SURMODICS INC
Form 10-K/A
December 14, 2009

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SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

Form 10-K/A

Amendment No. 1

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

For the fiscal year ended September 30, 2009

Commission file number 0-23837

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

Minnesota *(State or other jurisdiction of incorporation or organization)*	**41-1356149** *(IRS Employer Identification No.)*
9924 West 74th Street **Eden Prairie, Minnesota** *(Address of Principal Executive Offices)*	**55344** *(Zip Code)*

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

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Exchange on Which Registered
Common Stock, $0.05 par value	NASDAQ Global Select Market

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No þ

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No þ

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 þ No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No o

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

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

Large accelerated filer o	Accelerated filer þ
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No þ

The aggregate market value of the Common Stock held by shareholders other than officers, directors or holders of more than 5% of the outstanding stock of the registrant as of March 31, 2009 was approximately $197 million (based upon the closing sale price of the registrant s Common Stock on such date).

The number of shares of the registrant s Common Stock outstanding as of December 7, 2009 was 17,471,760.

DOCUMENTS INCORPORATED BY REFERENCE

None

EXPLANATORY NOTE

SurModics, Inc. (the Company) filed a Form 10-K for the fiscal year ended September 30, 2009 (the Original Filing) with the Securities and Exchange Commission on December 11, 2009. This Amendment No. 1 is being filed solely for the purpose of adding the signature of DELOITTE & TOUCHE LLP, the Company s Independent Registered Public Accounting Firm, to Deloitte & Touche LLP s Report of Independent Registered Public Accounting Firm (Report) on page F-1 included in this Amendment No. 1, which signature was inadvertently omitted from the Original Filing.

For purposes of this Amendment No. 1, and in accordance with Rule 12b-15 under the Securities Exchange Act of 1934, as amended, Item 8 of Part II and Item 15 of Part IV of the Original Filing are amended and restated in their entirety. Other than adding Deloitte & Touche LLP s signature to its Report on page F-1 of the financial statements, there are no other changes to Item 8 of Part II and Item 15 of Part IV of the Original Filing. Except as expressly set forth in this Amendment No. 1, the Original Filing has not been amended, updated or otherwise modified.

In addition, as required by Rule 12b-15 under the Securities Exchange Act of 1934, as amended, new certifications by our principal executive officer and principal financial officer are being filed as exhibits to this Amendment No. 1.

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ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

The consolidated balance sheets as of September 30, 2009 and 2008 and the consolidated statements of income, stockholders equity and cash flows for each of the three years in the period ended September 30, 2009, together with Report of Independent Registered Public Accounting Firm and related footnotes (including selected unaudited quarterly financial data) begin on page F-1 of this Form 10-K/A.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES.

(a) 1. *Financial Statements*

The following statements are included in this report on the pages indicated:

2. *Financial Statement Schedules.* See Schedule II Valuation and Qualifying Accounts in this section of this Form 10-K/A. All other schedules are omitted because they are inapplicable, not required, or the information is in the consolidated financial statements or related notes.

3. *Listing of Exhibits.* The exhibits which are filed with this report or which are incorporated herein by reference are set forth in the Exhibit Index following the signature page.

SurModics, Inc.
Valuation and Qualifying Accounts

Column A	**Column B**	**Column C**	**Column D**	**Column E**
Description	**Balance at Beginning of Period**	**Additions Charged to Expenses**	**Deductions From Reserves**	**Balance at End of Period**
Year Ended September 30, 2007 Allowance for doubtful accounts	$ 40	$ 7	$ 7(a)	$ 40
Year Ended September 30, 2008 Allowance for doubtful accounts	$ 40	$ 228	$ 133(a)	$ 135
Year Ended September 30, 2009 Allowance for doubtful accounts	$ 135	$ (34)	$ 19(a)	$ 82
Restructuring accrual	$	$ 1,763	$ 808(b)	$ 955

(a) Uncollectible accounts written

off and adjustments to the allowance.

(b) Adjustments to the accrual account reflect payments or non-cash charges associated with the accrual.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

Dated: December 14, 2009

By: /s/ Bruce J Barclay
Bruce J Barclay
Chief Executive Officer

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

Signature	Title	Date
/s/ Bruce J Barclay Bruce J Barclay	President and Chief Executive Officer (principal executive officer)	December 14, 2009
/s/ Philip D. Ankeny Philip D. Ankeny	Senior Vice President and Chief Financial Officer (principal financial officer)	December 14, 2009
/s/ Mark A. Lehman Mark A. Lehman	Corporate Controller (principal accounting officer)	December 14, 2009
* José H. Bedoya	Director	December 14, 2009
* John W. Benson	Director	December 14, 2009
* Mary K. Brainerd	Director	December 14, 2009
* Robert C. Buhrmaster	Director	December 14, 2009
* Gerald B. Fischer	Director	December 14, 2009
* Kenneth H. Keller	Director	December 14, 2009

*	Director	December 14, 2009
Susan E. Knight		
*	Director	December 14, 2009
John A. Meslow		

* BY: /s/ Bruce J Barclay

Name: Bruce J Barclay
Attorney-in-Fact

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SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
EXHIBIT INDEX TO FORM 10-K/A
For the Fiscal Year Ended September 30, 2009
SURMODICS, INC.

Exhibit	
23	Consent of Deloitte & Touche LLP.*
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.*

* Filed herewith

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Stockholders
SurModics, Inc.
Eden Prairie, Minnesota

We have audited the accompanying consolidated balance sheets of SurModics, Inc. and subsidiaries (the Company) as of September 30, 2009 and 2008, and the related consolidated statements of income, stockholders equity, and cash flows for each of the three years in the period ended September 30, 2009. Our audits also include the financial statement schedule listed in the Index at Item 15. These financial statements and financial statement schedule are the responsibility of the Company s management. Our responsibility is to express an opinion on the financial statements and financial statement schedule based on our audits.

