

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-QSB

Quarterly report under Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended June 30, 1998

OR

Transition report under Section 13 or 15(d) of the Exchange Act

For the transition period from to

Commission file number 0-23837

SurModics, Inc.

(Exact Name of Small Business Issuer as Specified in Its Charter)

MINNESOTA

(State or Other Jurisdiction of Incorporation or Organization)

41-1356149

(IRS Employer Identification No.)

9924 West 74th Street

Eden Prairie, Minnesota 55344

(Address of Principal Executive Offices)

(612) 829-2700

(Issuer's Telephone Number, Including Area Code)

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

Yes X No

As of July 31, 1998, there were 7,199,760 shares of Common Stock outstanding.

Traditional Small Business Disclosure Format (check one): Yes No X

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

SURMODICS, INC.
Condensed Balance Sheets
(In thousands, except share data)

	June 30, 1998	September 30, 1997
	----- (Unaudited)	-----
ASSETS		
CURRENT ASSETS:		
Cash & cash equivalents	\$ 1,841	\$ 492
Short-term investments	2,617	1,456
Accounts receivable, net	1,123	922
Inventories	304	264
Prepays and other	215	74
	-----	-----
Total current assets	6,100	3,208
	-----	-----
PROPERTY AND EQUIPMENT, net	1,238	1,065
LONG-TERM INVESTMENTS	15,644	1,874
OTHER ASSETS, net	184	303
	-----	-----
	\$ 23,166	\$ 6,450
	=====	=====

LIABILITIES AND STOCKHOLDERS' EQUITY

CURRENT LIABILITIES:

Accounts payable	\$ 183	\$ 280
Accrued liabilities	797	493
Deferred revenues	222	308

Total current liabilities	1,202	1,081
DEFERRED REVENUES AND OTHER, less current portion	162	267
Total liabilities	1,364	1,348
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' EQUITY:		
Series A convertible preferred stock-		
\$.05 par value; none and 376,828 shares		
issued and outstanding	--	19
Voting common stock-		
\$.05 par value, 15,000,000 shares authorized;		
7,199,160 and 3,400,868 shares issued and outstanding	360	170
Additional paid-in capital	28,876	13,492
Unearned compensation	(185)	(259)
Stock purchase notes receivable	(182)	(160)
Accumulated deficit	(7,067)	(8,160)
Total stockholders' equity	21,802	5,102
	\$ 23,166	\$ 6,450
	=====	=====

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

SURMODICS, INC.
Condensed Statements of Operations
(In thousands, except per share data)
(Unaudited)

	Three Months Ended June 30,		Nine Months Ended June 30,	
	1998	1997	1998	1997
REVENUES:				
Royalties	\$1,240	\$ 731	\$3,447	\$2,141
License fees	88	155	148	412
Product sales	831	588	2,063	1,514
Research and development	513	480	1,502	1,408
	-----	-----	-----	-----
Total revenues	2,672	1,954	7,160	5,475
	-----	-----	-----	-----
OPERATING COSTS AND EXPENSES:				
Product	344	319	912	905
Research and development	1,184	955	3,244	2,781
Sales and marketing	361	267	1,105	754
General and administrative	453	394	1,180	1,013
	-----	-----	-----	-----
Total operating costs and expenses	2,342	1,935	6,441	5,453
	-----	-----	-----	-----
INCOME FROM OPERATIONS	330	19	719	22
INTEREST INCOME, net	248	54	399	155
	-----	-----	-----	-----
INCOME BEFORE PROVISION FOR INCOME TAXES	578	73	1,118	177
PROVISION FOR INCOME TAXES	12	--	25	10
	-----	-----	-----	-----
NET INCOME	\$ 566	\$ 73	\$1,093	\$ 167
	=====	=====	=====	=====
NET INCOME PER SHARE:				
Basic	\$ 0.08	\$ 0.01	\$ 0.19	\$ 0.03
Diluted	\$ 0.07	\$ 0.01	\$ 0.17	\$ 0.03
WEIGHTED AVERAGE SHARES OUTSTANDING:				
Basic weighted average common shares outstanding	7,218	4,864	5,897	4,848
Dilutive effect of outstanding stock options	646	508	543	485
	-----	-----	-----	-----
Diluted weighted average common shares outstanding	7,864	5,372	6,440	5,333

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

SURMODICS, INC.
Condensed Statements of Cash Flows
(In thousands)
(Unaudited)

