

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 DECEMBER 31, 2000

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 41-1356149  
(State of incorporation) (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 X No  
-----

The number of shares of the registrant's Common Stock, \$.05 par value per share, outstanding as of January 31, 2001 was 16,684,686.

## PART I - FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

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

	December 31, 2000	September 30, 2000
	----- (Unaudited)	-----
ASSETS		
CURRENT ASSETS:		
Cash & cash equivalents	\$ 1,461	\$ 1,510
Short-term investments	16,531	15,847
Accounts receivable, net	1,735	1,406
Inventories	573	500
Deferred tax asset	232	912
Prepays and other	1,015	911
	-----	-----
Total current assets	21,547	21,086
	-----	-----
PROPERTY AND EQUIPMENT, net	7,280	7,166
LONG-TERM INVESTMENTS	22,999	22,293
OTHER ASSETS, net	222	204
	-----	-----
	\$ 52,048	\$ 50,749
	=====	=====
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	\$ 224	\$ 379
Accrued liabilities	1,243	1,584
Deferred revenues	456	433
	-----	-----
Total current liabilities	1,923	2,396
DEFERRED REVENUES, less current portion	--	50
	-----	-----
Total liabilities	1,923	2,446
	-----	-----
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;		
16,620,986 and 16,556,002 shares issued and outstanding	831	828
Additional paid-in capital	45,942	45,740
Unearned compensation	(262)	(289)
Stock purchase notes receivable	(7)	(7)
Accumulated other comprehensive income (loss)	179	(46)
Retained earnings	3,442	2,077
	-----	-----
Total stockholders' equity	50,125	48,303
	-----	-----
	\$ 52,048	\$ 50,749
	=====	=====

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

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

	Three Months Ended December 31,	
	2000	1999
REVENUES:		
Royalties	\$ 2,058	\$ 2,350
License fees	435	100
Product sales	1,557	1,234
Research and development	782	465
Total revenues	4,832	4,149
OPERATING COSTS AND EXPENSES:		
Product	608	396
Research and development	1,775	1,608
Sales and marketing	414	377
General and administrative	713	562
Total operating costs and expenses	3,510	2,943
INCOME FROM OPERATIONS	1,322	1,206
OTHER INCOME:		
Investment income, net	631	293
Gain on sale of investments	150	1
Other income, net	781	294
INCOME BEFORE PROVISION FOR INCOME TAXES	2,103	1,500
INCOME TAX PROVISION	(737)	(556)
NET INCOME	\$ 1,366	\$ 944
NET INCOME PER SHARE:		
Basic	\$ 0.08	\$ 0.06
Diluted	\$ 0.08	\$ 0.06
WEIGHTED AVERAGE SHARES OUTSTANDING:		
Basic weighted average common shares outstanding	16,590	15,436
Dilutive effect of outstanding stock options	1,106	1,046
Diluted weighted average common shares outstanding	17,696	16,482

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

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

	Three Months Ended December 31,	
	2000	1999
OPERATING ACTIVITIES:		
Net income	\$ 1,366	\$ 944
Adjustments to reconcile net income to net cash provided by operating activities-		
Depreciation and amortization	361	210
Amortization of unearned compensation, net	27	22
Change in deferred tax	680	555
Change in assets and liabilities:		
Accounts receivable	(329)	222
Inventories	(73)	(14)
Prepays and other	(128)	(150)
Accounts payable and accrued liabilities	(496)	(765)
Deferred revenues	(27)	(13)
Net cash provided by operating activities	1,381	1,011
INVESTING ACTIVITIES:		
Purchases of property and equipment, net	(470)	(1,313)
Purchases of available-for-sale investments	(14,046)	(3,943)
Sales/maturities available-for-sale investments	12,881	3,843
Repayment of stock purchase notes receivable	--	20
Net cash used in investing activities	(1,635)	(1,393)
FINANCING ACTIVITIES:		
Issuance of common stock	205	184
Net decrease in cash and cash equivalents	(49)	(198)
CASH AND CASH EQUIVALENTS:		
Beginning of period	1,510	1,975
End of period	\$ 1,461	\$ 1,777

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 ended December 31, 2000 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, 2000 and footnotes thereto included in the Company's form 10-K as filed with the Securities and Exchange Commission.

(2) 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 will adopt SAB 101 when required, which is currently expected to be in the fourth quarter of fiscal 2001. The Company is currently evaluating SAB 101 to determine whether its implementation will have any material impact on the Company's financial position or results of operations with respect to the license fees earned by SurModics. Any adjustment would result in a charge to earnings for the cumulative effect of the change. This amount would then be deferred and be recognized as revenue in future periods.

(3) COMPREHENSIVE INCOME

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

	Three months ended December 31,	
	2000	1999
	-----	-----
	(dollars in thousands)	
Net income	\$ 1,366	\$ 944
Other comprehensive income:		
Change in unrealized gain (loss)		
on available-for-sale securities	225	(96)
	-----	-----
Total comprehensive income	\$ 1,591	\$ 848
	=====	=====

(4) OPERATING SEGMENTS  
(dollars in thousands)

	Licensing	Manufacturing	Research & Development	Corporate	Consolidated
	-----	-----	-----	-----	-----
Three Months Ended December 31, 2000					
Revenues:					
PhotoLink	\$ 1,861	\$ 723	\$ 709	\$ --	\$ 3,293
Diagnostic	632	--	--	--	632
Stabilization & other	--	834	--	--	834
Government	--	--	73	--	73
	-----	-----	-----	-----	-----
Total Revenues	2,493	1,557	782	--	4,832
Expenses	--	608	1,775	1,127	3,510
	-----	-----	-----	-----	-----
Operating income (loss)	2,493	949	(993)	(1,127)	1,322
Other income					
				781	781
Income tax provision				(737)	(737)
					-----
Net income					\$ 1,366
					=====
Three Months Ended December 31, 1999					
Revenues:					
PhotoLink	\$ 1,744	\$ 605	\$ 272	\$ --	\$ 2,621
Diagnostic	705	--	--	--	705
Stabilization & other	--	630	--	--	630
Government	--	--	193	--	193
	-----	-----	-----	-----	-----
Total Revenues	2,449	1,235	465	--	4,149
Expenses	--	396	1,608	939	2,943
	-----	-----	-----	-----	-----
Operating income (loss)	2,449	839	(1,143)	(939)	1,206
Other income				294	294
Income tax provision				(556)	(556)
					-----
Net income					\$ 944
					=====

(5) 2-FOR-1 STOCK SPLIT

On November 13, 2000, the Board of Directors declared a 2-for-1 stock split of the Company's Common Stock, payable on December 6, 2000, to shareholders of record on November 27, 2000. All share, per share and weighted average share information has been restated to reflect the split.

## (6) STOCKHOLDERS' EQUITY

On November 13, 2000, the Board of Directors adopted a resolution that designated an additional 300,000 of the then 4,850,000 undesignated shares as Series A Preferred Stock. The total number of authorized shares of the Company are now 50,000,000 consisting of 45,000,000 shares of Common Stock, \$0.05 par value per share, 450,000 of Series A Preferred Stock, \$.05 par value per share, and 4,550,000 undesignated shares.

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; the sale of photoreactive 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.

