CRDENTIA CORP
Form 4
April 16, 2007

FORM 4

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

STATEMENT OF CHANGES IN BENEFICIAL OWNERSHIP OF SECURITIES

Filed pursuant to Section 16(a) of the Securities Exchange Act of 1934, Section 17(a) of the Public Utility Holding Company Act of 1935 or Section 30(h) of the Investment Company Act of 1940

OMB APPROVAL

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Check this box if no longer subject to Section 16. Form 4 or Form 5 obligations may continue. *See* Instruction 1(b).

(Print or Type Responses)

1. Name and Address of Reporting Person *
MEDCAP PARTNERS LP

(Last) (First) (Middle)

500 THIRD STREET #535

(Street)

SAN FRANCISCO, CA 94107

(City) (State) (Zip)

2. Issuer Name **and** Ticker or Trading Symbol
CRDENTIA CORP [CRDT]

3. Date of Earliest Transaction (Month/Day/Year)
04/12/2007

4. If Amendment, Date Original Filed(Month/Day/Year)

5. Relationship of Reporting Person(s) to Issuer

(Check all applicable)

_____ Director __X__ 10% Owner
_____ Officer (give title below) _____ Other (specify below)

6. Individual or Joint/Group Filing(Check Applicable Line)
_X_ Form filed by One Reporting Person
___ Form filed by More than One Reporting Person

Table I - Non-Derivative Securities Acquired, Disposed of, or Beneficially Owned

1.Title of Security (Instr. 3)	2. Transaction Date (Month/Day/Year)	2A. Deemed Execution Date, if any (Month/Day/Year)	3. Transaction Code (Instr. 8)		4. Securities Acquired (A) or Disposed of (D) (Instr. 3, 4 and 5)			5. Amount of Securities Beneficially Owned Following Reported Transaction(s) (Instr. 3 and 4)	6. Ownership Form: Direct (D) or Indirect (I) (Instr. 4)	7. Nature of Indirect Beneficial Ownership (Instr. 4)
			Code	V	Amount	(A) or (D)	Price			
Common Stock	04/12/2007		P(1)		416,666	A	$ 0.6	10,569,763	D	
Common Stock	04/16/2007		P(1)		250,000	A	$ 0.6	10,819,763	D	

Reminder: Report on a separate line for each class of securities beneficially owned directly or indirectly.

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SEC 1474 (9-02)

Table II - Derivative Securities Acquired, Disposed of, or Beneficially Owned
(*e.g.*, puts, calls, warrants, options, convertible securities)

1. Title of Derivative Security (Instr. 3)	2. Conversion or Exercise Price of Derivative Security	3. Transaction Date (Month/Day/Year)	3A. Deemed Execution Date, if any (Month/Day/Year)	4. Transaction Code (Instr. 8)		5. Number of Derivative Securities Acquired (A) or Disposed of (D) (Instr. 3, 4, and 5)		6. Date Exercisable and Expiration Date (Month/Day/Year)		7. Title and Amount of Underlying Securities (Instr. 3 and 4)		8. Price of Derivative Security (Instr. 5)	9. Nu Deriv Secur Bene Owne Follo Repo Trans (Instr
				Code	V	(A)	(D)	Date Exercisable	Expiration Date	Title	Amount or Number of Shares		

Reporting Owners

Reporting Owner Name / Address	Relationships			
	Director	10% Owner	Officer	Other
MEDCAP PARTNERS LP 500 THIRD STREET #535 SAN FRANCISCO, CA 94107		X		

Signatures

MedCap Partners L.P.; By: MedCap Management & Research LLC, its General Partner; By: C. Fred Toney, its Managing Member; /s/ C. Fred Toney	04/16/2007
**Signature of Reporting Person	Date

Explanation of Responses:

***** If the form is filed by more than one reporting person, *see* Instruction 4(b)(v).

****** Intentional misstatements or omissions of facts constitute Federal Criminal Violations. *See* 18 U.S.C. 1001 and 15 U.S.C. 78ff(a).