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

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of SurModics, Inc. and subsidiaries as of September 30, 2009 and 2008, and the results of their operations and their cash flows for each of the three years in the period ended September 30, 2009, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company s internal control over financial reporting as of September 30, 2009, based on the criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated December 11, 2009 expressed an unqualified opinion on the Company s internal control over financial reporting.

As discussed in Note 8 to the consolidated financial statements, on October 1, 2007, the Company adopted new accounting guidance on the accounting for uncertainty in income taxes.

DELOITTE & TOUCHE LLP

Minneapolis, Minnesota
December 11, 2009

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SurModics, Inc. and Subsidiaries

Consolidated Balance Sheets
As of September 30

	2009	2008
	(In thousands, except share data)	
ASSETS		
Current Assets		
Cash and cash equivalents	$ 11,636	$ 15,376
Short-term investments	8,932	9,251
Accounts receivable, net of allowance for doubtful accounts of $82 and $135 as of September 30, 2009 and 2008, respectively	11,320	14,589
Inventories	3,330	2,651
Deferred tax asset	353	1,058
Prepaids and other	1,443	3,584
Total Current Assets	37,014	46,509
Property and equipment, net	66,915	41,897
Long-term investments	27,300	47,351
Deferred tax asset	2,548	11,099
Intangible assets, net	17,458	16,870
Goodwill	21,070	18,001
Other assets, net	13,257	9,301
Total Assets	$ 185,562	$ 191,028
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities		
Accounts payable	$ 3,468	$ 3,466
Accrued liabilities:		
Compensation	926	3,015
Accrued income taxes payable	186	
Accrued other	1,637	1,407
Deferred revenue	905	4,335
Other current liabilities	862	303
Total Current Liabilities	7,984	12,526
Deferred revenue, less current portion	623	33,243
Other long-term liabilities	4,583	3,453
Total Liabilities	13,190	49,222
Commitments and Contingencies (Note 9)		

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; 17,471,472 and 18,030,270 shares issued and outstanding	874	901
Additional paid-in capital	66,005	74,573
Accumulated other comprehensive income (loss)	1,504	(107)
Retained earnings	103,989	66,439
Total Stockholders Equity	172,372	141,806
Total Liabilities and Stockholders Equity	$ 185,562	$ 191,028

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

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SurModics, Inc. and Subsidiaries

Consolidated Statements of Income
For the Years Ended September 30

	2009	2008	2007
	(In thousands, except net income per share)		
Revenue			
Royalties and license fees	$ 75,464	$ 51,788	$ 52,679
Product sales	19,333	20,052	13,543
Research and development	26,737	25,211	6,942
Total revenue	121,534	97,051	73,164
Operating Costs and Expenses			
Product	7,508	8,476	5,584
Customer research and development	13,183	19,187	5,840
Other research and development	21,179	21,311	22,625
Selling, general and administrative	17,200	20,816	13,643
Purchased in-process research and development	3,200		15,573
Restructuring charges	1,763		
Total operating costs and expenses	64,033	69,790	63,265
Income from Operations	57,501	27,261	9,899
Other Income (Loss)			
Investment income, net	1,839	3,329	4,844
Impairment loss on investment		(4,314)	
Other income (loss), net	184	616	(75)
Other income (loss), net	2,023	(369)	4,769
Income Before Income Taxes	59,524	26,892	14,668
Income Tax Provision	(21,974)	(12,153)	(11,321)
Net Income	$ 37,550	$ 14,739	$ 3,347
Basic net income per share	$ 2.15	$ 0.82	$ 0.19
Diluted net income per share	$ 2.15	$ 0.80	$ 0.18
Weighted Average Shares Outstanding			
Basic	17,435	18,026	18,033
Dilutive effect of outstanding stock options	34	304	184
Diluted	17,469	18,330	18,217

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

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SurModics, Inc. and Subsidiaries

Consolidated Statements of Stockholders Equity
For the Years Ended September 30, 2009, 2008 and 2007

	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Total Stockholders Equity
			(In thousands)			
Balance September 30, 2006	18,830	$ 942	$ 96,281	$ (293)	$ 48,273	$ 145,203
Components of comprehensive income, net of tax:						
Net income					3,347	3,347
Unrealized holding gains on available-for-sale securities arising during the period				1,999		1,999
Add reclassification for losses included in net income, net of tax benefit of $10				17		17
Comprehensive income						5,363
Issuance of common stock	14	1	457			458
Common stock repurchased	(1,008)	(50)	(34,980)			(35,030)
Common stock options exercised, net	217	11	4,778			4,789
Purchase of common stock to pay employee taxes	112	5	(379)			(374)
Excess tax benefit from exercise of stock options			466			466
Stock-based compensation			10,312			10,312
Other			(265)			(265)
Balance September 30, 2007	18,165	909	76,670	1,723	51,620	130,922
Components of comprehensive income, net of tax:						
Net income					14,739	14,739
Unrealized holding losses on available-for-sale securities arising during the period				(5,882)		(5,882)
Add reclassification for losses included in net income, net of tax provision of $167				4,052		4,052
Comprehensive income						12,909