RESULTS OF OPERATIONS

THREE MONTHS ENDED DECEMBER 31, 2000 AND 1999

Revenues. The Company's revenues were \$4.8 million for the first quarter of fiscal 2001, an increase of \$683,000, or 16%, over the same period of fiscal 2000. The revenue components were as follows (in thousands):

	2000	1999	\$ Increase (Decrease)	% Increase (Decrease)
	----	----	-----	-----
PhotoLink (R) revenue:				
Royalties	\$1,426	\$1,644	\$ (218)	(13%)
License fees	435	100	335	335%
Reagent chemical sales	723	605	118	20%
Commercial development	709	272	437	161%
	-----	-----	-----	
Total PhotoLink revenue	3,293	2,621	672	26%
Other revenue:				
Diagnostic royalties	632	705	(73)	(10%)
Stabilization & other products	834	630	204	32%
Government research	73	193	(120)	(62%)
	-----	-----	-----	
Total revenues	\$4,832	\$4,149	\$ 683	16%
	=====	=====	=====	

First quarter revenue growth of 16% was primarily due to a 26% increase in PhotoLink-related revenue. Commercial development revenue increased 161% to \$709,000. Much of this increase was due to a high level of effort on two projects: genomics work with Motorola and the continued development of a drug delivery stent with Johnson & Johnson's Cordis division. PhotoLink royalties fell \$218,000 to \$1.4 million. The bulk of the difference was due to a one-time royalty payment of \$225,000 recorded in last year's first quarter. Excluding this one-time payment, PhotoLink royalty growth was essentially flat with last year.

Reagent chemical sales (those chemicals used by licensees in the PhotoLink coating process) increased 20% to \$723,000. A single client purchased a little more than half of the reagents sold during the quarter. Reagent sales to all other clients more than doubled between years.

SurModics signed two new PhotoLink license agreements during the first quarter. Fees from the two new licenses and milestone payments on several previously executed licenses combined for total license revenue of \$435,000, a significant increase over last year. The Company now has license agreements with 49 companies covering over 100 different product applications. A 32% increase in



stabilization and other product (DNA slides) sales contributed to the bulk of revenue growth outside of PhotoLink.

Product costs. The Company's product costs were \$608,000 for the first quarter of fiscal 2001, an increase of \$212,000, or 54%, over the same period of fiscal 2000. Overall product margins decreased to 61% in the first quarter of fiscal 2001 from 68% in the same period of fiscal 2000. While the margin is down from last year, margins have been consistently running at 61% for the last four quarters.

Research and development expenses. Research and development expenses were \$1.8 million for the first quarter of fiscal 2001, an increase of \$167,000, or 10%, over the same period of fiscal 2000. The change was primarily due to compensation and benefits associated with technical personnel added by the Company over the last year, foreign patent filing fees and increased depreciation and facilities costs due to last year's construction of additional laboratory facilities.

Sales and marketing expenses. Sales and marketing expenses were \$414,000 for the first quarter of fiscal 2001, a \$37,000 or 10% increase from the same period of fiscal 2000. Increased compensation and benefits costs and additional business travel offset a decrease in promotional expenses.

General and administrative expenses. General and administrative expenses were \$713,000 for the first quarter of fiscal 2001, an increase of \$151,000, or 27%, over the same period of fiscal 2000. The increase was the result of additional facilities costs related to building additions added in the previous year, and rising compensation and benefit costs.

Income from operations. The Company's income from operations was \$1.3 million for the first quarter of fiscal 2001, an increase of \$116,000, or 10%, over the same period of fiscal 2000.

Other income, net. The Company's other income was \$781,000 for the first quarter of fiscal 2001, an increase of \$487,000, or 166%, over the same period of fiscal 2000. The increase in investment income was a direct result of the 90% increase in investment balances from last year's first quarter. In addition, the Company sold a portion of its bond portfolio to take advantage of a tax capital loss carryforward, generating a realized gain of \$150,000.

Income tax expense. The Company's income tax provision was \$737,000 for the first quarter of fiscal 2001 versus a \$556,000 in the same period of fiscal 2000.

Other comprehensive income. The Company had \$225,000 of other comprehensive income for the first quarter of fiscal 2001. This income was generated by an increase in the fair value of the Company's long-term available-for-sale investments. As of December 31, 2000, the Company had a net \$179,000 unrealized gain related to those investments.

#### LIQUIDITY AND CAPITAL RESOURCES

As of December 31, 2000, the Company had working capital of \$19.6 million and cash, cash equivalents and investments totaling approximately \$41.0 million. The Company's investments principally consist of U.S. 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 \$1.4 million in the first quarter, which was an increase of 37% for the same period of last year, primarily due to the increase in net income and the change in the deferred tax asset.

As of December 31, 2000, 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 the Company's operations into the foreseeable future.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company maintains an investment portfolio in accordance with its investment policy. The primary objectives of the Company's investment policy are to preserve principal, maintain proper liquidity to meet operating needs and maximize yields. The Company's 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. All of the Company's cash equivalents and marketable securities are classified as available-for-sale securities.

The securities held in the Company's investment portfolio are subject to interest rate risk. Changes in interest rates affect the fair value of the available-for-sale securities. The Company has determined that a hypothetical ten percent increase in interest rates would result in an approximate \$400,000 decrease in the fair value of the Company's available-for-sale securities as of December 31, 2000, but no material impact on the results of operations or cash flows.

### FORWARD LOOKING STATEMENTS

The statements contained in this quarterly report relating to future revenue growth and expense levels are based on current expectations and involve a number of risks and uncertainties. These statements are forward looking and are made pursuant to the safe harbor provisions of the Private Securities Reform Act of 1995. The following factors could cause royalty revenue to materially and adversely differ from that anticipated: the ability of the Company's licensees to successfully gain regulatory approval for, market and sell products incorporating the Company's technology; the amount and timing of resources devoted by the Company's licensees to market and sell products incorporating the Company's technology; the Company's ability to attract new licensees and to enter into agreements for additional applications with existing licensees; the Company's ability to maintain a competitive position in the development of technologies and products in its areas of focus; and business and general economic conditions. Investors should consider these risks and other risks identified in the Company's filings with the SEC when making investment decisions. Shareholders and other readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date on which they are made. SurModics undertakes no obligation to update publicly or revise any forward-looking statements.

## PART II - OTHER INFORMATION

## ITEM 1. LEGAL PROCEEDINGS.

None.

## ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS.

Use of Proceeds through the period ending December 31, 2000.

(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	\$ 3,110,000
	Sales and marketing	\$ 1,728,000
	Property and equipment upgrades	\$ 8,565,000
	Patent protection	\$ 334,000
	Working capital and general corporate purposes	\$ 1,150,000
	Administration	\$ 240,000
	Money market funds	\$ 394,102
	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.

- (a) The Company held its Annual Meeting of shareholders on January 22, 2001.
- (b) Proxies were solicited pursuant to Regulation 14A under the Securities Act of 1934. The shareholders voted on two matters: (i) to set the number of directors at eight (8) and (ii) to elect Class II directors. The shareholders approved both matters by the following votes:

	Votes For	Votes Against	Votes Abstained	Broker Non-Votes
	-----	-----	-----	-----
(i) Set the number of directors at eight (8)	13,512,880	5,780	22,210	0
	Votes For	Votes Withheld	Broker Non-Votes	
	-----	-----	-----	
(ii) Elect Class II directors				
James J. Grierson	13,469,070	71,800	0	
Kendrick B. Melrose	13,471,270	69,600	0	

## ITEM 5. OTHER INFORMATION.

None.

## ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K.

- (a) Exhibits - 3.1 Articles of Incorporation, as amended to date
- (b) Reports on Form 8-K - None

## 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.

SURMODICS, INC.

February 12, 2001

By: /s/ Stephen C. Hathaway

-----

Stephen C. Hathaway  
Vice President & CFO  
(Principal Financial Officer)

## EXHIBIT INDEX

Exhibit Number	Description
- -----	-----
3.1	Articles of Incorporation, as amended to date

STATEMENT OF DESIGNATION OF SHARES  
OF  
SURMODICS, INC.

I hereby certify that the following resolutions were duly adopted by the Board of Directors of SurModics, Inc. on November 13, 2000:

"Designation of Additional Series A Preferred Stock

WHEREAS, the Company's current authorized capitalization consists of 45,000,000 authorized shares of Common Stock, 150,000 authorized shares of Series A Preferred Stock and 4,850,000 authorized but undesignated shares; and

WHEREAS, pursuant to Section 3.1 of the Articles of Incorporation, the Board of Directors has authority to designate, from the 4,850,000 authorized but undesignated shares, additional shares of Common Stock or Series A Preferred Stock; and

WHEREAS, the directors deem it advisable to designate, from the undesignated shares, 300,000 additional shares as Series A Preferred Stock;

NOW, THEREFORE, RESOLVED, that of the 4,850,000 presently authorized but undesignated shares, 300,000 are hereby designated as additional Series A Preferred Stock.

FURTHER RESOLVED, that the Chairman and Chief Executive Officer, the President or any Vice President of the Company be and hereby is authorized and directed to file all necessary documentation with the Secretary of State to effect such designation."

I certify that I am authorized to execute this Statement and I further certify that I understand that by signing this Statement I am subject to the penalties of perjury as set forth in Section 609.48 as if I had signed this Statement under oath.

Dated: November 13, 2000.

/s/ Dale R. Olseth

-----  
Dale R. Olseth, Chairman and Chief  
Executive Officer

ARTICLES OF AMENDMENT OF ARTICLES OF INCORPORATION  
OF  
SURMODICS, INC.

Pursuant to the provisions of Minnesota Statutes, Section 302A.135, the following amendments to the Articles of Incorporation of SurModics, Inc., were adopted on January 24, 2000, by the shareholders of the corporation:

Section 3.1 of Article 3 is amended to read as follows:

3.1) Authorized Shares. The aggregate number of shares which the corporation shall have the authority to issue shall be 50.0 million, 45.0 million of which shall be designated Common Stock, \$.05 Par Value; 4.85 million of which shall be undesignated shares and 150,000 of which shall be designated Series A Preferred Stock, \$.05 Par Value (hereinafter referred to as the "Series A Preferred Stock"). (The Common Stock, any shares issued from the undesignated shares, and the Series A Preferred Stock are hereinafter referred to collectively as the "Capital Stock.") The Board of Directors of the corporation is authorized to establish from the undesignated shares, by resolution adopted and filed in the manner provided by law, one or more classes or series of shares, to designate each such class or series (which may include but is not limited to designation as additional shares of Common Stock or Series A Preferred Stock), and to fix the relative rights and preferences of each such class or series.

Section 4.1 of Article 4 is amended to read as follows:

4.1) Voting Privileges. Unless otherwise provided in these Articles of Incorporation, each holder of Common Stock shall have one vote on all matters submitted to the shareholders for each share of Common Stock standing in the name of such holder on the books of the corporation.

Section 4.4 of Article 4 is amended to read as follows:

4.4) Distributions. Except as otherwise provided in these Articles of Incorporation, on the liquidation, dissolution or winding up of the corporation, shares of Capital Stock shall share ratably in any dividends or distributions of the corporation, whether paid in cash, property or stock.

Section 4.5 of Article 4, entitled "Series A Convertible Preferred Stock," is deleted in its entirety.

Section 6.1 of Article 6 is amended to read as follows:

6.1) Any provision contained in these Articles of Incorporation may be amended, altered, changed or repealed by the affirmative vote of the holders of at least majority of the voting power of the shares present and entitled to vote at a duly held meeting or such greater percentage as may be otherwise prescribed by the laws of the State of Minnesota.

Article 7, entitled "Incorporators," is deleted in its entirety.

The undersigned swears that the foregoing is true and accurate and that the undersigned has the authority to sign this document on behalf of the corporation.

Dated: February 9, 2000.

/s/ David R. Busch

-----  
David R. Busch, Its Corporate Secretary



## STATEMENT OF DESIGNATION

OF

SERIES A PREFERRED STOCK

OF

SURMODICS, INC.

(Pursuant to Chapter 302A of the  
Minnesota Business Corporation Act)

-----

SurModics, Inc., a corporation organized and existing under the Minnesota Business Corporation Act (hereinafter called the "Company"), hereby certifies that the following resolution was adopted by the Board of Directors of the Company at a meeting duly called and held on March 22, 1999:

RESOLVED, that, pursuant to the authority granted to and vested in the Board of Directors of the Company (hereinafter called the "Board of Directors" or the "Board") in accordance with the provisions of Section 3.1 of the Articles of Incorporation, as amended to date (hereinafter called the "Articles of Incorporation"), the Board of Directors hereby creates a series of Preferred Stock, par value \$.05 per share (the "Preferred Stock"), of the Company and hereby states the designation and number of shares, and fixes the relative rights, preferences, and limitations thereof as follows:

## Series A Preferred Stock:

Section 1. Designation and Amount. The shares of such series shall be designated as "Series A Preferred Stock" (the "Series A Preferred Stock"), and the number of shares constituting the Series A Preferred Stock shall be One Hundred Fifty Thousand (150,000). Such number of shares may be increased or decreased by resolution of the Board of Directors; provided, that, no decrease shall reduce the number of shares of Series A Preferred Stock to a number less than the number of shares then outstanding plus the number of shares reserved for issuance upon the exercise of outstanding options, rights or warrants or upon the conversion of any outstanding securities issued by the Company convertible into Series A Preferred Stock.

