

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2003

OR

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

For the transition period from to

Commission File Number 0-23837

SurModics, Inc.

(Exact name of registrant as specified in its Charter)

MINNESOTA
(State of incorporation)

41-1356149
(I.R.S. Employer Identification No.)

9924 West 74th Street
Eden Prairie, Minnesota 55344
(Address of principal executive offices)

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

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

Yes No

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes No

The number of shares of the registrant's Common Stock, \$.05 par value per share, outstanding as of July 31, 2003 was 17,437,270.

TABLE OF CONTENTS

PART I — FINANCIAL INFORMATION

Item 1. Financial Statements

SIGNATURES

EX-31.1 Certification of CEO Pursuant to Sec. 302

EX-31.2 Certification of CFO Pursuant to Sec. 302

EX-32.1 Certification of CEO Pursuant to Sec. 906

EX-32.2 Certification of CFO Pursuant to Sec. 906

PART I — FINANCIAL INFORMATION**Item 1. Financial Statements****SURMODICS, INC.**

Condensed Balance Sheets
(In thousands, except share and per share data)
(Unaudited)

	June 30, 2003	September 30, 2002
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 5,257	\$ 9,207
Short-term investments	1,660	3,942
Accounts receivable, net	8,257	5,506
Inventories	831	746
Deferred tax asset	417	417
Prepays and other	865	1,058
Total current assets	17,287	20,876
Property and equipment, net	29,328	18,836
Long-term investments	40,144	30,726
Deferred tax asset	803	740
Other assets, net	6,964	6,070
	\$ 94,526	\$ 77,248
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities		
Accounts payable	\$ 372	\$ 877
Accrued liabilities	6,529	3,899
Accrued income taxes payable	2,608	—
Deferred revenue	1,513	281
Total current liabilities	11,022	5,057
Deferred revenue, less current portion	1,831	2,196
Total liabilities	12,853	7,253
Commitments and Contingencies		
Stockholders' Equity		
Series A Preferred stock- \$.05 par value, 450,000 shares authorized; no shares issued and outstanding	—	—
Common stock- \$.05 par value, 45,000,000 shares authorized; 17,431,420 and 17,271,594 shares issued and outstanding	872	864
Additional paid-in capital	56,295	53,936
Unearned compensation	(490)	(460)
Accumulated other comprehensive income	521	673
Retained earnings	24,475	14,982
Total stockholders' equity	81,673	69,995
	\$ 94,526	\$ 77,248

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

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

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2003	2002	2003	2002
Revenue				
Royalties	\$ 7,997	\$ 3,020	\$ 16,120	\$ 8,603
License fees	534	110	1,189	569
Product sales	2,824	2,571	8,756	6,124
Research and development	1,464	1,900	4,543	5,473
Total revenue	12,819	7,601	30,608	20,769
Operating costs and expenses				
Product	582	678	1,952	1,932
Research and development	3,133	2,323	8,719	7,015
Sales and marketing	575	346	1,646	1,065
General and administrative	1,570	1,351	4,485	3,650
Total operating costs and expenses	5,860	4,698	16,802	13,662
Income from operations	6,959	2,903	13,806	7,107
Other income				
Investment income, net	354	371	1,101	1,158
Gain on sale of investments	133	(45)	423	5
Other income, net	487	326	1,524	1,163
Income before income taxes	7,446	3,229	15,330	8,270
Income tax provision	(2,874)	(1,198)	(5,837)	(3,071)
Net income	\$ 4,572	\$ 2,031	\$ 9,493	\$ 5,199
Basic net income per share	\$ 0.26	\$ 0.12	\$ 0.55	\$ 0.31
Diluted net income per share	\$ 0.26	\$ 0.11	\$ 0.53	\$ 0.29
Weighted average shares outstanding				
Basic	17,402	17,119	17,338	16,941
Dilutive effect of outstanding stock options	482	731	495	904
Diluted	17,884	17,850	17,833	17,845

