718	$ 4,651	3 to 5
Office furniture and equipment	2,401	1,790	3 to 5
Building and improvements	6,213	5,811	5 to 20
Construction-in-progress	--	52	
Less-Accumulated depreciation and amortization	(6,660)	(5,138)	
Property and equipment, net	$ 7,672	$ 7,166	

OTHER ASSETS

Other assets consist principally of real property and patents. The real property represents land that was purchased in fiscal 2001 for approximately $2.5 million and is currently held for resale. The cost of the patents is amortized over 7 to 12 years. Accumulated amortization was $113,000 and $87,000 as of September 30, 2001 and 2000, respectively.

IMPAIRMENT OF LONG-LIVED ASSETS

The Company periodically evaluates whether events and circumstances have occurred which may affect the estimated useful life or the recoverability of the remaining balance of its long-lived assets. 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) were less that the carrying amount of the assets, the Company would recognize an impairment loss. No such impairment losses were required to be recorded in the years ended September 30, 2001, 2000, and 1999.

REVENUE RECOGNITION

Revenue on product sales is recognized as products are shipped. Revenue for research and development is recorded as performance progresses under the applicable contract. Royalties are recognized as third-party licensees report sales of the licensed product or as minimum royalties become due. Cash received prior to performance is recorded as deferred revenue in the accompanying balance sheets.

Historically, the Company recognized initial license fees as revenue upon receipt, after a license agreement transferring the technology was executed and all significant obligations had been performed. In December 1999, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 101 ("SAB 101"), "Revenue Recognition in Financial Statements." SAB 101 required that license and other up-front fees be recognized over the term of the agreement unless the fee is in exchange for products delivered or services performed that represent the culmination of a separate earnings process.

Effective October 1, 2000, the Company adopted SAB 101. The Company now recognizes initial license fees over the term of the related agreement. As a result of adopting SAB 101, the Company recorded a cumulative effect of a change in accounting principle related to license fees recognized in prior years in the amount of $1,705,000, net of tax of $1,000,000, or $.09 per diluted share. Revenue related to performance milestones is recognized based on the achievement of the milestone, as defined in the respective agreements.

Prior period financial statements have not been restated to retroactively apply SAB 101; however, the pro forma amounts included in the statements of income show the net income and net income per share assuming the Company had retroactively applied SAB 101 to all prior periods.

Certain non-refundable license and research and development fees are recoverable by the licensees as offsets against a percentage of future earned royalties.

USE OF ESTIMATES

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the

reported amounts of revenue and expenses during the reporting period. Estimates are used for such items as depreciable lives and uncollectible accounts. Ultimate results could differ from those estimates.

NEW ACCOUNTING PRONOUNCEMENTS

In June 2001, the FASB issued Statement of Financial Accounting Standards No. 141, "Business Combinations" ("SFAS No. 141") and No. 142, "Goodwill and Other Intangible Assets" ("SFAS 142"). SFAS 141 supercedes Accounting Principles Board ("APB") Opinion No. 16 and requires that all business combinations initiated after June 30, 2001 be accounted for by the purchase method. SFAS 141 also changes the requirements for recognizing intangible assets as assets apart from goodwill in business combinations accounted for by the purchase method for which the date of acquisition is July 1, 2001, or later. SFAS 142 addresses how intangible assets that are acquired individually or with a group of other assets (but not in a business combination) should be accounted for upon their acquisition. SurModics will adopt SFAS 141 and 142 on October 1, 2002, and management expects no material impact on its financial statements.

3. STOCKHOLDERS' EQUITY

2000 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. The Company issued 21,764 shares under the Stock Purchase Plan during fiscal 2001, the first full year of the Plan. As of September 30, 2001, there was approximately $209,000 of employee contributions included in accrued liabilities in the accompanying balance sheets.

RESTRICTED STOCK AWARDS

The Company has entered into restricted stock agreements with certain key employees, covering the issuance of Common Stock ("Restricted Stock"). The Restricted Stock will be released to the key employees if they are employed by the Company at the end of a five-year waiting period. Unearned compensation has been recognized for the estimated fair value of the applicable common shares, reflected as a reduction of stockholders' equity, and is being charged to income over the five-year term.