## Section 2. Dividends and Distributions.

(A) Subject to the rights of the holders of any shares of any series of Preferred Stock, par value \$.05 per share (the "Preferred Stock"), of the Company or Preferred Stock (or any similar stock) ranking prior and superior to the Series A Preferred Stock with respect to

dividends, the holders of shares of Series A Preferred Stock, in preference to the holders of Common Stock, par value \$.05 per share (the "Common Stock"), of the Company, and of any other junior stock, shall be entitled to receive, when, as and if declared by the Board of Directors out of funds legally available for the purpose, quarterly dividends payable in cash on the first day of March, June, September and December in each year (each such date being referred to herein as a "Quarterly Dividend Payment Date"), commencing on the first Quarterly Dividend Payment Date after the first issuance of a share or fraction of a share of Series A Preferred Stock, in an amount per share (rounded to the nearest cent) equal to the greater of (a) \$1 or (b) subject to the provision for adjustment hereinafter set forth, 100 times (as adjusted, the "Dividend Multiple") the aggregate per share amount of all cash dividends, and 100 times the aggregate per share amount (payable in kind) of all non-cash dividends or other distributions, other than a dividend payable in shares of Common Stock or a subdivision of the outstanding shares of Common Stock (by reclassification or otherwise), declared on the Common Stock since the immediately preceding Quarterly Dividend Payment Date or, with respect to the first Quarterly Dividend Payment Date, since the first issuance of any share or fraction of a share of Series A Preferred Stock. In the event the Company shall at any time declare or pay any dividend on the Common Stock payable in shares of Common Stock, or effect a subdivision or combination or consolidation of the outstanding shares of Common Stock (by reclassification or otherwise) into a greater or lesser number of shares of Common Stock, then in each such case the Dividend Multiple shall be adjusted by multiplying such amount by a fraction, the numerator of which is the number of shares of Common Stock outstanding immediately after such event and the denominator of which is the number of shares of Common Stock that were outstanding immediately prior to such event.

(B) The Company shall declare a dividend or distribution on the Series A Preferred Stock as provided in paragraph (A) of this Section immediately after it declares a dividend or distribution on the Common Stock (other than a dividend payable in shares of Common Stock); provided, that, in the event no dividend or distribution shall have been declared on the Common Stock during the period between any Quarterly Dividend Payment Date and the next subsequent Quarterly Dividend Payment Date, a dividend of \$1 per share on the Series A Preferred Stock shall nevertheless be payable on such subsequent Quarterly Dividend Payment Date.

(C) Dividends shall begin to accrue and be cumulative on outstanding shares of Series A Preferred Stock from the Quarterly Dividend Payment Date next preceding the date of issue of such shares, unless the date of issue of such shares is prior to the record date for the first Quarterly Dividend Payment Date, in which case dividends on such shares shall begin to accrue from the date of issue of such shares, or unless the date of issue is a Quarterly Dividend Payment Date or is a date after the record date for the determination of holders of shares of Series A Preferred Stock entitled to receive a quarterly dividend and before such Quarterly Dividend Payment Date, in either of which events such dividends shall begin to accrue and be cumulative from such Quarterly Dividend Payment Date. Accrued but unpaid dividends shall not bear interest. Dividends paid on the shares of Series A Preferred Stock in an amount less than the total amount of such dividends at the time accrued and payable on such shares shall be allocated pro rata on a share-by-share basis among all such shares at the time outstanding. The Board of Directors may fix a record date for the determination of holders of shares of Series A Preferred

Stock entitled to receive payment of a dividend or distribution declared thereon, which record date shall be not more than sixty (60) days prior to the date fixed for the payment thereof.

Section 3. Voting Rights. The holders of shares of Series A Preferred Stock shall have the following voting rights:

(A) Subject to the provision for adjustment hereinafter set forth, each share of Series A Preferred Stock shall entitle the holder thereof to 100 votes (as adjusted, the "Vote Multiple") on all matters submitted to a vote of the stockholders of the Company. In the event the Company shall at any time declare or pay any dividend on the Common Stock payable in shares of Common Stock, or effect a subdivision or combination or consolidation of the outstanding shares of Common Stock (by reclassification or otherwise) into a greater or lesser number of shares of Common Stock, then in each such case the Vote Multiple shall be adjusted by multiplying such number by a fraction, the numerator of which is the number of shares of Common Stock outstanding immediately after such event and the denominator of which is the number of shares of Common Stock that were outstanding immediately prior to such event.

(B) Except as otherwise provided in Section 10 hereof, in any other Statement of Designation creating a series of Preferred Stock or any similar stock, or by law, the holders of shares of Series A Preferred Stock and the holders of shares of Common Stock and any other capital stock of the Company having general voting rights shall vote together as one class on all matters submitted to a vote of stockholders of the Company.

(C) Except as set forth herein, or as otherwise provided by law, holders of Series A Preferred Stock shall have no special voting rights and their consent shall not be required (except to the extent they are entitled to vote with holders of Common Stock as set forth herein) for taking any corporate action.

Section 4. Certain Restrictions.

(A) Whenever quarterly dividends or other dividends or distributions payable on the Series A Preferred Stock as provided in Section 2 are in arrears, thereafter and until all accrued and unpaid dividends and distributions, whether or not declared, on shares of Series A Preferred Stock outstanding shall have been paid in full, the Company shall not:

(i) declare or pay dividends, or make any other distributions, on any shares of stock ranking junior (either as to dividends or upon liquidation, dissolution or winding up) to the Series A Preferred Stock;

(ii) declare or pay dividends, or make any other distributions, on any shares of stock ranking on a parity (either as to dividends or upon liquidation, dissolution or winding up) with the Series A Preferred Stock, except dividends paid ratably on the Series A Preferred Stock and all such parity stock on which

dividends are payable or in arrears in proportion to the total amounts to which the holders of all such shares are then entitled;

(iii) redeem or purchase or otherwise acquire for consideration shares of any stock ranking junior (either as to dividends or upon liquidation, dissolution or winding up) to the Series A Preferred Stock, provided that the Company may at any time redeem, purchase or otherwise acquire shares of any such junior stock in exchange for shares of any stock of the Company ranking junior (as to dividends and upon dissolution, liquidation and winding up) to the Series A Preferred Stock; or

(iv) redeem or purchase or otherwise acquire for consideration any shares of Series A Preferred Stock, or any shares of stock ranking on a parity (either as to dividends or upon liquidation, dissolution or winding up) with the Series A Preferred Stock, except in accordance with a purchase offer made in writing or by publication (as determined by the Board) to all holders of such shares upon such terms as the Board, after consideration of the respective annual dividend rates and other relative rights and preferences of the respective series and classes, shall determine in good faith will result in fair and equitable treatment among the respective series or classes.

(B) The Company shall not permit any subsidiary of the Company to purchase or otherwise acquire for consideration any shares of stock of the Company unless the Company could, under paragraph (A) of this Section 4, purchase or otherwise acquire such shares at such time and in such manner.

Section 5. Reacquired Shares. Any shares of Series A Preferred Stock purchased or otherwise acquired by the Company in any manner whatsoever shall be retired and cancelled promptly after the acquisition thereof. All such shares shall upon their cancellation become authorized but unissued shares of Preferred Stock and may be reissued as part of a new series of Preferred Stock subject to the conditions and restrictions on issuance set forth herein, in the Articles of Incorporation, or in any other Statement of Designation creating a series of Preferred Stock or any similar stock or as otherwise required by law.

Section 6. Liquidation, Dissolution or Winding Up. Upon any liquidation, dissolution or winding up of the Company, no distribution shall be made (A) to the holders of shares of stock ranking junior (either as to dividends or upon liquidation, dissolution or winding up) to the Series A Preferred Stock unless, prior thereto, the holders of shares of Series A Preferred Stock shall have received the greater of (i) \$100 per share, plus an amount equal to accrued and unpaid dividends and distributions thereon, whether or not declared, to the date of such payment, or (ii) subject to the provision for adjustment hereinafter set forth, 100 times (as adjusted, the "Liquidation Preference Multiple") the aggregate amount to be distributed per share to holders of shares of Common Stock, or (B) to the holders of shares of stock ranking on a parity (either as to dividends or upon liquidation, dissolution or winding up) with the Series A Preferred Stock, except distributions made ratably on the Series A Preferred Stock and all such parity stock in proportion to the total amounts to which the holders of all such shares are entitled

upon such liquidation, dissolution or winding up. In the event the Company shall at any time declare or pay any dividend on the Common Stock payable in shares of Common Stock, or effect a subdivision or combination or consolidation of the outstanding shares of Common Stock (by reclassification or otherwise) into a greater or lesser number of shares of Common Stock, then in each such case the Liquidation Preference Multiple shall be adjusted by multiplying such amount by a fraction the numerator of which is the number of shares of Common Stock outstanding immediately after such event and the denominator of which is the number of shares of Common Stock that were outstanding immediately prior to such event.