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,	
	2003	2002
Operating Activities		
Net income	\$ 9,493	\$ 5,199
Adjustments to reconcile net income to net cash provided by operating activities-		
Depreciation and amortization	1,860	1,377
Gain on sale of investments	(423)	(5)
Amortization of unearned compensation	112	87
Deferred tax	(63)	59
Tax benefit from exercise of stock options	1,100	3,500
Change in operating assets and liabilities:		
Accounts receivable	(2,751)	(1,285)
Inventories	(85)	(7)
Accounts payable and accrued liabilities	1,640	(37)
Income taxes	3,093	(1,508)
Deferred revenue	867	66
Prepays and other	206	260
Net cash provided by operating activities	15,049	7,706
Investing Activities		
Purchases of property and equipment	(12,334)	(9,582)
Purchases of available-for-sale investments	(58,263)	(29,037)
Sales/maturities of available-for-sale investments	51,399	30,821
Purchase of other assets	(925)	(3,911)
Net cash used in investing activities	(20,123)	(11,709)
Financing Activities		
Issuance of common stock	1,124	1,352
Net change in cash and cash equivalents	(3,950)	(2,651)
Cash and Cash Equivalents		
Beginning of period	9,207	9,044
End of period	\$ 5,257	\$ 6,393
Supplemental Information		
Cash paid for income taxes	\$ 1,630	\$ 1,068

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 accounting principles generally accepted in the United States 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 impact of any change in estimates is included in the determination of earnings in the period in which the change in estimate is identified. The results of operations for the nine months ended June 30, 2003, are not necessarily indicative of the results that may be expected for the entire fiscal year.

According to the rules and regulations of the United States Securities and Exchange Commission, the Company has omitted footnote disclosures that would substantially duplicate the disclosures contained in the audited 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, 2002, and footnotes thereto included in the Company's Form 10-K as filed with the United States Securities and Exchange Commission.

(2) New Accounting Pronouncements

In November 2002, the Emerging Issues Task Force (EITF) reached a consensus on Issue No. 00-21, "Revenue Arrangements with Multiple Deliverables," which provides guidance on how to account for arrangements that involve the delivery or performance of multiple products, services and/or right to use assets. The provisions of EITF Issue No. 00-21 will apply to revenue arrangements entered into in fiscal periods beginning after June 15, 2003. The adoption of EITF Issue No. 00-21 will not have an impact on the Company's financial statements.

(3) Inventories (dollars in thousands)

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:

	June 30, 2003	September 30, 2002
Raw materials	\$ 361	\$ 408
Finished goods	470	338
	<u>\$ 831</u>	<u>\$ 746</u>

(4) Operating Segments (dollars in thousands)

	<u>Licensing</u>	<u>Manufacturing</u>	<u>Research & Development</u>	<u>Corporate</u>	<u>Consolidated</u>
Three Months Ended June 30, 2003					
Revenue:					
Coating	\$ 7,938	\$ 2,138	\$ 1,367	\$ —	\$ 11,443
Diagnostic	593	—	—	—	593
Stabilization & other	—	686	—	—	686
Government research	—	—	97	—	97
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Total revenue	8,531	2,824	1,464	—	12,819
Expenses	—	582	3,133	2,145	5,860
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Operating income (loss)	8,531	2,242	(1,669)	(2,145)	6,959
Other income, net				487	487
Income tax provision				(2,874)	(2,874)
				<u> </u>	<u> </u>
Net income					\$ 4,572
					<u> </u>
Three Months Ended June 30, 2002					
Revenue:					
Coating	\$ 2,382	\$ 1,834	\$ 1,766	\$ —	\$ 5,982
Diagnostic	748	—	—	—	748
Stabilization & other	—	737	—	—	737
Government research	—	—	134	—	134
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Total revenue	3,130	2,571	1,900	—	7,601
Expenses	—	678	2,323	1,697	4,698
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Operating income (loss)	3,130	1,893	(423)	(1,697)	2,903
Other income, net				326	326
Income tax provision				(1,198)	(1,198)
				<u> </u>	<u> </u>
Net income					\$ 2,031
					<u> </u>

(4) Operating Segments —continued (dollars in thousands)