Transactions in restricted stock were as follows:

Outstanding at September 30, 1998	128,000
Granted	25,000
Canceled	(8,000)
Outstanding at September 30, 1999	145,000
Granted	11,000
Canceled	(12,500)
Exercised	(48,000)
Outstanding at September 30, 2000	95,500
Granted	5,500
Outstanding at September 30, 2001	101,000

STOCK PURCHASE NOTES RECEIVABLE

The Company established a loan program during fiscal 1997 to assist employees in purchasing shares of the Company's Common Stock. The loans were collateralized by the employees' purchased shares and required annual interest payments at a rate equal to prime at the date of issuance. All loans have been repaid in full. This program has been discontinued, with no additional loans granted since fiscal 1997.

4. STOCK-BASED COMPENSATION PLAN

Under the Company's 1997 Incentive Stock Option Plan (the Plan), 1.2 million shares of Common Stock were reserved for issuance to employees and officers. The Plan requires that the option price per share must be 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. Options expire in five to seven years or upon termination of employment and are exercisable at a rate of 20% per year from the date of grant or 20% per year commencing one year after the date of grant. In addition, options representing a total of 112,800 shares remain outstanding from the Company's 1987 Incentive Stock Option Plan that was replaced by the 1997 Plan.

Under the Company's Nonqualified Stock Option Plan, 1,944,480 shares of Common Stock were reserved for issuance to outside directors, employees and officers. The options are granted at fair market value. Options expire in 5 to 10 years and are exercisable at a rate of 20% per year from the date of grant or 20% per year commencing two years after the date of grant.

As of September 30, 2001, there were 596,850 additional shares available for grant under the stock plans. Information regarding stock options under all plans is summarized as follows:

	2001		2000		1999	
Options	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding, beginning of year	1,565,560	$7.45	1,748,580	$3.76	2,539,280	$2.43
Granted	16,550	42.29	267,800	23.96	367,400	7.87
Exercised	(191,510)	3.26	(417,720)	2.56	(1,082,060)	2.08
Canceled	(7,340)	15.50	(33,100)	4.83	(76,040)	2.91
Outstanding, end of year	1,383,260	$8.41	1,565,560	$7.45	1,748,580	$3.76
Exercisable, end of year	851,190	$4.80	727,280	$3.19	878,820	$2.59
Weighted average fair value of options granted	$31.11		$16.92		$5.73	

The options outstanding at September 30, 2001 have exercise prices ranging between $2.50 and $53.00, with a weighted average exercise price of $8.41 and a weighted average remaining contractual life of 3.21 years.

The fair value of each option is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions used for grants in 2001, 2000 and 1999, respectively: risk-free interest rates of 4.51%, 5.95% and 6.01%; expected lives of 7.0, 7.2 and 7.3; and expected volatility of 77%, 72% and 71%.

The Company accounts for the options under APB Opinion No. 25, under which no compensation cost has been recognized. Had compensation cost for the options been determined consistent with SFAS No. 123, "Accounting for Stock-Based Compensation," the Company's net income would have been the following pro forma amounts for the years ended September 30 (in thousands, except per share data):

	2001	2000	1999
Net income:			
As reported	$ 5,109	$ 4,240	$ 4,360
Pro forma	$ 3,496	$ 3,565	$ 4,120
Diluted net income per share:			
As reported	$ .29	$ .25	$ .27
Pro forma	$ .20	$ .21	$ .26

Because the SFAS No. 123 method of accounting has not been applied to options granted prior to October 1, 1995, the resulting pro forma information may not be representative of that to be expected in future periods.

5. INCOME TAXES

The Company utilizes the liability method to account for income taxes. Deferred taxes are based on the estimated future tax effects of differences between the financial statement and tax basis of assets and liabilities given the provisions of the enacted tax laws.