Section 7. Consolidation, Merger, Etc. In case the Company shall enter into any consolidation, merger, statutory exchange combination or other transaction in which the shares of Common Stock are exchanged for or changed into other stock or securities, cash and/or any other property, then in any such case each share of Series A Preferred Stock shall at the same time be similarly exchanged or changed into an amount per share, subject to the provision for adjustment hereinafter set forth, equal to 100 times (as adjusted, the "Exchange Multiple") the aggregate amount of stock, securities, cash and/or any other property (payable in kind), as the case may be, into which or for which each share of Common Stock is changed or exchanged. In the event the Company shall at any time declare or pay any dividend on the Common Stock payable in shares of Common Stock, or effect a subdivision or combination or consolidation of the outstanding shares of Common Stock (by reclassification or otherwise) into a greater or lesser number of shares of Common Stock, then in each such case the Exchange Multiple shall be adjusted by multiplying such amount by a fraction, the numerator of which is the number of shares of Common Stock outstanding immediately after such event and the denominator of which is the number of shares of Common Stock that were outstanding immediately prior to such event.

Section 8. No Redemption. The shares of Series A Preferred Stock shall not be redeemable.

Section 9. Rank. The Series A Preferred Stock shall rank, with respect to the payment of dividends and the distribution of assets, junior to all series of any other class of Preferred Stock hereafter issued that specifically provide that they shall rank senior to the Series A Preferred Stock.

Section 10. Amendment. If any proposed amendment to the Articles of Incorporation or this Statement of Designation would alter or change the preferences, special rights or powers given to the Series A Preferred Stock so as to affect the Series A Preferred Stock adversely, or would authorize the issuance of a class or classes of stock having preferences or rights with respect to dividends or dissolutions or the distribution of assets that would be superior to the preferences or rights of the Series A Preferred Stock, then the holders of the Series A Preferred Stock shall be entitled to vote as a series upon such amendment, and the affirmative vote of two-thirds of the outstanding shares of Series A Preferred Stock shall be necessary to the adoption thereof, in addition to such other vote as may be required by the Minnesota Business Corporation Act.

Section 11. Fractional Shares. Series A Preferred Stock may be issued in fractions of a share which shall entitle the holder, in proportion to such holder's fractional shares, to exercise voting rights, receive dividends, participate in distributions and to have the benefit of all other rights of holders of Series A Preferred Stock.

I certify that I am authorized to execute this Statement of Designation, and I further certify that I understand that by signing this Statement of Designation I am subject to the penalties of perjury as set forth in Minnesota Statutes, Section 609.48, as if I had signed this Statement of Designation under oath.

Dated: April 5, 1999

/s/ Dale R. Olseth

-----  
Dale R. Olseth, Chief Executive Officer

STATEMENT OF CANCELLATION OF PREFERRED SHARES  
OF  
SURMODICS, INC. (f/k/a BSI CORPORATION)

SurModics, Inc. (f/k/a BSI Corporation) hereby cancels 376,828 shares of its authorized Series A Convertible Preferred Stock, \$0.05 par value. After giving effect to the cancellation, the aggregate number of shares which the corporation shall have the authority to issue shall be 20,000,000, 15.0 million of which shall be designated Voting Common Stock, \$.05 Par Value, and 5.0 million of which shall be undesignated.

This statement is pursuant to Section 302A.553 Subdivision 2. of the Minnesota Business Corporation Act.

The undersigned swears that the foregoing is true and accurate and that the undersigned has the authority to sign this document on behalf of the corporation.

Dated: April 16, 1998

/s/ David R. Busch

-----  
David R. Busch, Its Corporate Secretary

ARTICLES OF AMENDMENT OF ARTICLES OF INCORPORATION  
OF  
SURMODICS, INC. (f/k/a BSI CORPORATION)

Pursuant to the provisions of Minnesota Statutes, Section 302A.135, the following amendments of Section 3.1 of Article 3 and Section 4.5 of Article 4 of the Articles of Incorporation of SurModics, Inc. (f/k/a BSI Corporation) were adopted on January 26, 1998, by the shareholders of the corporation:

Section 3.1 of Article 3 is amended in its entirety to read as follows:

"3.1 Authorized Shares. The aggregate number of shares which the corporation shall have the authority to issue shall be 20,376,828, 15.0 million of which shall be designated Voting Common Stock, \$.05 Par Value; 5.0 million of which shall be undesignated shares and 376,828 of which shall be designated Series A Convertible Preferred Stock, \$.05 Par Value (hereinafter referred to as the "Preferred Stock"). (The Voting Common Stock, any shares issued from the undesignated shares, and the Preferred Stock are hereinafter referred to collectively as the "Capital Stock".) The Board of Directors of the corporation is authorized to establish from the undesignated shares, by resolution adopted and filed in the manner provided by law, one or more classes or series of shares, to designate each such class or series (which may include but is not limited to designation as additional common shares), and to fix the relative rights and preferences of each such class or series."

Section 4.5 of Article 4 is amended to add the following to the end of such section:

"(d) If and when all outstanding shares of Preferred Stock have been converted pursuant to this Section 4.5, such shares shall be deemed canceled and shall not be reissuable by the corporation, this Section 4.5 shall be null and void and any restatement of these Articles of Incorporation may exclude this Section 4.5 and the reference to Series A Convertible Preferred Stock contained in Section 3.1 of Article 3."

The undersigned swears that the foregoing is true and accurate and that the undersigned has the authority to sign this document on behalf of the corporation.

Dated: January 26, 1998.

/s/ David R. Busch

-----  
David R. Busch, Its Corporate Secretary



ARTICLES OF AMENDMENT OF ARTICLES OF INCORPORATION  
OF  
BSI CORPORATION

Pursuant to the provisions of Minnesota Statutes, Section 302A.135, the following amendment of Section 1.1 of Article 1 of the Articles of Incorporation of BSI Corporation was adopted on June 4, 1997, by the shareholders of the corporation:

Section 1.1 of Article 1 is amended in its entirety to read as follows:

"1.1 The name of the corporation shall be  
SurModics, Inc."

The undersigned swears that the foregoing is true and accurate and that the undersigned has the authority to sign this document on behalf of the corporation.

Dated: June 4, 1997.

/s/ David R. Busch

-----  
David R. Busch, Its Corporate Secretary

ARTICLES OF AMENDMENT OF ARTICLES OF INCORPORATION  
OF  
BSI CORPORATION (f/k/a BIO-METRIC SYSTEMS, INC.)