Issuance of common stock	16	1	516			517
Common stock repurchased	(342)	(17)	(13,954)			(13,971)
Common stock options exercised, net	114	4	2,514			2,518
Purchase of common stock to pay employee taxes	77	4	(1,678)			(1,674)
Excess tax benefit from exercise of stock options			1,081			1,081
Stock-based compensation			9,652			9,652
Other			(228)			(228)
Accounting change for income taxes					80	80
Balance September 30, 2008	18,030	901	74,573	(107)	66,439	141,806
Components of comprehensive income, net of tax:						
Net income					37,550	37,550
Unrealized holding gains on available-for-sale securities arising during the period				2,123		2,123
Add reclassification for gains included in net income, net of tax provision of $299				(512)		(512)
Comprehensive income						39,161
Issuance of common stock	40	2	611			613
Common stock repurchased	(624)	(31)	(14,967)			(14,998)
Common stock options exercised, net	15	1	65			66
Purchase of common stock to pay employee taxes	10	1	(569)			(568)
Excess tax benefit from exercise of stock options			(366)			(366)
Stock-based compensation			6,853			6,853
Other			(195)			(195)
Balance September 30, 2009	17,471	$ 874	$ 66,005	$ 1,504	$ 103,989	$ 172,372

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

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SurModics, Inc. and Subsidiaries

Consolidated Statements of Cash Flows
For the Years Ended September 30

	2009	2008	2007
		(In thousands)	
Operating Activities			
Net income	$ 37,550	$ 14,739	$ 3,347
Adjustments to reconcile net income to net cash provided by operating activities			
Depreciation and amortization	5,912	6,071	4,214
(Gain) loss on equity method investments and sales of investments	(103)	415	75
Amortization of premium (discount) on investments	139	70	(1,388)
Impairment loss on investment		4,314	
Stock-based compensation	6,853	9,652	10,312
Purchased in-process research & development	3,200		15,573
Restructuring charges	1,763		
Deferred tax	8,229	(3,428)	(9,434)
Excess tax benefit from exercise of stock options	366	(1,081)	(466)
Loss on disposals of property and equipment	291	78	379
Other	(250)		
Change in operating assets and liabilities:			
Accounts receivable	3,269	1,548	1,940
Inventories	(679)	(154)	(850)
Accounts payable and accrued liabilities	(2,387)	(264)	2,594
Income taxes	2,656	(5,003)	5,501
Deferred revenue	(36,050)	11,452	19,166
Prepaids and other	562	1,413	(248)
Net cash provided by operating activities	31,321	39,822	50,715
Investing Activities			
Purchases of property and equipment	(29,364)	(23,866)	(3,626)
Sales of property and equipment		32	37
Purchases of available-for-sale investments	(33,568)	(22,857)	(136,498)
Sales/maturities of available-for-sale investments	55,263	29,258	185,075
Purchases of held-to-maturity investments		(6,485)	
Investment in other strategic assets	(2,500)	(2,562)	(5,749)
Purchase of licenses and patents	(631)	(2,452)	(1,355)
Acquisitions, net of cash acquired	(8,585)	(3,219)	(49,112)
Repayment of notes receivable		5,870	530
Other investing activities	(187)	(228)	(265)
Net cash used in investing activities	(19,572)	(26,509)	(10,963)
Financing Activities			

Excess tax benefit from exercise of stock options	(366)	1,081	466
Issuance of common stock	679	3,037	5,247
Repurchase of common stock	(14,998)	(13,971)	(35,030)
Purchase of common stock to pay employee taxes	(568)	(1,674)	(374)
Repayment of notes payable	(236)	(222)	
Net cash used in financing activities	(15,489)	(11,749)	(29,691)
Net change in cash and cash equivalents	(3,740)	1,564	10,061
Cash and Cash Equivalents			
Beginning of year	15,376	13,812	3,751
End of year	$ 11,636	$ 15,376	$ 13,812
Supplemental Information			
Cash paid for income taxes	$ 11,285	$ 21,058	$ 14,930
Noncash transaction acquisition of property, plant, and equipment on account	$ 1,247	$ 1,745	$ 252
Noncash transaction acquisition of intangibles on account	$ 210	$	$

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

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SurModics, Inc. and Subsidiaries

Notes to Consolidated Financial Statements
September 30, 2009 and 2008

1. Description

SurModics, Inc. and subsidiaries (the Company) develops, manufactures and markets innovative drug delivery and surface modification technologies for the healthcare industry. The Company s revenue is derived from three primary sources: (1) royalties and license fees from licensing its patented drug delivery and surface modification technologies and *in vitro* diagnostic formats to customers; (2) the sale of polymers and reagent chemicals to licensees; substrates, antigens and stabilization products to the diagnostics industry; microarray slides to the diagnostic and biomedical research markets; and (3) research and development fees generated on projects for customers.

Basis of Presentation

The consolidated financial statements include all accounts and wholly owned subsidiaries, and have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). All significant inter-company transactions have been eliminated.

Subsequent Events

Subsequent events have been evaluated through December 11, 2009, the date the financial statements were issued.

On October 5, 2009, the Company entered into a license and development agreement with F. Hoffmann-La Roche, Ltd. (Roche) and Genentech, Inc., a wholly owned member of the Roche Group (Genentech), associated with the Company s proprietary biodegradable microparticles drug delivery system. SurModics received an up front licensing fee of $3.5 million, could be eligible to receive up to approximately $200 million in fees and milestone payments in the event of the successful development and commercialization of multiple products, and will be paid for development work done on these products. Roche and Genentech will have the right to obtain manufacturing services from SurModics. In the event a commercial product is developed, the Company will also receive royalties on sales of such products.

2. Summary of Significant Accounting Policies

Cash and Cash Equivalents

Cash and cash equivalents consist of financial instruments with original maturities of three months or less and are stated at cost which approximates fair value.