The deferred income tax provision (benefit) reflects the net change during the year in deferred tax assets and liabilities. Income taxes in the accompanying statements of income for the years ended September 30 were as follows (in thousands):

	2001	2000	1999
Current provision:			
Federal	$ 2,672	$ 904	$ --
State and foreign	362	77	17
Total current provision	3,034	981	17
Deferred provision:			
Federal	832	1,528	(735)
State	(59)	--	(65)
Total deferred provision (benefit)	773	1,528	(800)
Total provision (benefit)	$ 3,807	$ 2,509	$ (783)

The reconciliation of the difference between amounts calculated at the statutory federal tax rate of 34% and the Company's effective tax rate was as follows (in thousands):

	2001	2000	1999
Amount at statutory federal income tax rate	$ 3,605	$ 2,500	$ 1,323
Change due to:			
Reversal of tax valuation allowance	(161)	--	(2,466)
State taxes	201	--	--
Rate difference for deferred tax assets	--	--	180
Other	162	9	180
Income tax provision (benefit)	$ 3,807	$ 2,509	$ (783)

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):

	2001	2000
Depreciation	$ 455	$ 319
Deferred revenue	996	129
Accruals and reserves	297	297
Net operating loss carryforwards	--	167
Capital loss carryforwards	--	149
Equity items	(169)	--
Other	(636)	--
Total deferred tax assets	943	1,061
Less- valuation allowance	--	(149)
Net deferred tax assets	943	912
Current deferred tax assets	297	--
Noncurrent deferred tax assets	$ 646	$ 912

6. COMMITMENTS AND CONTINGENCIES

Under provisions contained in the government research contracts, representatives of the government agencies have the right to access and review the Company's underlying records of contract costs. The government retains the right to reject expenses considered unallowable under the terms of the contract. The Defense Contract Audit Agency has reviewed the contracts through 1989. In the opinion of management, future amounts due, if any, with respect to open contract years will not have a material impact on the financial position or results of operations of the Company.

The Company entered into an agreement to purchase a 135,000-square-foot laboratory facility on 27 acres of land in Bloomington, Minnesota, for $7.1 million. The purchase was completed in October 2001. It is the Company's intent to transfer its operations into the facility towards the end of 2002.

7. DEFINED CONTRIBUTION PLAN

The Company has a 401(k) retirement and savings plan for the benefit of qualified employees. Under the plan, qualified employees may elect to defer up to 20% of their compensation, subject to a maximum limit determined by the Internal Revenue Service. The Company matches 50% of each dollar of the first 6% of the tax deferral elected by each employee. Company contributions totaling $166,000, $138,000 and $122,000 have been charged to income for the years ended September 30, 2001, 2000 and 1999, respectively.

8. OPERATING SEGMENTS (DOLLARS IN THOUSANDS)

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.

The Company manages its business on the basis of three business segments: licensing, manufacturing, and research and development. The licensing segment includes all license fees and royalty revenue generated from the transfer of the Company's technology. No expenses are allocated to the licensing segment. The manufacturing segment includes revenue from the sale of PhotoLink reagents, stabilization products and DNA slides. The expenses include all production costs, including analytical costs to verify quality of the finished products and certain technical support. The research and development segment includes the revenue generated from development projects for commercial customers and research revenue received from government grants. The expenses include all costs of the Company's technical personnel. Corporate includes all administrative, sales and marketing costs of the Company. These costs, along with interest income and income taxes, are not allocated to the other business segments. The Company's assets are not reviewed by business segment. The accounting policies for segment reporting are the same as for the Company as a whole (see Note 2).

	Licensing	Manufacturing	Research & development	Corporate	Consolidated
Year Ended September 30, 2001					
Revenues:					
PhotoLink	$ 9,575	$ 2,638	$ 3,648	$ --	$15,861
Diagnostic	3,253	--	--	--	3,253
Stabilization & other	--	3,047	--	--	3,047
Government	--	--	532	--	532
Total revenues	12,828	5,685	4,180	--	22,693
Operating expenses	--	2,440	7,997	4,690	15,127
Operating income (loss)	12,828	3,245	(3,817)	(4,690)	7,566
Other income				3,055	3,055
Income tax provision				(3,807)	(3,807)
Income before cumulative effect of a change in accounting principle					6,814
Year Ended September 30, 2000					
Revenues:					
PhotoLink	$ 8,233	$ 2,393	$ 1,445	$ --	$12,071
Diagnostic	2,917	--	--	--	2,917
Stabilization & other	--	2,687	--	--	2,687
Government	--	--	604	--	604
Total revenues	11,150	5,080	2,049	--	18,279
Operating expenses	--	1,903	6,797	4,246	12,946
Operating income (loss)	11,150	3,177	(4,748)	(4,246)	5,333
Other income				1,416	1,416
Income tax expense				(2,509)	(2,509)
Net income					$ 4,240
Year Ended September 30, 1999					
Revenues:					
PhotoLink	$ 4,557	$ 1,876	$ 1,122	$ --	$ 7,555
Diagnostic	2,758	--	--	--	2,758
Stabilization & other	--	2,261	--	--	2,261
Government	--	--	920	--	920
Total Revenues	7,315	4,137	2,042	--	13,494
Operating expenses	--	1,511	5,248	4,316	11,075
Operating income (loss)	7,315	2,626	(3,206)	(4,316)	2,419
Other income				1,158	1,158
Income tax expense				783	783
Net income					$ 4,360