	<u>Licensing</u>	<u>Manufacturing</u>	<u>Research & Development</u>	<u>Corporate</u>	<u>Consolidated</u>
Nine Months Ended June 30, 2003					
Revenue:					
Coating	\$ 15,248	\$ 6,638	\$ 4,226	\$ —	\$ 26,112
Diagnostic	2,061	—	—	—	2,061
Stabilization & other	—	2,118	—	—	2,118
Government	—	—	317	—	317
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Total Revenue	17,309	8,756	4,543	—	30,608
Expenses	—	1,952	8,719	6,131	16,802
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Operating income (loss)	17,309	6,804	(4,176)	(6,131)	13,806
Other income				1,524	1,524
Income tax provision				(5,837)	(5,837)
				<u> </u>	<u> </u>
Net income					\$ 9,493
					<u> </u>
Nine Months Ended June 30, 2002					
Revenue:					
Coating	\$ 7,238	\$ 4,006	\$ 5,047	\$ —	\$ 16,291
Diagnostic	1,934	—	—	—	1,934
Stabilization & other	—	2,118	—	—	2,118
Government	—	—	426	—	426
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Total Revenue	9,172	6,124	5,473	—	20,769
Expenses	—	1,932	7,015	4,715	13,662
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Operating income (loss)	9,172	4,192	(1,542)	(4,715)	7,107
Other income				1,163	1,163
Income tax provision				(3,071)	(3,071)
				<u> </u>	<u> </u>
Net income					\$ 5,199
					<u> </u>

(5) Stock-based Compensation

Had the Company determined stock-based compensation costs based on the estimated fair value at the grant date for its stock options, the Company's net income and basic and diluted net income per share for the three and nine months ended June 30, 2003 and June 30, 2002 would have been as follows (in thousands, except per share data):

	Three months ended June 30,		Nine months ended June 30,	
	2003	2002	2003	2002
Net income				
As reported	\$ 4,572	\$ 2,031	\$ 9,493	\$ 5,199
Fair value compensation expense, net of tax	(433)	(304)	(1,039)	(871)
Pro forma	\$ 4,139	\$ 1,727	\$ 8,454	\$ 4,328
Basic net income per share:				
As reported	\$ 0.26	\$ 0.12	\$ 0.55	\$ 0.31
Fair value compensation expense, net of tax	(.02)	(.02)	(.06)	(.06)
Pro forma	\$ 0.24	\$ 0.10	\$ 0.49	\$ 0.26
Diluted net income per share:				
As reported	\$ 0.26	\$ 0.11	\$ 0.53	\$ 0.29
Fair value compensation expense, net of tax	(.03)	(.01)	(.06)	(.05)
Pro forma	\$ 0.23	\$ 0.10	\$ 0.47	\$ 0.24

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 for the three months ended June 30, 2003 and June 30, 2002, respectively: risk-free interest rates of 3.18% and 4.53%; expected lives of 7.9 and 7.0; and expected volatility of 70% and 74%. The weighted-average assumptions for the nine months ended June 30, 2003 and June 30, 2002, respectively: risk-free interest rates of 3.05% and 3.70%; expected lives of 7.3 and 7.1; and expected volatility of 70% and 74%.

(6) Comprehensive Income (dollars in thousands)

The components of comprehensive income for the three-month and nine-month periods are as follows:

	Three months ended June 30,		Nine months ended June 30,	
	2003	2002	2003	2002
Net income	\$ 4,572	\$ 2,031	\$ 9,493	\$ 5,199
Other comprehensive income:				
Unrealized holding gains (losses) on available-for-sale securities arising during the period, net of tax	87	314	110	103
Less reclassification adjustment for realized gains included in net income, net of tax	(82)	28	(262)	(3)
Other comprehensive income (loss)	5	342	(152)	100
Comprehensive income	\$ 4,577	\$ 2,373	\$ 9,341	\$ 5,299

ITEM 2. 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; product sales (reagent chemical compounds to licensees, stabilization products to the diagnostics industry, and coated slides to the genomics market); and research and development fees generated on projects for commercial customers and pursuant to government grants.

Critical Accounting Policies and Estimates

Critical accounting policies are those policies that require the application of management's most challenging, subjective or complex judgment, often as a result of the need to make estimates about the effect of matters that are inherently uncertain and may change in subsequent periods. Critical accounting policies involve judgements and uncertainties that are sufficiently sensitive to result in materially different results under different assumptions and conditions. For a detailed description of our critical accounting policies, see the notes to the financial statements included in our Annual Report on Form 10-K for the year ended September 30, 2002.