Pursuant to the provisions of Minnesota Statutes, Section 302A.135, the following amendment of Section 3.1 of Article 3 of the Articles of Incorporation of BSI Corporation (f/k/a Bio-Metric Systems, Inc.) was adopted on January 27, 1997, by the shareholders of the corporation:

Section 3.1 of Article 3 is amended in its entirety to read as follows:

"3.1 Authorized Shares. The aggregate number of shares which the corporation shall have the authority to issue shall be 20,450,000, 15.0 million of which shall be designated Voting Common Stock, \$.05 Par Value; 5.0 million of which shall be undesignated shares and 450,000 of which shall be designated Series A Convertible Preferred Stock, \$.05 Par Value (hereinafter referred to as the "Preferred Stock"). (The Voting Common Stock, any shares issued from the undesignated shares, and the Preferred Stock are hereinafter referred to collectively as the "Capital Stock".) The Board of Directors of the corporation is authorized to establish from the undesignated shares, by resolution adopted and filed in the manner provided by law, one or more classes or series of shares, to designate each such class or series (which may include but is not limited to designation as additional common shares), and to fix the relative rights and preferences of each such class or series."

The undersigned swears that the foregoing is true and accurate and that the undersigned has the authority to sign this document on behalf of the corporation.

Dated: January 29, 1997.

/s/ David R. Busch

-----  
David R. Busch, Its Corporate Secretary

ARTICLES OF AMENDMENT OF ARTICLES OF INCORPORATION  
OF  
BIO-METRIC SYSTEMS, INC.

Pursuant to the provisions of Minnesota Statutes, Section 302A.135, the following amendments of Section 1.1 of Article 1 and Section 2.1 of Article 2 of the Articles of Incorporation of Bio-Metric Systems, Inc. were adopted on January 17, 1994, by the shareholders of the corporation:

"ARTICLE 1 - NAME

- 1.1) The name of the corporation shall be BSI Corporation.

ARTICLE 2 - REGISTERED OFFICE

- 2.1) The registered office of the corporation is located at 9924 West 74th Street, Eden Prairie, Minnesota 55344."

The undersigned swears that the foregoing is true and accurate and that the undersigned has the authority to sign this document on behalf of the corporation.

Dated: January 17, 1994.

/s/ David R. Busch

-----  
David R. Busch, Its Corporate Secretary

RESTATED ARTICLES OF INCORPORATION  
OF  
BIO-METRIC SYSTEMS, INC.

We, the undersigned, DALE R. OLSETH and DAVID R. BUSCH, the Chairman/President/Chief Executive officer and Secretary, respectively, of Bio-Metric Systems, Inc., a Minnesota corporation, do hereby certify that at a special meeting of the shareholders of Bio-Metric Systems, Inc. held on April 10, 1989, notice of such meeting having been mailed to each shareholder entitled to vote thereon at least ten (10) days prior to such meeting, the shareholders, by at least a majority of the voting power of the shares of Voting Common Stock, present in person or by proxy, adopted resolutions to restate the Articles of Incorporation of Bio-Metric Systems, Inc. as set forth below.

ARTICLE 1 - NAME

1.1) The name of the corporation shall be BIO-METRIC SYSTEMS, INC.

ARTICLE 2 - REGISTERED OFFICE

2.1) The registered office of the corporation is located at 9942 West 74th Street, Eden Prairie, Minnesota 55344.

ARTICLE 3 - CAPITAL STOCK

3.1) Authorized Shares; Establishment of Classes and Series. The aggregate number of shares which the corporation shall have the authority to issue shall be 5,500,000 shares, 5,000,000 of which shall be designated Voting Common Stock, \$.05 par value; 50,000 of which shall be designated Nonvoting Common Stock, \$.05 par value; and 450,000 of which shall be designated Series A Convertible Preferred Stock, \$.05 par value, (hereinafter referred to as the "Preferred Stock"). The Common Stock and Preferred Stock are hereinafter referred to collectively as the "Capital Stock".

3.2) Issuance of Shares. The Board of Directors of the corporation is authorized from time to time to accept subscriptions for, issue, sell and deliver shares of Capital Stock of the corporation to such persons, at such times and upon such terms and conditions as the Board shall determine, valuing all nonmonetary consideration and establishing a price in money or other consideration, or a minimum price, or a general formula or method by which the price will be determined.

3.3) Issuance of Rights to Purchase Shares. The Board of Directors is further authorized from time to time to grant and issue rights to subscribe for, purchase, exchange securities for, or convert securities into, shares of Capital Stock, and to fix the terms, provisions and conditions of such rights, including the exchange or conversion basis or the price at which such shares may be purchased or subscribed for.

3.4) Issuance of Shares to Holders of Another Class or Series. The Board is further authorized to issue shares of one class or series of Capital Stock to holders of that class or series of Capital Stock or to holders of another class or series of Capital Stock to effect share dividends or splits.

#### ARTICLE 4 - RIGHTS AND PRIVILEGES OF SHARES AND OF SHAREHOLDERS

The rights, preferences, privileges and restrictions granted to or imposed upon the Capital Stock or the holders thereof are set forth below.

4.1) Voting Privileges. Each holder of Voting Common Stock shall have one vote on all matters submitted to the shareholders for each share of Voting Common Stock standing in the name of such holder on the books of the corporation. Each holder of Preferred Stock shall have one vote on all matters submitted to the shareholders for each share of Voting Common Stock which such holder of Preferred Stock would be entitled to receive upon the conversion of his Preferred Stock as provided in subsection 4.5(c). In addition, each holder of Preferred Stock shall have the special voting rights which are described in subsection 4.5(b). Except as may be required by the Minnesota Business Corporation Act, the holders of Nonvoting Common Stock shall have no voting rights with respect to any matter submitted to a vote of the shareholders of the corporation.

4.2) Preemptive Rights. No holder of shares of any class or series of Capital Stock shall be entitled as such, as a matter of right, to subscribe for or purchase additional shares of that class or series or any other class or series of Capital Stock of the corporation now or hereafter authorized or issued.

4.3) No Cumulative Voting. There shall be no cumulative voting by the shareholders of the corporation.

4.4) Distributions. Except as provided in subsection 4.5(a) on the liquidation, dissolution or winding up of the corporation, shares of Capital Stock shall share ratably in any dividends or distributions of the corporation, whether paid in cash, property or stock.

#### 4.5) Series A Convertible Preferred Stock.

(a) Liquidation Preference. In the event of the liquidation, dissolution or winding up of the corporation, whether voluntary or involuntary, the holders of the Preferred Stock shall be entitled to receive out of assets of the corporation, an amount equal to \$13.50 (hereinafter referred to as the "Liquidation Preference") for each outstanding share of Preferred Stock before any payment shall be made or any assets distributed to the holders of Voting Common Stock or Nonvoting Common Stock or any other class of stock of this corporation ranking junior to the Preferred Stock upon liquidation or dissolution of the corporation. If, upon any liquidation, dissolution, or winding up of the corporation, the assets of the corporation are insufficient to pay the Liquidation Preference for each outstanding share of Preferred Stock, the holders of Preferred Stock shall share pro rata in any such distribution in proportion to the full

amounts to which they would otherwise be entitled. If, upon any liquidation, dissolution or winding up of the corporation, the holders of Preferred Stock would be entitled to receive in excess of the Liquidation Preference for each outstanding share of Preferred Stock in any such distribution if all such shares of Preferred Stock had been converted to shares of Voting Common Stock pursuant to subsection 4.5(c), instead of receiving the Liquidation Preference, each holder of Preferred Stock shall receive an amount equal to the distribution such holder would receive if all his outstanding shares of Preferred Stock had been converted to shares of Voting Common Stock pursuant to subsection 4.5(c) on the day preceding the date of such liquidation, dissolution or winding up. The Liquidation Preference shall be appropriately adjusted to reflect stock splits and reverse stock splits of the Preferred Stock or dividends or distributions payable in shares of Preferred Stock. Nothing hereinabove set forth shall affect in any way the right or obligation of each holder of shares of Preferred Stock to convert such shares into shares of Voting Common Stock, at any time and from time to time, in accordance with subsection 4.5(c) below.