MAJOR CUSTOMERS

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

	2001	2000	1999
Company A	19%	20%	20%
Company B	16%	24%	12%
Company C	16%	9%	7%
Company D	15%	7%	--

The revenues from each of the customers are derived from all three revenue segments.

GEOGRAPHIC REVENUE

Geographic revenues were as follows for the years ended September 30:

	2001	2000	1999
Domestic	89%	89%	87%
Foreign	11%	11%	13%

9. QUARTERLY FINANCIAL DATA

The following is a summary of the unaudited quarterly results for the years ended September 30, 2001 and 2000 (in thousands, except per share data). The results for 2001 reflect the Company's adoption of SAB 101 in the fourth quarter of 2001 (see Note 2). The effect of the change on results previously reported for the first three quarters of 2001 are presented below. The pro forma effect assuming retroactive treatment of SAB 101 on each quarter of 2000 is also presented.

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Fiscal 2001				
Revenue	$ 4,757	$ 5,443	$ 5,675	$ 6,818
Income from operations	1,256	1,698	1,884	2,728
Net income (loss)	(380)	1,610	1,675	2,204
Net income (loss) per share:				
Basic	(.02)	.10	.10	.13
Diluted	(.02)	.09	.09	.12
Net income originally reported	1,366	1,566	1,618	
Cumulative effect to September 30, 2000	(1,705)	--	--	
Effect of change	(41)	44	57	
Diluted net income (loss) as restated	(380)	1,610	1,675	
Diluted net income per share originally reported	.08	.09	.09	
Cumulative effect to September 30, 2000	(.10)	--	--	
Effect of change	--	--	--	
Diluted net income per share as restated	(.02)	.09	.09	
Fiscal 2000				
Revenue	$ 4,149	$ 4,441	$ 4,165	$ 5,524
Income from operations	1,206	1,151	1,039	1,937
Net income	944	904	861	1,531
Net income per share:				
Basic	.06	.06	.06	.10
Diluted	.06	.05	.05	.09
Pro forma to reflect SAB 101:				
Net income	995	848	868	958
Diluted net income per share	.06	.05	.05	.06

STOCK LISTING AND PRICE HISTORY

SurModics' stock is traded on the Nasdaq National Market under the symbol "SRDX." The table below sets forth the range of high and low closing sale prices for the Company's Common Stock, as reported by Nasdaq, since the date of the Company's Initial Public Offering in March 1998.

FISCAL QUARTER ENDED:	HIGH	LOW
September 30, 2001	59.00	35.37
June 30, 2001	59.37	35.37
March 31, 2001	37.06	23.25
December 31, 2000	36.81	20.81
September 30, 2000	28.46	14.44
June 30, 2000	18.66	9.56
March 31, 2000	17.31	11.25
December 31, 1999	16.06	6.75
September 30, 1999	9.38	7.06
June 30, 1999	8.38	6.38
March 31, 1999	7.25	4.94
December 31, 1998	7.75	3.25
September 30, 1998	7.06	3.59
June 30, 1998	5.88	4.13
March 31, 1998	4.50	3.88

According to the records of the Company's transfer agent, as of November 26, 2001, the Company had 262 holders of record of the Company's Common Stock and approximately 5,000 beneficial owners of shares registered in nominee or street name.

The Company has never paid any cash dividends on its Common Stock and does not anticipate doing so in the foreseeable future.

EXHIBIT 23

CONSENT OF INDEPENDENT PUBLIC ACCOUNTANTS

As independent public accountants, we hereby consent to the incorporation of our report incorporated by reference in this Form 10-K, into the Company's previously filed Registration Statement File Nos. 333-64171, 333-64173, 333-79741 and 333-54266

Arthur Andersen LLP

Minneapolis, Minnesota,
December 21, 2001