	Nine Months Ended June 30,	
	1998	1997
OPERATING ACTIVITIES:		
Net income	\$ 1,093	\$ 167
Adjustments to reconcile net income to net cash provided by operating activities-		
Depreciation and amortization	436	344
Amortization of unearned compensation, net	94	(125)
Change in deferred rent	(12)	(1)
Change in assets and liabilities:		
Accounts receivable	(201)	(101)
Inventories	(40)	3
Accounts payable and accrued liabilities	207	147
Deferred revenues	(180)	(286)
Prepays and other	(141)	(108)
	-----	-----
Net cash provided by operating activities	1,256	40
	-----	-----
INVESTING ACTIVITIES:		
Purchases of property and equipment, net	(597)	(145)
Purchases of investments available for sale	(17,500)	(3,324)
Sales of investments available for sale	2,569	1,832
Other	(22)	(171)
	-----	-----
Net cash used in investing activities	(15,550)	(1,808)
	-----	-----
FINANCING ACTIVITIES:		
Issuance of common stock, net of offering costs	15,643	205
	-----	-----
Net increase (decrease) in cash and cash equivalents	1,349	(1,563)
CASH AND CASH EQUIVALENTS:		
Beginning of period	492	2,013
	=====	=====
End of period	\$ 1,841	\$ 450
	=====	=====

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

SURMODICS, INC.
Notes to Condensed Financial Statements
(Unaudited)

(1) Basis of Presentation:

In the opinion of management, the accompanying unaudited condensed financial statements have been prepared in accordance with generally accepted accounting principles and reflect all adjustments, consisting solely of normal recurring adjustments, needed to fairly present the financial results for these interim periods. These financial statements include some amounts that are based on management's best estimates and judgments. These estimates may be adjusted as more information becomes available, and any adjustment could be significant. The results of operations for the three months and nine months ended June 30, 1998 are not necessarily indicative of the results that may be expected for the entire fiscal year.

According to the rules and regulations of the Securities and Exchange Commission, the Company has omitted footnote disclosures that would substantially duplicate the disclosures contained in the audited financial statements of the Company. Read together with the disclosures below, management believes the interim financial statements are presented fairly. However, these unaudited condensed financial statements should be read together with the financial statements for the year ended September 30, 1997 and footnotes thereto included in the Company's Registration Statement on Form SB-2 as filed with the Securities and Exchange Commission on March 4, 1998.

(2) New Accounting Pronouncements

The Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 130, "Reporting Comprehensive Income," which establishes standards for reporting and displaying comprehensive income and its components in financial statements. The Company will adopt the provisions of SFAS No. 130 in fiscal 1999.

The FASB issued SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information," which establishes a new model for segment reporting, called the "management approach" and requires certain disclosures for each segment. The management approach is based on the way the chief operating decision maker organizes segments within a company for making operating decisions and assessing performance. The Company will adopt the provisions of SFAS No. 131 in fiscal 1999.

(3) Initial Public Offering

On March 9, 1998, the Company completed an initial public offering of 2.0 million shares of Common Stock. Subsequently, on March 25, 1998, the underwriters purchased an additional 300,000 shares of Common Stock pursuant to the exercise of an overallotment option. In total, the offering generated net proceeds to the Company of approximately \$15.5 million after deducting all offering expenses.

(4) Preferred Stock Conversion

Each share of the Series A Convertible Preferred Stock was automatically converted into four shares of voting Common Stock upon the closing of the initial public offering. The authorized shares of Series A Convertible Preferred Stock were eliminated and this class of stock was canceled.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION.

General

The Company is a leading provider of surface modification solutions to medical device manufacturers. The Company's revenues have come from four primary sources: licensing of its patented technology to customers; royalties received from licensees based on their sales of products incorporating SurModics' technology; the sale of photo-reactive chemical compounds to licensees and stabilization products to the diagnostics industry; and research and development fees generated on projects for commercial customers and pursuant to government grants. In March 1998, the Company completed an initial public offering of 2.3 million shares of Common Stock with proceeds of approximately \$15.5 million, net of related offering costs.