Investments

Investments consist principally of U.S. government and government agency obligations and mortgage-backed securities and are classified as available-for-sale or held-to-maturity at September 30, 2009 and 2008. Available-for-sale investments are reported at fair value with unrealized gains and losses net of tax excluded from operations and reported as a separate component of stockholders equity, except for other-than-temporary impairments, which are reported as a charge to current operations. A loss would be recognized when there is an other-than-temporary impairment in the fair value of any individual security classified as available-for-sale, with the associated net unrealized loss reclassified out of accumulated other comprehensive income with a corresponding adjustment to other income (loss). This adjustment results in a new cost basis for the investment. Investments that management has the intent and ability to hold to maturity are classified as held-to-maturity and reported at amortized cost. If there is an other-than-temporary impairment in the fair value of any individual security classified as held-to-maturity, the Company will write down the security to fair value with a corresponding adjustment to other income (loss). Interest on debt securities, including amortization of premiums and accretion of discounts, is

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SurModics, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Continued)

included in other income (loss). Realized gains and losses from the sales of debt securities, which are included in other income (loss), are determined using the specific identification method.

The original cost, unrealized holding gains and losses, and fair value of available-for-sale investments as of September 30 were as follows *(in thousands):*

	2009			
	Original Cost	Unrealized Gains	Unrealized Losses	Fair Value
U.S. government obligations	$ 10,837	$ 253	$	$ 11,090
Mortgage-backed securities	7,938	177	(106)	8,009
Municipal bonds	7,210	232		7,442
Asset-backed securities	2,334	65	(143)	2,256
Corporate bonds	1,181	3		1,184
Total	$ 29,500	$ 730	$ (249)	$ 29,981

	2008			
	Original Cost	Unrealized Gains	Unrealized Losses	Fair Value
U.S. government obligations	$ 18,440	$ 91	$ (87)	$ 18,444
Mortgage-backed securities	10,147	46	(179)	10,014
Municipal bonds	11,022	153	(3)	11,172
Asset-backed securities	6,193	2	(171)	6,024
Corporate bonds	4,582	8	(33)	4,557
Total	$ 50,384	$ 300	$ (473)	$ 50,211

The original cost and fair value of investments by contractual maturity at September 30, 2009 were as follows *(in thousands):*

	Original Cost	Fair Value
Debt securities due within:		
One year	$ 6,830	$ 6,911
One to five years	14,297	14,749
Five years or more	8,373	8,321

Total	$ 29,500	$ 29,981

The following table summarizes sales of available-for-sale securities for the years ended September 30, 2009, 2008 and 2007 *(in thousands):*

	2009	**2008**	**2007**
Proceeds from sales	$ 55,263	$ 29,258	$ 185,075
Gross realized gains	$ 823	$ 454	$ 7
Gross realized losses	$ (12)	$ (26)	$ (34)

At September 30, 2009, the amortized cost and fair market value of held-to-maturity debt securities were $6.3 million and $6.4 million, respectively. Investments in securities designated as held-to-maturity consist of tax-exempt municipal bonds and have maturity dates ranging between three months and three years from September 30, 2009. At September 30, 2008, the amortized cost and fair market value of held-to-maturity debt securities were $6.4 million and $6.3 million, respectively.

SurModics, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Continued)

Inventories

Inventories are principally stated at the lower of cost or market using the specific identification method and include direct labor, materials and overhead. Inventories consisted of the following as of September 30 *(in thousands):*

	2009	2008
Raw materials	$ 1,287	$ 1,308
Finished products	2,043	1,343
Total	$ 3,330	$ 2,651

Property and Equipment

Property and equipment are stated at cost and are depreciated using the straight-line method over 1 to 32 years, the estimated useful lives of the assets. The Company recorded depreciation expense of $3.8 million, $3.1 million and $2.2 million for the years ended September 30, 2009, 2008 and 2007, respectively.

The September 30, 2009 and 2008 balances in construction-in-progress include the cost of enhancing the capabilities of the Company s Eden Prairie, Minnesota and Birmingham, Alabama facilities. As assets are placed in service, construction-in-progress is transferred to the specific property and equipment categories and depreciated over the estimated useful lives of the assets.

In April 2008, the Company acquired a 286,000 square foot facility situated on 42 acres in Birmingham, Alabama for $12.2 million. The Company has been renovating the existing facility to accommodate research and development, clinical manufacturing and commercial manufacturing of drug delivery products for pharmaceutical and biotechnology customers. The building is currently classified as construction-in-progress until renovation and remodeling is completed. The value of the land associated with the purchase is classified as part of the total land carrying value.

In August 2008, the Company acquired approximately five acres of undeveloped land adjacent to its headquarters in Eden Prairie, Minnesota for $3.6 million. The value of the land purchase is classified as part of the total land carrying value.

Property and equipment consisted of the following components as of September 30 *(in thousands):*

	Useful Life (In years)	2009	2008
Land		$ 7,409	$ 7,409
Laboratory fixtures and equipment	3 to 12	19,549	15,767

Building and improvements	1 to 32	15,911	15,025
Office furniture and equipment	3 to 10	4,550	4,156
Construction-in-progress		40,210	16,931
Less accumulated depreciation		(20,714)	(17,391)
Property and equipment, net		$ 66,915	$ 41,897

Other Assets

Other assets consist principally of strategic investments. In fiscal 2009, the balance in other assets increased primarily as a result of an investment in a medical technology company and an increase in the value of the Company s investment in OctoPlus N.V. (OctoPlus).