Results of Operations*Three Months Ended June 30, 2003 and 2002*

Revenue. The Company's revenue was \$12.8 million in the third quarter of fiscal 2003, an increase of \$5.2 million, or 69%, compared with the same period of fiscal 2002. The revenue components were as follows (in thousands):

	2003	2002	\$ Increase (Decrease)	% Increase (Decrease)
Coatings revenue:				
Royalties	\$ 7,404	\$ 2,272	\$ 5,132	226%
License fees	534	110	424	385%
Reagent sales	2,138	1,834	304	17%
Commercial development	1,367	1,766	(399)	(23%)
Total coatings revenue	11,443	5,982	5,461	91%
Other revenue:				
Diagnostic royalties	593	748	(155)	(21%)
Stabilization & slide sales	686	737	(51)	(7%)
Government research	97	134	(37)	(28%)
Total revenue	\$ 12,819	\$ 7,601	\$ 5,218	69%

Third quarter increase in total revenue resulted from a 91% increase in coatings revenue. Revenue from coatings royalties was \$7.4 million in the third quarter of 2003, an increase of \$5.1 million or 226% from the same period in 2002. The growth resulted primarily from the royalty obligations of Cordis Corporation on its Cypher stent. The growth also reflects a one-time back royalty of \$1.0 million on product sales by a licensee and an increase in minimum royalties from Amersham plc on its gene chip. License fee revenue increased 385% to \$534,000 compared with \$110,000 for the same period last year. Results include a \$500,000 milestone payment from Amersham for a product that it introduced to the market during the quarter.

Table of Contents

Revenue from reagent chemical sales was \$2.1 million, an increase of \$304,000 or 17% from the same period in 2002. The growth primarily reflects increased sales to Cordis in support of their Cypher stent manufacturing process. Cordis continues to purchase a substantial majority of reagents sold. Commercial development revenue was \$1.4 million in the third quarter of 2003, down 23% from the \$1.8 million from the same period in 2002. Substantially all of the decrease results from a lower level of clinical coating work on Cypher since Cordis has now received U.S. Food and Drug Administration (FDA) approval. However, the Company continues to perform other development work for Cordis and other customers, but on a smaller scale. Cordis accounted for a substantial majority of the development work performed by the Company during the quarter.

Product costs. Product costs were \$582,000 for the third quarter of fiscal 2003, a decrease of \$96,000, or 14%, compared with the same period of fiscal 2002. Overall product margins increased to 79% in the third quarter of fiscal 2003 from 74% in the same period last year as a result of reduced scrap costs and the fact that higher margin reagent product sales constituted a greater percentage of total product sales.

Research and development expenses. Research and development expenses were \$3.1 million for the third quarter of fiscal 2003, an increase of \$810,000, or 35%, compared with the same period of fiscal 2002. The increase was primarily a result of higher depreciation and facilities costs as the Company moved segments of its research and development activities to a portion of its new Bloomington facility during the first fiscal quarter of 2003. In addition, compensation and benefits associated with technical personnel added by the Company during the last year contributed to the increase.

Sales and marketing expenses. Sales and marketing expenses were \$575,000 for the third quarter of fiscal 2003, a \$229,000 or 66% increase from the same period of fiscal 2002. The increase reflects higher promotional costs, increased compensation, benefits, and business travel related to marketing personnel added in the first quarter of fiscal 2003 and licensing costs.

General and administrative expenses. General and administrative expenses were \$1.6 million for the third quarter of fiscal 2003, an increase of \$219,000, or 16%, compared with the same period of fiscal 2002. The increase was principally a result of legal fees related to contract negotiation and intellectual property work. In addition, the third quarter of fiscal 2003 was the first quarter to bear the full impact of directors and officers insurance premiums that tripled compared with the same period last year. These increases were partially offset by a decrease in facilities costs as they were allocated to research and development expenses described above.

Other income, net. The Company's other income was \$487,000 for the third quarter of fiscal 2003, an increase of \$161,000, or 49%, compared with the same period of fiscal 2002. An increase in realized gains from activity in the Company's investment portfolio was partially offset by a decrease in investment income as a result of lower investment yields.