Results of Operations

Three Months Ended June 30, 1998 and 1997

Revenues. The Company's revenues were \$2.7 million for the third quarter of fiscal 1998, an increase of \$718,000, or 36.7%, over the same period of fiscal 1997. The revenue increase was primarily due to an increase in royalty revenue received from licensed customers of \$509,000 or 69.7%. Within this total, royalties generated from PhotoLink(R) licenses increased 51.2% and royalties from diagnostic licensing increased 87.6%. In addition, the Company's product sales increased \$243,000 or 41.4% between periods. The sales of reagent chemicals, the chemicals used by licensees in the PhotoLink coating process, increased 113.2%, while stabilization product sales increased 23.5%. These increases were due to additional customer demand for the Company's chemical products.

Product costs. The Company's product costs were \$344,000 for the third quarter of fiscal 1998, an increase of \$25,000, or 7.8%, over the same period of fiscal 1997. Overall product margins increased to 58.6% in the third quarter of fiscal 1998 from 45.7% in the same period of fiscal 1997. These improvements were primarily due to the continued impact of a formulation change in certain of the stabilization products and production efficiencies achieved in manufacturing reagent chemicals due to increased volumes.

Research and development expenses. Research and development expenses were \$1,184,000 for the third quarter of fiscal 1998, an increase of \$229,000, or 24.0%, over the same period of fiscal 1997. The change was primarily due to the added compensation, benefit, and general business expenses associated with additional technical personnel added by the Company over the last year; and increased depreciation expense associated with the build-out of some additional laboratory space.

Sales and marketing expenses. Sales and marketing expenses were \$361,000 for the third quarter of fiscal 1998, an increase of \$94,000, or 35.2%, over the same period of fiscal 1997. This increase was primarily due to the additional compensation and travel expense associated with additional marketing personnel and higher spending for advertising and promotions.

General and administrative expenses. General and administrative expenses were \$453,000 for the third quarter of fiscal 1998, an increase of \$59,000, or 15.0%, over the same period of fiscal 1997. The increase was due to costs associated with a new directors and officers liability insurance policy and other general business expenses incurred as a result of the Company's overall business growth.

Interest income, net. The Company's net interest income was \$248,000 for the third quarter of fiscal 1998, an increase of \$194,000, or 359.3%, over the same period of fiscal 1997 due to the increased interest income earned on investments due to the proceeds received from the public stock offering.

Nine Months Ended June 30, 1998 and 1997

Revenues. The Company's revenues were \$7.2 million for the first nine months of fiscal 1998, an increase of \$1.7 million or 30.8%, over the same period of fiscal 1997. The revenue increases were primarily due to an increase in royalty revenue of \$1.3 million or 61.0%; an increase in sales of the Company's stabilization products of \$364,000 or 32.0%; an increase in sales of the Company's reagent chemicals of \$187,000 or 49.7%; and an increase in customer-funded research and development revenue of \$172,000 or 32.3% between periods. Royalties generated from PhotoLink licenses increased 44.0% and royalties from diagnostic licensing increased 77.6%. Much of the increase in sales of stabilization products was due to larger shipments to one customer. The increase in reagent chemicals is a result of additional coating activities by existing PhotoLink customers. The increase in customer-funded research and development was due to greater customer development activity, especially related to work on drug delivery from coatings. Offsetting these revenue increases was a reduction in license fees from \$412,000 in the first nine months of fiscal 1997 to \$148,000 in the same period of fiscal 1998. The fiscal 1997 results included the receipt of one large license fee with no similar transaction in fiscal 1998.

Product costs. The Company's product costs were \$912,000 for the first nine months of fiscal 1998, an increase of \$7,000, or 0.8%, over the same period of fiscal 1997. Product margins increased to 55.8% in 1998 from 40.2% in 1997. These improvements were primarily due to the continued impact of a formulation change in certain of the stabilization products and production efficiencies achieved in manufacturing reagent chemicals due to increased volumes.

Research and development expenses. Research and development expenses were \$3.2 million for the first nine months of fiscal 1998, an increase of \$463,000, or 16.6%, over the same period of fiscal 1997. The change was primarily due to the added compensation and benefit costs associated with additional technical personnel added by the Company over the last year and increased depreciation expense associated with the build-out of some additional laboratory space. These changes were offset by lower costs incurred on research studies performed by external laboratories.

Sales and marketing expenses. Sales and marketing expenses were \$1.1 million for the first nine months of fiscal 1998, an increase of \$351,000, or 46.6%, over the same period of fiscal 1997. This increase was primarily due to the additional compensation and travel expenses of additional marketing personnel, a related increase in recruitment costs, and the costs associated with a market research study completed by an external consulting firm.