(b) Special Voting Rights. Without the affirmative vote of the holders (acting together as a class) of at least a majority of the Preferred Stock at the time outstanding given in person or by proxy at any annual meeting, or at such special meeting called for that purpose, or, if permitted by law, in writing without a meeting, the corporation shall not:

(1) authorize or issue any shares of stock having priority over the Preferred Stock as to the payment of dividends or the payment or distribution of assets upon the liquidation or dissolution, voluntary or involuntary, of the corporation; or

(2) amend the Articles of Incorporation of the corporation so as to alter this Article 4 in any respect.

(c) Conversion Rights; Mandatory Conversion.

(1) At the option of the holder thereof, each share of Preferred Stock shall be convertible, at the offices of the corporation (or at such other office or offices, if any, as the Board of Directors may designate), into one (1) share of Voting Common Stock of the corporation, subject to adjustment as provided in subsection 4.5(c)(2) below. In order to convert shares of Preferred Stock into shares of Voting Common Stock, the holder thereof, shall surrender at the principal executive offices of the corporation the certificate or certificates therefor, duly endorsed to the corporation or in blank, and give written notice to the corporation at such office that such holder elects to convert a specified portion or all of such shares of Preferred Stock into shares of Voting Common Stock. Shares of Preferred Stock shall be deemed to have been converted on the day of surrender of the certificate representing such shares for conversion in accordance with the foregoing provisions (the "Conversion Date"), and the person entitled to receive the shares of Voting Common Stock of the corporation issuable upon such conversion shall be treated for all purposes as the record holder of such shares of

Voting Common Stock at that time. As promptly as practicable on or after the Conversion Date, the corporation shall issue and mail or deliver or cause to be issued and mailed or delivered to such holder a certificate or certificates for the number of shares of Voting Common Stock issuable upon conversion and a certificate or certificates for the balance of the Preferred Stock surrendered, if any, not so converted into shares of Voting Common Stock.

(2) The number of shares of Voting Common Stock issuable in exchange for shares of Preferred Stock upon the exercise of these conversion rights (the "Conversion Ratio"), which shall initially be one share of Voting Common Stock for one share of Preferred Stock, shall be subject to adjustment from time to time as hereinafter provided:

(i) In case the corporation shall at any time subdivide or split its outstanding Common Stock into a greater number of shares, the Conversion Ratio in effect immediately prior to such subdivision or split shall be proportionately increased; and, conversely, in case the outstanding Common Stock of the corporation shall be combined into a smaller number of shares the Conversion Ratio in effect immediately prior to such combination shall be proportionately reduced.

(ii) If any capital reorganization or reclassification of the Capital Stock of the corporation or consolidation or merger of the corporation with another corporation or the sale of all or substantially all of its assets to another corporation shall be affected in such a way that holders of Common Stock shall be entitled to receive stock, securities or assets with respect to or in exchange for Common Stock, then, as a condition of such reorganization, reclassification, consolidation, merger or sale, lawful and adequate provision shall be made whereby the holders of Preferred Stock shall thereafter have the right to receive, in lieu of the Voting Common Stock of the corporation immediately theretofore receivable upon the conversion of any such Preferred Stock, such shares of stock, securities or assets as may be issued or payable with respect to or in exchange for a number of outstanding shares of Voting Common Stock equal to the number of shares of Voting Common Stock immediately theretofore receivable upon the conversion of such Preferred Stock had such reorganization, reclassification, consolidation, merger or sale not taken place; and, in any such case, appropriate provision shall be made with respect to the rights and interests of the holders of the Preferred Stock to the end that the provisions hereof (including without limitation provisions for adjustments of the Conversion Ratio and of the number of shares receivable upon the conversion of such Preferred Stock) shall thereafter be applicable as nearly as may be, in relation to any shares of stock, securities or assets hereafter receivable upon the conversion of such Preferred Stock. The corporation shall not effect any such consolidation, merger or sale, unless prior to the consummation thereof the surviving

corporation (if other than the corporation), the corporation resulting from such consolidation or the corporation purchasing such assets shall assume by written instrument executed and mailed to the registered holders of the Preferred Stock at the last address of such holders appearing on the books of the corporation, the obligation to deliver to such holders such shares of stock, securities or assets as, in accordance with the foregoing provisions, such holders may be entitled to receive.

(iii) If and whenever the corporation shall issue or sell any Common Stock for a consideration per share less than the Liquidation Preference (except for the issuance or sale of up to 50,000 shares of Nonvoting Common Stock pursuant to the corporation's 1984 Stock Option Plan, up to 200,000 shares of Voting Common Stock pursuant to the corporation's 1987 Stock Option Plan and up to 50,000 shares of Voting Common Stock to Simplot Development Corporation (hereinafter referred to as the "Excluded Stock Issuances")) or shall issue any options, warrants or other rights for the purchase of shares of Common Stock at a consideration per share of less than the Liquidation Preference, forthwith upon such issuance or sale of such shares, options, warrants or other rights for purchase, the Conversion Ratio in effect immediately prior to such issuance or sale for the Preferred Stock shall be adjusted so that each share of Preferred Stock shall thereafter be convertible into that number of shares of Voting Common Stock as is equal to the number determined by multiplying the Conversion Ratio by a fraction, the numerator of which shall be the amount determined by multiplying (aa) the number of shares of Common Stock outstanding immediately after such issuance or sale plus the number of shares of Common Stock issuable upon the exercise of any purchase rights thus issued, by (bb) the Liquidation Preference, and the denominator of which shall be an amount equal to the sum of (aa) the number of shares of Common Stock outstanding immediately prior to such issuance or sale multiplied by the Liquidation Preference, and (bb) the total consideration payable to the corporation upon such issuance or sale of such shares and such purchase rights and upon the exercise of such purchase rights. If any options or purchase rights taken into account in any such adjustment of the Conversion Ratio subsequently expire without exercise, the Conversion Ratio shall be recomputed by deleting such options or purchase rights. For purposes of this subsection 4.5(c)(2), the number of shares of Voting Common Stock or Nonvoting Common Stock which may be issued as Excluded Stock Issuances shall be appropriately adjusted to reflect stock splits, stock dividends, reorganizations, consolidations and similar changes.

(iv) The anti-dilution provisions of this subsection 4.5(c)(2) may be waived by the affirmative vote of the holders (acting together as a class) of at least a majority of the then outstanding shares of Preferred Stock.