SurModics, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Continued)

In January 2005, the Company made an initial equity investment of approximately $3.9 million in OctoPlus, a company based in the Netherlands active in the development of pharmaceutical formulations incorporating novel biodegradable polymers. Subsequent investments brought the Company s total investment to $6.0 million. In October 2006, OctoPlus common stock began trading on an international exchange following an initial public offering of its common stock. With a readily determinable fair market value, the Company now treats the investment in OctoPlus as an available-for-sale investment rather than a cost method investment. Available-for-sale investments are reported at fair value with unrealized gains and losses reported as a separate component of stockholders equity, except for other-than-temporary impairments, which are reported as a charge to current operations, recorded in the other income (loss) section of the consolidated statements of income, and result in a new cost basis for the investment. As of September 30, 2009, the investment in OctoPlus represented an ownership interest of less than 10%. The Company recorded no realized gain or loss related to this investment in fiscal 2009. The Company recognized an impairment loss on the investment totaling $4.3 million in fiscal 2008 based on a significant decline in the stock price of OctoPlus as a result of market conditions. The cost basis in the Company s investment in OctoPlus is $1.7 million.

Beginning in May 2005, the Company has invested $1.2 million in ThermopeutiX, Inc. (ThermopeutiX), a California-based early stage company developing novel medical devices for the treatment of vascular and neurovascular diseases. In addition to the investment, SurModics has licensed its hydrophilic and hemocompatible coating technologies to ThermopeutiX for use with its devices. The Company s investment in ThermopeutiX, which is accounted for under the cost method, represents an ownership interest of less than 20%.

The Company has invested a total of $5.2 million in Novocell, Inc. (Novocell), a privately-held California-based biotechnology firm that is developing a unique treatment for diabetes using coated islet cells, the cells that produce insulin in the human body. In fiscal 2006, the Company determined its investment in Novocell was impaired and that the impairment was other-than-temporary. Accordingly, the Company recorded an impairment loss of $4.7 million. The balance of the investment, $559,000, which is accounted for under the cost method, represents less than a 5% ownership interest.

In July 2007, the Company made equity investments in Paragon Intellectual Properties, LLC (Paragon) and Apollo Therapeutics, LLC (Apollo), a Paragon subsidiary, totaling $3.5 million. SurModics made an additional equity investment in fiscal 2008 totaling $2.5 million, based upon successful completion of specified development milestones. In addition to the investments, the Company has licensed its Finale™ prohealing coating technology and provides development services on a time and materials basis to Apollo. In October 2008, Paragon announced that it had restructured, moving from a limited liability company with seven subsidiaries to a single C-corporation named Nexeon MedSystems, Inc. (Nexeon). SurModics continued to account for the investments in Paragon and Apollo under the equity method in the first quarter of fiscal 2009, as both entities report results to us on a one-quarter lag. Commencing with the second quarter of fiscal 2009, SurModics accounted for the investment in Nexeon under the cost method as the Company s ownership level is less than 20%. The Company made an additional investment of $500,000 in Nexeon in fiscal 2009.

In August 2009, the Company invested $2.0 million in a medical technology company. The Company s investment is accounted for under the cost method, as the Company s ownership interest is less than 20%. This investment is included in the category titled Other in the table below.

SurModics, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Continued)

Other assets consisted of the following components as of September 30 *(in thousands):*

	2009	2008
Investment in OctoPlus	$ 3,700	$ 1,714
Investment in Nexeon MedSystems	5,651	5,388
Investment in ThermopeutiX	1,185	1,185
Investment in Novocell	559	559
Other	2,162	455
Other assets, net	$ 13,257	$ 9,301

In the years ended September 30, 2009, 2008 and 2007, the Company recognized revenue of $1.4 million, $4.1 million and $909,000, respectively, from activity with companies in which it had a strategic investment.

Intangible Assets

Intangible assets consist principally of acquired patents and technology, customer relationships, licenses, and trademarks. The Company recorded amortization expense of $2.1 million, $3.0 million, and $2.0 million for the years ended September 30, 2009, 2008 and 2007, respectively.

In fiscal 2009, the Company acquired certain assets of PR Pharmaceuticals, Inc., which resulted in an increase to intangible assets. See Note 4 for further information regarding the acquisition.

Intangible assets consisted of the following as of September 30 *(in thousands):*

	Useful Life (In years)	2009	2008
Customer lists	9-11	$ 8,657	$ 7,340
Abbott license	4		7,037
Core technology	8-18	8,330	6,930
Patents and other	2-20	3,076	3,398
Trademarks		600	580
Less accumulated amortization		(3,205)	(8,415)
Intangible assets, net		$ 17,458	$ 16,870

The Abbott license was fully amortized as of September 30, 2009 and the original cost and accumulated amortization have been removed from the 2009 amounts presented. Based on the intangible assets in service as of September 30, 2009, estimated amortization expense for the next five fiscal years is as follows (*in thousands*):

2010	$ 1,627
2011	1,604
2012	1,602
2013	1,602
2014	1,602

Goodwill

Goodwill represents the excess of the cost of the acquired entities over the fair value assigned to the assets purchased and liabilities assumed in connection with the Company s acquisitions (see Note 4 for further information). The carrying amount of goodwill is evaluated annually, and between annual evaluations if events occur or circumstances change indicating that the carrying amount of goodwill may be impaired.

SurModics, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Continued)

In fiscal 2009 a milestone was achieved associated with the July 2007 acquisition of SurModics Pharmaceuticals, and $3 million of additional purchase price was recorded as an increase to goodwill.

Impairment of Long-Lived Assets

The Company periodically evaluates whether events and circumstances have occurred that may affect the estimated useful life or the recoverability of the remaining balance of long-lived assets, such as property and equipment and investments. If such events or circumstances were to indicate that the carrying amount of these assets would not be recoverable, the Company would estimate the future cash flows expected to result from the use of the assets and their eventual disposition. If the sum of the expected future cash flows (undiscounted and without interest charges) or other measure of fair value were less than the carrying amount of the assets, the Company would recognize an impairment loss reducing the carrying value to fair market value.