Income tax expense. The Company's income tax provision was \$2.9 million for the third quarter of fiscal 2003 compared with \$1.2 million in the same period of fiscal 2002. The current quarter provision increased the effective tax rates to 38.0% for fiscal 2003 compared with 37.0% in fiscal 2002.

Nine Months Ended June 30, 2003 and 2002

Revenue. The Company's revenue was \$30.6 million for the first nine months of fiscal 2003, an increase of \$9.8 million, or 47%, compared with the same period of fiscal 2002. The revenue components were as follows (in thousands):

[Table of Contents](#)

	2003	2002	\$ Increase (Decrease)	% Increase (Decrease)
Coatings revenue:				
Royalties	\$ 14,059	\$ 6,669	\$ 7,390	111%
License fees	1,189	569	620	109%
Reagent chemical sales	6,638	4,006	2,632	66%
Commercial development	4,226	5,047	(821)	(16%)
Total coatings revenue	26,112	16,291	9,821	60%
Other revenue:				
Diagnostic royalties	2,061	1,934	127	7%
Stabilization & slide sales	2,118	2,118	—	—%
Government research	317	426	(109)	(26%)
Total revenues	\$ 30,608	\$ 20,769	\$ 9,839	47%

Substantially all of the revenue increase for the first nine months of fiscal 2003 reflects the growth in coatings revenue, royalties and reagent sales in particular. The 111% growth in coatings royalties was primarily a result of royalties from Cordis and minimum royalty payments from Amersham. Reagent chemical sales increased 66% to \$6.6 million compared with the same period last year. The increase principally reflects purchases by Cordis in support of their Cypher stent manufacturing process. Cordis continues to purchase a substantial percentage of reagents sold. On April 24, 2003, Cordis received FDA approval to begin marketing its Cypher stent in the U.S. Accordingly, management expects Cordis to continue to purchase a substantial percentage of the reagents sold for the balance of the fiscal year, in addition to being a significant source of royalty revenue.

Commercial development revenue decreased 16% to \$4.2 million. Substantially all of the decrease results from a reduced level of Cordis drug eluting stent work described earlier. Cordis accounted for a substantial majority of the development work performed by the Company during the first nine months of fiscal 2003. Most of the work performed for Cordis was to support their clinical trials. Now that Cordis has received FDA approval, management expects demand for this type of work on the Cypher stent to decrease significantly. The Company continues to provide commercial development services to Cordis and other customers, but on a smaller scale, because in many cases the projects are at earlier stages of development.

License fees increased 109% to \$1.2 million from the same period in fiscal 2002. Substantially all of the increase was attributable to the \$500,000 milestone payment discussed above and a non-performing license the Company cancelled in the first quarter of fiscal 2003 that resulted in the recognition of approximately \$340,000 of deferred license fee revenue. It should also be noted that prior year results included a one-time milestone payment of \$250,000. Taking into account the one-time nature of the cancelled license and the milestone payments, management expects annualized year to date license fee results to be a good indication of licensing activity for the near future.

Product costs. The Company's product costs were \$2.0 million for the first nine months of fiscal 2003, an increase of approximately 1% compared with the same period of fiscal 2002. Overall product margins were 78% in the first nine months of fiscal 2003 compared with 68% in the same period of fiscal 2002. As stated above, higher margin reagent product sales constituted a greater percentage of total product sales.

Research and development expenses. Research and development expenses were \$8.7 million for the first nine months of fiscal 2003, an increase of \$1.7 million, or 24%, compared with the same period of fiscal 2002. The change was primarily a result of compensation and benefits associated with technical personnel added by the Company during the past year and increased depreciation and facilities expenses. The Company moved segments of its research and development activities to a portion of the newly renovated Bloomington facility early in fiscal year 2003. Management expects research and development expenses to increase throughout the balance of the fiscal year and into fiscal year 2004 as

[Table of Contents](#)

the Company completes more of its renovations and moves additional research and development activity to the Bloomington facility.