General and administrative expenses. General and administrative expenses were \$1.2 million for the first nine months of fiscal 1998, an increase of \$167,000, or 16.5%, over the same period of fiscal 1997. The increase was primarily due to higher compensation, benefit, and general business costs as described above.

Interest income, net. The Company's net interest income was \$399,000 for the first nine months of fiscal 1998, an increase of \$244,000, or 157.4%, over the same period of fiscal 1997 due to the increased interest income earned on investments due to the proceeds received from the public stock offering.

Year 2000 Compliance

The Company has evaluated its information technology infrastructure for Year 2000 compliance and does not expect that the cost to modify its information technology infrastructure to be Year 2000 compliant will be material to its financial condition or results of operations. The Company does not anticipate any material disruption in its operations as a result of any failure by the Company or its suppliers or customers to be in compliance.

Liquidity and Capital Resources

On March 9, 1998, the Company completed an initial public offering of 2.0 million shares of Common Stock. Subsequently, on March 25, 1998, the underwriters purchased an additional 300,000 shares of Common Stock pursuant to the exercise of an overallotment option. In total, the offering generated net proceeds to the Company of approximately \$15.5 million after deducting all offering expenses.

As of June 30, 1998, the Company had working capital of approximately \$2.9 million. For the last three fiscal years and for the first nine months of fiscal 1998, the Company has generated positive cash flow from operations.

As of June 30, 1998, the Company had cash, cash equivalents and investments totaling approximately \$20.1 million. The Company's funds are currently invested in money market funds and investment grade, interest-bearing securities with maturity dates of less than three years. As of June 30, 1998, the Company had no debt, nor did it have any credit agreements.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings.

None.

Item 2. Changes in Securities and Use of Proceeds.

(a) The following stock option exercises occurred during the quarter ended June 30, 1998:

Date	Relationship	Shares	Option Price
April 30, 1998	Former employee	320	\$5.00
May 1, 1998	Former employee	1,920	\$5.00
May 28, 1998	Former employee	400	\$4.00
June 8, 1998	Current employee	100	\$5.00

The Company relied on the exemption from registration available under section 3(b) of the Securities Act of 1933, as amended, and Rule 701 thereunder.

(b) Use of Proceeds for the period ending June 30, 1998.

(1)	Effective Date:	March 3, 1998
	SEC File Number:	333-43217
(2)	Offering Date:	March 3, 1998
(4) (i)	The offering has terminated; all securities registered were sold.	
(4) (ii)	Managing Underwriter:	John G. Kinnard and Company, Incorporated
(4) (iii)	Title of Securities:	Common Stock
(4) (iv)	Amount Registered:	2,300,000
	Aggregate Offering Price:	\$17,250,000
	Amount Sold:	2,300,000
	Aggregate Offering Price Sold:	\$17,250,000
(4) (v)	Underwriting Discount and Commissions	\$ 1,293,750
	Other Expenses \$ 435,148 Total Expenses	\$ 1,728,898
	All the above items represented direct or indirect payments to others.	
(4) (vi)	Net Offering Proceeds	\$15,521,102
(4) (vii)	Use of Net Offering Proceeds:	
	Research and development	\$ 74,184
	Sales and marketing	\$ 166,460
	Equipment upgrades	\$ 139,150
	Patent protection	\$ --
	Working capital and general corporate purposes	\$ 84,449
	Money market funds	\$15,056,859
	All the above items represented direct or indirect payments to others.	

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Submission of Matters to a Vote of Security Holders.

None.

Item 5. Other Information.

None.

Item 6. Exhibits and Reports on Form 8-K.

- (a) Exhibits - 27 Financial Data Schedule
- (b) Reports on Form 8-K - None

SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

SurModics, Inc.

August 13, 1998

By: /s/ Stephen C. Hathaway
Stephen C. Hathaway
Vice President & CFO
(Principal Financial Officer)

Exhibit Index

Exhibit Number	Description
27	Financial Data Schedule

1,000
U.S. Dollars

	9-MOS	SEP-30-1998	OCT-01-1997	JUN-30-1998
	1			
		2,617		
		1,123		
		0		
		304		
	6,100			
		3,223		
		23,166		
1,202				
	0			
		0		
		360		
23,166				
		21,442		
		2,063		
	7,160			
		6,441		
		0		
		0		
		0		
		1,118		
		25		
1,093				
		0		
		0		
		1,093		
		0.19		
		0.17		