Revenue Recognition

In accordance with Securities and Exchange Commission (SEC) guidance, revenue is recognized when all of the following criteria are met: (1) persuasive evidence of an arrangement exists; (2) shipment has occurred or delivery has occurred if the terms specify destination; (3) the sales price is fixed or determinable; and (4) collectability is reasonably assured. However, when there are additional performance requirements, revenue is recognized when all such requirements have been satisfied. Under revenue arrangements with multiple deliverables, the Company recognizes each separable deliverable as it is earned.

The Company s revenue is derived from three primary sources: (1) royalties and license fees from licensing patented drug delivery and surface modification technologies and *in vitro* diagnostic formats to customers; (2) the sale of polymers and reagent chemicals, stabilization products, antigens, substrates and microarray slides to the diagnostics and biomedical research industries; and (3) research and development fees generated on customer projects.

Taxes collected from customers and remitted to governmental authorities are excluded from revenue and amounted to $187,000, $309,000 and $170,000 for the years ended September 30, 2009, 2008 and 2007, respectively.

Royalties & License Fees. The Company licenses technology to third parties and collects royalties. Royalty revenue is generated when a customer sells products incorporating the Company s licensed technologies. Royalty revenue is recognized as licensees report it to the Company, and payment is typically submitted concurrently with the report. Generally, license fees are recognized as revenue when the Company receives payment and the contract price is fixed or determinable. For stand-alone license agreements, up-front license fees are recognized over the term of the related licensing agreement. Minimum royalty fees are recognized in the period earned.

Revenue related to a performance milestone is recognized upon the achievement of the milestone, as defined in the respective agreements and provided the following conditions have been met:

The milestone payment is non-refundable.

The milestone is achieved, involves a significant degree of risk, and was not reasonably assured at the inception of the arrangement.

Accomplishment of the milestone involves substantial effort.

The amount of the milestone payment is commensurate with the related effort and risk.

A reasonable amount of time passes between the initial license payment and the first and subsequent milestone payments.

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Notes to Consolidated Financial Statements (Continued)

If these conditions have not been met, the milestone payment is deferred and recognized over the term of the agreement.

Product Sales. Product sales to third parties are recognized at the time of shipment, provided that an order has been received, the price is fixed or determinable, collectability of the resulting receivable is reasonably assured and returns can be reasonably estimated. The Company s sales terms provide no right of return outside of the standard warranty policy. Payment terms are generally set at 30-45 days.

Research and Development. The Company performs third party research and development activities, which are typically provided on a time and materials basis. Generally, revenue for research and development is recorded as performance progresses under the applicable contract.

Arrangements with multiple deliverables. Arrangements such as license and development agreements are analyzed to determine whether the deliverables, which often include a license and performance obligations such as research and development, can be separated or whether they must be accounted for as a single unit of accounting in accordance with accounting guidance. The Company recognizes up-front license payments under these agreements over the economic life of the technology licensed. If the fair value of the undelivered performance obligations can be determined, such obligations would then be accounted for separately. If the license is considered to either (i) not have stand-alone value or (ii) have stand-alone value but the fair value of any of the undelivered performance obligations cannot be determined, the arrangement would then be accounted for as a single unit of accounting, and the license payments and payments for performance obligations would be recognized as revenue over the estimated period of when the performance obligations are performed, or the economic life of the technology licensed to the customer. When the Company determines that an arrangement should be accounted for as a single unit of accounting, it recognizes the related revenue based on a time-based accounting model. Revenue associated with arrangements with multiple deliverables totaled $45.3 million, $4.2 million and $0.3 million in fiscal 2009, 2008 and 2007, respectively. The fiscal 2009 revenue associated with multiple deliverable arrangements is reflected in royalties and license fees revenue ($37.6 million) and in research and development revenue ($7.7 million) in the consolidated statements of income.

Merck Agreement. On June 27, 2007 the Company announced a license and research collaboration agreement with Merck & Co., Inc. (Merck). The agreement called for SurModics and Merck to pursue the joint development and commercialization of SurModics I-vation sustained drug delivery system with TA (triamcinolone acetonide), and other products combining certain of Merck s proprietary drug compounds and the I-vation system for the treatment of serious retinal diseases. Under the terms of the agreement, Merck led and funded development and commercialization activities. SurModics received an up-front license fee of $20 million in fiscal 2007 and additional license fees totaling $11 million in fiscal 2008. In addition, the Company was paid for its activities in researching and developing the combination products. Research and development fees totaling $5.8 million were billed in fiscal 2008. The Company recognized out-of-pocket reimbursements, totaling $1.6 million in fiscal 2008, as revenue in the period since the related costs were incurred when commensurate value was transferred to Merck in exchange for the reimbursement received.

The Company recognized revenue from the up-front license fee, additional license fees and research and development fees over the economic life of the technology licensed to Merck, which was 16 years.

In September 2008, following a strategic review of Merck s business and product development portfolio, Merck gave notice to SurModics of its intent to terminate the collaborative research and license agreement as well as the supply agreement entered into in June 2007. The termination was effective December 2008. The Company recognized all remaining deferred revenue related to the Merck agreement, totaling $34.8 million, as revenue in fiscal 2009. The Company also recognized a $9 million milestone payment from Merck associated with the termination of the triamcinolone acetonide development program in fiscal 2009. As of September 30, 2009, there were no deferred revenue amounts from Merck, compared with $34.8 million of license fees and research and development fees in deferred revenue as of September 30, 2008.