Sales and marketing expenses. Sales and marketing expenses were \$1.6 million for the first nine months of fiscal 2003, an increase of \$581,000 or 55% from the same period of fiscal 2002. As explained earlier, most of the increase is attributable to compensation and benefits expense on marketing personnel added in the first quarter of fiscal 2003 along with increased business travel and promotional expenses. Management expects sales and marketing expenses to increase throughout the balance of the fiscal year and into fiscal 2004, although at a lower rate of growth.

General and administrative expenses. General and administrative expenses were \$4.5 million for the first nine months of fiscal 2003, an increase of \$835,000, or 23%, compared with the same period of fiscal 2002. The increase was primarily a result of costs associated with contract negotiations. Management expects general and administrative expenses to moderate for the balance of fiscal 2003 as the carrying costs of the Bloomington facility are transferred to research and development.

Other income, net. The Company's other income was \$1.5 million for the first nine months of fiscal 2003, an increase of \$361,000, or 31%, compared with the same period of fiscal 2002. Investment income decreased 5% in the current period reflecting lower yields. Offsetting this decrease were realized gains of \$423,000 for the first nine months of fiscal 2003 compared with \$5,000 in fiscal 2002.

Income tax expense. The Company's income tax provision was \$5.8 million for the first nine months of fiscal 2003 compared with \$3.1 million in the same period of fiscal 2002. The effective tax rates were 38.0% in fiscal 2003 and 37.0% in fiscal 2002.

Liquidity and Capital Resources

As of June 30, 2003, the Company had working capital of \$6.3 million and cash, cash equivalents and investments totaling \$47.1 million. 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. The Company generated positive cash flows from operating activities of \$15.0 million in the first nine months, an increase of 95% from the same period of last year.

In October 2001, the Company purchased a facility in Bloomington, Minnesota, situated on 27 acres of land, for approximately \$7.1 million and expended an additional \$4.0 million throughout fiscal 2002 on capital improvements. During fiscal 2003, the Company expects to invest approximately \$12.4 million to construct additional manufacturing capacity at this location. Approximately \$9.7 million of this amount was incurred during the first nine months of fiscal 2003.

In the first quarter of fiscal 2002, the Company invested \$4.0 million in Novocell, Inc., a privately held Irvine, California-based biotech firm that is developing a potential cure for diabetes. On April 29, 2003, the Company invested an additional \$925,000 in Novocell. The \$4.9 million investment, which is accounted for under the cost basis, is included in other assets and represents an ownership interest of less than 15%.

As of June 30, 2003, 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 November 2002, the Emerging Issues Task Force (EITF) reached a consensus on Issue No. 00-21, "Revenue Arrangements with Multiple Deliverables," which provides guidance on how to

[Table of Contents](#)

account for arrangements that involve the delivery or performance of multiple products, services and/or right to use assets. The provisions of EITF Issue No. 00-21 will apply to revenue arrangements entered into in fiscal periods beginning after June 15, 2003. The adoption of EITF Issue No. 00-21 will not have an impact on the Company's financial statements.

Forward Looking Statements

Certain statements contained in this 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. Any statement that is not a historical fact, including estimates, projections, future trends and the outcome of events that have not yet occurred, are forward-looking statements. The Company's forward-looking statements generally relate to its growth strategy, financial results, product development programs, sales efforts, and the impact of the Cordis agreement. 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) frequent intellectual property litigation in the medical device industry that may directly or indirectly adversely affect our customers ability to market their products incorporating SurModics' technology; (iii) our ability to protect our own intellectual property; (iv) health care reform efforts and reimbursement rates for medical device products that may adversely affect our customers' ability to cost-effectively market and sell devices incorporating SurModics' technology; (v) the Company's significant dependence upon Cordis, which causes our results to be subject indirectly to factors affecting Cordis and its Cypher stent program, including among others, the rate of market penetration by Cordis, the timing of market introduction of competing products, intellectual property litigation generally and specifically the litigation involving Boston Scientific Scimed, Inc. and Cordis currently pending in U.S. District Court for the District of Delaware, and product safety or efficacy concerns; (vi) the Company's ability to attract new licensees and to enter into agreements for additional product applications with existing licensees, the willingness of potential licensees to sign license agreements under the terms offered by the Company, and the Company's ability to maintain satisfactory relationships with its licensees; (vii) the success of existing licensees in selling products incorporating SurModics' technology and the timing of new product introductions by licensees; (viii) 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; (ix) 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; (x) product liability claims not covered by insurance; (xi) the development of new products or technologies by competitors, technological obsolescence and other changes in competitive factors; (xii) economic and other factors over which the Company has no control, including changes in inflation and consumer confidence; and (xiii) acts of God or terrorism which impact the Company's personnel or facilities. Many of these factors are outside the control and knowledge of the Company and could result in increased volatility in period-to-period results. Investors are advised not to place undue reliance upon the Company's forward-looking information and to consult