(3) Upon receipt of a written notice to the corporation from a holder of shares of Preferred Stock delivered to the corporation's principal executive offices requesting a computation of the then current Conversion Ratio, the corporation shall promptly give written notice by first-class mail, postage prepaid, addressed to the holder of the Preferred Stock making such request at the address of such holder as shown on the books of the corporation which notice shall state the then current Conversion Ratio, setting forth in reasonable detail the method of calculation and the facts upon which such calculation is based.

(4) In case any time:

(i) the corporation shall pay any dividend payable in stock upon its Common Stock or make any distribution (other than regular cash dividends) to the holders of its Common Stock; or

(ii) the corporation shall offer for subscription pro rata to the holders of its Common Stock any additional shares of stock of any class or other rights; or

(iii) there shall be any capital reorganization, reclassification of the Capital Stock of the corporation or consolidation or merger of the corporation with or sale of all or substantially all of its assets to another corporation; or

(iv) there shall be a voluntary or involuntary dissolution, liquidation or winding up of the corporation; then in any one or more of said cases the corporation shall give written notice, by first-class mail, postage prepaid, addressed to the holders of the Preferred Stock at the addresses of such holders as shown on the books of this corporation, of the date on which (aa) the books of the corporation shall close or a record shall be taken for such dividend, distribution or subscription rights or (bb) such reorganization, reclassification, consolidation, merger, sale, dissolution, liquidation or winding up shall take place, as the case may be. Such notice shall also specify the date as of which the holders of Common Stock of record shall participate in such dividend, distribution or subscription rights or shall be entitled to exchange their Common Stock for securities or other property deliverable upon such reorganization, reclassification, consolidation, merger, sale, dissolution, liquidation or winding up, as the case may be. Such written notice shall be given at least 20 days prior to the action in question and not less than 20 days prior to the record date or the date on which this corporation's transfer books are closed in respect thereto.

(5) As used in this subsection 4.5(c), the term Common Stock shall mean and include the corporation's presently authorized Voting Common Stock

and Nonvoting Common Stock and shall also include any capital stock of any class of the corporation hereafter authorized which shall have the right to vote on all matters submitted to the shareholders of the corporation and shall not be limited to a fixed sum or percentage in respect of the rights of the holders thereof to participate in dividends or in the distribution of assets upon the voluntary or involuntary liquidation, dissolution or winding up of the corporation; provided that the shares receivable pursuant to conversion of the Preferred Stock shall include shares designated as Voting Common Stock of the corporation as of the date of issuance of such Preferred Stock or, in the case of any reclassification of the outstanding shares thereof, the stock, securities or assets provided for in subsection 4.5(c)(2)(ii) above.

(6) The number of shares of Voting Common Stock issuable upon conversion of shares of Preferred Stock shall be computed to the nearest one hundredth of a full share; however, no fractional shares of Voting Common Stock shall be issued upon conversion. The corporation shall pay a cash adjustment in respect of any fraction of a share in an amount equal to the same fraction of the market price per share of Voting Common Stock as of the close of business on the day of conversion. "Market price" shall mean the average of the high and low prices of the Voting Common Stock sales on all exchanges on which the Voting Common Stock may at the time be listed or as reported by the National Association of Securities Dealers, Inc. Automated Quotation System National Market System ("NASDAQ-NMS"), or, if there shall have been no sales on any such exchange or as reported by NASDAQ-NMS on any such day, the average of the bid and asked prices at the end of such day, or, if the Voting Common Stock shall not be so listed or transactions so reported, the average of the bid and asked prices at the end of the day in the over-the-counter market, in each case averaged over a period of 20 consecutive business days prior to the date as of which I, market price" is being determined. If at any time the Voting Common Stock is not listed on any exchange, reported by NASDAQ-NMS or quote in the over-the-counter market, the "market price" shall be deemed to be the higher of (a) the book value thereof as determined by any firm of independent public accountants of recognized standing selected by the Board of Directors of the Corporation as of the last day of any month ending within 60 days preceding the date as of which the determination is to be made, or (b) the fair value thereof determined in good faith by the Board of Directors of the Corporation as of a date which is within 15 days of the date as of which the determination is to be made.

(7) Notwithstanding the foregoing right to convert at the option of the holder, each share of Preferred Stock shall automatically be converted into the appropriate number of shares of Voting Common Stock of the corporation in the manner and upon the terms set forth herein, without any act by the corporation or the holders of Preferred Stock, concurrently with the closing of:

(i) the sale by the corporation of shares of Voting Common Stock in a public offering which was registered under the Securities Act of

1933, as amended, was underwritten by an investment banking firm on a firm commitment basis and results in the Voting Common Stock being of the corporation being quoted on the National Association of Securities Dealers, Inc. Automated Quotation System ("NASDAQ") or listed on the New York Stock Exchange, American Stock Exchange or other national stock exchange; or

(ii) a merger of the corporation with or the acquisition of the corporation by another entity in which the surviving entity is a corporation with a class of securities which are quoted on NASDAQ or listed on the New York Stock Exchange, the American Stock Exchange or other national stock exchange.

#### ARTICLE 5 - MERGER, EXCHANGE, SALE OF ASSETS AND DISSOLUTION

5.1) Where approval of shareholders is required by law, the affirmative vote of the holders of at least a majority of the voting power of all shares entitled to vote shall be required to authorize the corporation (i) to merge into or with one or more other corporations, (ii) to exchange its shares for shares of one or more other corporations, (iii) to sell, lease, transfer or otherwise dispose of all or substantially all of its property and assets, including its goodwill, or (iv) to commence voluntary dissolution.

#### ARTICLE 6 - AMENDMENT OF ARTICLES OF INCORPORATION

6.1) Subject to the special voting rights of the holders of Preferred Stock set forth in subsection 4.5(b), any provision contained in these Articles of Incorporation may be amended, altered, changed or repealed by the affirmative vote of the holders of at least majority of the voting power of the shares present and entitled to vote at a duly held meeting or such greater percentage as may be otherwise prescribed by the laws of the State of Minnesota.

#### ARTICLE 7 - INCORPORATORS

7.1) The name and mailing address of the original incorporator was as follows: Stephen A. A. Goddard 1645 Hennepin Avenue South Suite 212 Minneapolis, Minnesota 55403.

#### ARTICLE 8 - DIRECTOR LIABILITY

8.1) Limitation on Director Liability. To the fullest extent permitted by the Minnesota Business Corporation Act, as the same exists or may hereafter be amended, a director of this corporation shall not be personally liable to the corporation or its shareholders for monetary damages for breach of fiduciary duty as a director.

IN WITNESS WHEREOF, we have hereunto set our hands this 10th day of April, 1989.

/s/ Dale R. Olseth  
-----

Dale R. Olseth, Chairman, President, and  
Chief Executive Officer

/s/ David R. Busch

-----  
David R. Busch, Secretary

STATE OF MINNESOTA        )  
                              ) ss.  
COUNTY OF HENNEPIN        )

The foregoing instrument was acknowledged before me this 10th day of  
April, 1989, by Dale R. Olseth and David R. Busch, Chairman/President/Chief  
Executive Officer and Secretary, respectively, of Bio-Metric Systems, Inc., a  
Minnesota corporation, on behalf of the corporation.

/s/ Walter H. Diers

-----  
Notary Public