SurModics, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Continued)

Deferred Revenue

Amounts received prior to satisfying the above revenue recognition criteria are recorded as deferred revenue in the accompanying consolidated balance sheets, with deferred revenue to be recognized beyond one year being classified as non-current deferred revenue. As of September 30, 2009 and 2008, the Company had deferred revenue of $1.5 million and $37.6 million, respectively.

Costs related to products and services delivered are recognized in the period revenue is recognized except for services related to the Merck agreement, which were recognized as incurred. Customer advances are accounted for as a liability until all criteria for revenue recognition have been met.

Research and Development Costs

Research and development costs are expensed as incurred. Some research and development costs are related to third party contracts, and the related revenue is recognized as described in Revenue Recognition above. The research and development costs are presented in the consolidated statements of income in two categories; those associated with customer related projects and those associated with other research and development costs.

Costs associated with customer related research and development include specific project direct labor costs and material expenses as well as an allocation of overhead costs based on direct labor dollars.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Ultimate results could differ from those estimates.

New Accounting Pronouncements

In October 2009, the Financial Accounting Standards Board (FASB) issued an update to authoritative accounting guidance to address the accounting for multiple-deliverable arrangements. This accounting update enables vendors to account for products and services (deliverables) separately rather than as a combined unit. This authoritative guidance establishes the accounting and reporting for arrangements under which the vendor will perform multiple revenue-generating activities. The amendments to the authoritative guidance establish a selling price hierarchy for determining the selling price of a deliverable. The selling price used for each deliverable will be based on vendor-specific objective evidence if available, third-party evidence if vendor-specific objective evidence is not available, or estimated selling price if neither vendor-specific objective evidence nor third-party evidence is available. The authoritative guidance also expands the disclosures related to multiple-deliverable revenue arrangements and in the year of adoption requires additional disclosures following previous authoritative guidance. The authoritative guidance is effective for the Company beginning in fiscal 2011 with early adoption permitted. The Company expects to early adopt this authoritative guidance in the first quarter of fiscal 2010 and is currently evaluating the impact on the consolidated financial statements.

In June 2009, the FASB issued authoritative guidance to eliminate the historical GAAP hierarchy and establish only two levels of GAAP, authoritative and nonauthoritative. When launched on July 1, 2009, the FASB Accounting Standards Codification (ASC) became the single source of authoritative, nongovernmental GAAP, except for rules and interpretive releases of the Securities and Exchange Commission (SEC), which are sources of authoritative GAAP for SEC registrants. All other nongrandfathered, non-SEC accounting literature not included in the ASC became nonauthoritative. The subsequent issuances of new standards will be in the form of Accounting Standards Updates that will be included in the ASC. This authoritative guidance was effective for financial statements for interim or annual reporting periods ended after September 15, 2009. The Company adopted the new codification in

SurModics, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Continued)

the fourth quarter of fiscal 2009. As the codification was not intended to change or alter existing GAAP, it did not have any impact on the Company s consolidated financial statements.

In April 2008, the FASB issued authoritative accounting guidance which amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of intangible assets under goodwill and other intangible asset accounting. The authoritative guidance is intended to improve the consistency between the useful life of a recognized intangible asset under goodwill and intangible asset accounting and the period of the expected cash flows used to measure the fair value of the asset under business combination accounting and other GAAP. The authoritative guidance is effective for the Company in fiscal 2010, with early adoption prohibited. The Company does not expect the adoption of the authoritative guidance to have a material impact on its consolidated financial statements.

In December 2007, the FASB issued authoritative accounting guidance which establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in an acquiree, including the recognition and measurement of goodwill acquired in a business combination. The authoritative guidance is effective for the Company in fiscal 2010 and once adopted will impact recognition and measurement of future business combinations.

In September 2006, the FASB issued authoritative accounting guidance associated with fair value measurements. This guidance defines fair value, establishes a consistent framework for measuring fair value, gives guidance regarding methods used for measuring fair value and expands disclosures about fair value measurements. These provisions were implemented in fiscal 2009. See Note 3 for additional information regarding fair value measurements. However, in February 2008, the FASB issued guidance which delayed the effective date from fiscal 2009 to fiscal 2010 for all nonfinancial assets and liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). The Company is currently evaluating the potential impact of the authoritative guidance for which the effective date was delayed until fiscal 2010 on its consolidated financial statements.

No other new accounting pronouncement issued or effective has had, or is expected to have, a material impact on the Company s consolidated financial statements.

3. Fair Value Measurements

Effective October 1, 2008, the Company adopted new accounting guidance on fair value measurements. The new guidance defines fair value, establishes a framework for measuring fair value under GAAP, and expands disclosures about fair value measurements. The guidance is applicable for all financial assets and liabilities and for all nonfinancial assets and liabilities recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). Fair value is defined as the exchange price that would be received from selling an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants at the measurement date. When determining the fair value measurements for assets and liabilities required or permitted to be recorded at fair value, the Company considers the principal or most advantageous market in which it would transact and also considers assumptions that market participants would use when pricing the asset or liability, such as inherent risk, transfer restrictions and risk of nonperformance.

Fair Value Hierarchy

New accounting guidance on fair value measurements requires that assets and liabilities carried at fair value be classified and disclosed in one of the following three categories:

Level 1 Quoted (unadjusted) prices in active markets for identical assets or liabilities.

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Notes to Consolidated Financial Statements (Continued)

The Company s Level 1 asset consists of its investment in OctoPlus (see Note 2 for further information). The fair market value of this investment is based on the quoted price of OctoPlus shares as traded on the Amsterdam Stock Exchange.

Level 2 Observable inputs other than quoted prices included in Level 1, such as quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the asset or liability.