[Table of Contents](#)

any further disclosures by the Company on this subject in its filings with the Securities and Exchange Commission.

ITEM 3. 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 one percentage point increase in interest rates would result in an approximate \$630,000 decrease in the fair value of the Company's available-for-sale securities as of June 30, 2003, 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.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

As of the end of the period covered by this report, the Company conducted an evaluation under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer regarding the effectiveness of the design and operation of the Company's disclosure controls and procedures pursuant to Rules 13a-15(b) of the Securities Exchange Act of 1934 (the "Exchange Act"). Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective to ensure that information that is required to be disclosed by the Company in reports that it files under the Exchange Act is recorded, processed, summarized and reported within the time period specified in the rules of the Securities Exchange Commission.

Changes in Internal Controls

There were no changes in the Company's internal control over financial reporting that occurred during the period covered by this report that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II — OTHER INFORMATION

Item 1. Legal Proceedings.

None.

Item 2. Changes in Securities and Use of Proceeds.

None.

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 —

- 31.1 Certification of Chief Executive Officer Pursuant to Section 302 of Sarbanes-Oxley Act of 2002
- 31.2 Certification of Chief Financial Officer Pursuant to Section 302 of Sarbanes-Oxley Act of 2002
- 32.1 Certification of Chief Executive Officer Pursuant to Section 906 of Sarbanes-Oxley Act of 2002
- 32.2 Certification of Chief Financial Officer Pursuant to Section 906 of Sarbanes-Oxley Act of 2002

(b) Reports on Form 8-K — A report on Form 8-K dated April 16, 2003 was filed on April 18, 2003, reporting under Item 12 the issuance of a press release relating to the results of operations and financial condition of the company as of and for the quarter ended March 31, 2003.

SIGNATURES

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

August 14, 2003

SurModics, Inc.

By: /s/ Philip D. Ankeny

Philip D. Ankeny
Chief Financial Officer

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

EXHIBIT INDEX TO FORM 10-Q

For the Quarter Ended June 30, 2003

SURMODICS, INC.

Exhibit	Description
31.1	Certification of Chief Executive Officer Pursuant to Section 302 of Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer Pursuant to Section 302 of Sarbanes-Oxley Act of 2002
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**CERTIFICATION PURSUANT TO SECTION 302
OF SARBANES-OXLEY ACT OF 2002**

I, Dale R. Olseth, Chief Executive Officer, certify that:

1. I have reviewed this quarterly report on Form 10-Q of SurModics, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and we have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting.
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: August 14, 2003

Signature: /s/ Dale R. Olseth

Dale R. Olseth
Chief Executive Officer

**CERTIFICATION PURSUANT TO SECTION 302
OF SARBANES-OXLEY ACT OF 2002**

I, Philip D. Ankeny, Chief Financial Officer, certify that:

1. I have reviewed this quarterly report on Form 10-Q of SurModics, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and we have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting.
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: August 14, 2003

Signature: /s/ Philip D. Ankeny

Philip D. Ankeny
Chief Financial Officer

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of SurModics, Inc. (the "Company") on Form 10-Q for the quarter ended June 30, 2003, as filed with the Securities and Exchange Commission (the "Report"), I, Dale R. Olseth, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: August 14, 2003

/s/ Dale R. Olseth

Dale R. Olseth
Chief Executive Officer

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of SurModics, Inc. (the "Company") on Form 10-Q for the quarter ended June 30, 2003, as filed with the Securities and Exchange Commission (the "Report"), I, Philip D. Ankeny, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: August 14, 2003

/s/ Philip D. Ankeny

Philip D. Ankeny
Chief Financial Officer