The Company s Level 2 assets consist of money market funds, U.S. Treasury securities, corporate bonds, municipal bonds, U.S. agency securities, agency and municipal securities and certain asset-backed securities and mortgage-backed securities. Fair market values for these assets are based on quoted vendor prices and broker pricing where all significant inputs are observable.

Level 3 Unobservable inputs to the valuation methodology that are supported by little or no market activity and that are significant to the measurement of the fair value of the assets or liabilities. Level 3 assets and liabilities include those whose fair value measurements are determined using pricing models, discounted cash flow methodologies or similar valuation techniques, as well as significant management judgment or estimation.

The Company s Level 3 assets include a U.S. government agency security and certain asset-backed and mortgage-backed securities. The fair market values of these investments were determined by broker pricing where not all significant inputs were observable.

In valuing assets and liabilities, the Company is required to maximize the use of quoted market prices and minimize the use of unobservable inputs.

We did not significantly change our valuation techniques from prior periods.

Assets and Liabilities Measured at Fair Value on a Recurring Basis

In instances where the inputs used to measure fair value fall into different levels of the fair value hierarchy, the fair value measurement has been determined based on the lowest level input that is significant to the fair value measurement in its entirety. The Company s assessment of the significance of a particular item to the fair value measurement in its entirety requires judgment, including the consideration of inputs specific to the asset or liability. The following table presents information about the Company s financial assets and liabilities measured at fair value on a recurring basis as of September 30, 2009 *(in thousands)*:

	Quoted Prices in Active Markets for Identical Instruments	**Significant Other Observable Inputs**	**Significant Unobservable Inputs**	**Total Fair Value as of September 30,**

	(Level 1)	(Level 2)	(Level 3)	2009
Assets:				
Cash equivalents	$	$ 9,108	$	$ 9,108
Short-term investments		6,911		6,911
Long-term investments		21,867	1,203	23,070
Other assets	3,700			3,700
Total assets measured at fair value	$ 3,700	$ 37,886	$ 1,203	$ 42,789

Short-term and long-term investments disclosed in the consolidated balance sheets include held-to-maturity investments totaling $6.3 million as of September 30, 2009 and 2008. Held-to-maturity investments are carried at an amortized cost.

SurModics, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Continued)

Changes in Level 3 Instruments Measured at Fair Value on a Recurring Basis

The following table is a reconciliation of financial assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) *(in thousands)*:

	2009
Balance, beginning of year	$ 264
Total realized and unrealized gains included in other comprehensive income	25
Purchases, sales and maturities, net	339
Transfer in (out) of Level 3	575
Balance, end of year	$ 1,203

As of September 30, 2009, marketable securities measured at fair value using Level 3 inputs was comprised of $36,000 of a U.S. government agency security, $73,000 of a mortgage-backed security and $1,094,000 of asset-backed securities within the Company s available-for-sale investment portfolio. These securities were measured using observable market data and Level 3 inputs as a result of the lack of market activity and liquidity. The fair value of these securities was based on the Company s assessment of the underlying collateral and the creditworthiness of the issuer of the securities.

Assets and Liabilities Measured at Fair Value on a Non-Recurring Basis

The Company s investments in non-marketable securities of private companies are accounted for using the cost or equity method. These investments as well as held-to-maturity securities are measured at fair value on a non-recurring basis when they are deemed to be other-than-temporarily impaired. In determining whether a decline in value of non-marketable equity investments in private companies has occurred and is other-than-temporary, an assessment is made by considering available evidence, including the general market conditions in the investee s industry, the investee s product development status and subsequent rounds of financing and the related valuation and/or the Company s participation in such financings. The Company also assesses the investee s ability to meet business milestones and the financial condition and near-term prospects of the individual investee, including the rate at which the investee is using its cash and the investee s potential need for additional funding at a possibly lower valuation. The valuation methodology for determining the decline in value of non-marketable equity securities is based on inputs that require management judgment and are Level 3 inputs.

4. Acquisitions

PR Pharmaceuticals, Inc. On November 4, 2008, the Company s SurModics Pharmaceuticals, Inc. (formerly known as Brookwood Pharmaceuticals, Inc.) subsidiary entered into an asset purchase agreement with PR Pharmaceuticals, Inc. (PR Pharma), whereby it acquired certain contracts and assets of PR Pharma for $5.6 million consisting of $2.9 million in cash on the closing date, additional consideration of $2.4 million upon successful achievement of specified milestones and $0.3 million in transaction costs. PR Pharma is eligible to receive up to an additional

$3.6 million in cash upon the successful achievement of milestones for contract signing and invoicing, successful patent issuances and product development. Management believes this acquisition strengthens the Company s portfolio of drug delivery technologies for the pharmaceutical and biotechnology industries. The purchase price was allocated as follows as of November 4, 2008 *(in thousands)*:

Core technology	$ 1,400
Customer relationships	900
In-process research and development	3,200
Trade names	20
Non-compete agreements	50
Total purchase price	$ 5,570

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Notes to Consolidated Financial Statements (Continued)

The acquired developed technology is being amortized on a straight-line basis over 18 years, customer relationships are being amortized over 9 years, and non-compete agreements are being amortized over 2 years. The trade names have a life of less than one year and were fully amortized in fiscal 2009. As part of the acquisition, the Company recognized fair value associated with in-process research and development (IPR&D) of $3.2 million. The IPR&D was expensed on the date of acquisition and relates to polymer-based drug delivery systems. The value assigned to IPR&D is related to projects for which the related products have not achieved commercial feasibility and have no future alternative use. The amount of purchase price allocated to IPR&D was based on estimating the future cash flows of eac