(1) These purchases were made by the reporting person in a private (PIPE) transaction with the issuer.

Note: File three copies of this Form, one of which must be manually signed. If space is insufficient, *see* Instruction 6 for procedure.
Potential persons who are to respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB number. ; font-family: 'Times New Roman', Times; color: #000000; background: transparent">

Based on the intangible assets in service as of September 30, 2010, estimated amortization expense for the next five fiscal years is as follows (*in thousands*):

2011	$ 1,546
2012	1,544
2013	1,544
2014	1,544
2015	1,533

Goodwill

The following table summarizes the changes in the carrying amount of goodwill *(in thousands)*:

Balance at October 1, 2008	$ 18,001
Acquisitions	3,016
Adjustment	53
Balance at September 30, 2009	21,070
Acquisitions	750
Goodwill Impairment	(13,810)
Balance at September 30, 2010	$ 8,010

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. 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.

The Company has determined that the reporting units are the SurModics Pharmaceuticals, Inc. subsidiary, the In Vitro Diagnostics operations and the SurModics drug delivery and hydrophilic coatings operations. The reporting units with goodwill resulted from the acquisitions of SurModics Pharma and BioFX Laboratories, Inc. in fiscal 2007. Inherent in the determination of fair value of the reporting units are certain estimates and judgments, including the interpretation of current economic indicators and market valuations as well as the Company s strategic plans with regard to its operations.

The Company performed its annual impairment test of goodwill in the fourth quarter of fiscal 2010 and recognized a goodwill impairment charge of $13.8 million, which represented a full impairment of the goodwill associated with the SurModics Pharma reporting unit. Prior to testing goodwill for impairment the Company tested its definite-lived assets, property, plant and equipment as well as intangible assets, under the provisions of the accounting guidance for impairment or disposal of long-lived assets, and determined that there were no impairments of these assets. The Company did not record any goodwill impairment charges during fiscal 2009 or 2008.

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Notes to Consolidated Financial Statements (Continued)

The goodwill impairment in fiscal 2010 reflected a significant decline in the estimated fair value of the Company s reporting units, which resulted from a slowdown in business activity which was most pronounced in the fourth quarter of fiscal 2010, higher operating costs with the recently placed in-service current Good Manufacturing Practices (cGMP) manufacturing facility, and a significant decrease in the Company s stock price during the year. The stock price declined from $24.13 per share at October 1, 2009 to $12.03 at the date of the annual impairment test, which was August 31, 2010. While the Company continually evaluates whether any indications of impairment are present which would require an impairment analysis on an interim basis, no such indicators were considered present prior to the fourth quarter of fiscal 2010. Prior to the fourth quarter, based on the Company s outlook for future results and the fact that the market capitalization exceeded the Company s book value by a margin of 64% at June 30, 2010, Company management did not believe that the events and circumstances in existence at interim reporting dates indicated it was more likely than not that the fair value of any of the Company s reporting units would be less than its carrying amount.

In evaluating whether goodwill was impaired, the Company compared the fair value of the reporting units to which goodwill is assigned to their respective carrying values (Step 1 of the impairment test). In calculating fair value, the Company used the income approach as the primary indicator of fair value with the market approach used as a test of reasonableness. The income approach is a valuation technique under which the Company estimates future cash flows using the reporting units financial forecasts. Future estimated cash flows are discounted to their present value to calculate fair value. The market approach establishes fair value by comparing SurModics to other publicly traded guideline companies or by analysis of actual transactions of similar businesses or assets sold. The income approach is tailored to the circumstances of the Company s business, and the market approach is completed as a secondary test to ensure that the results of the income approach are reasonable and in line with comparable companies in the industry. The summation of the reporting units fair values were compared and reconciled to the Company s market capitalization as of the date of the impairment test.

In the situation where a reporting unit s carrying amount exceeds its fair value, the amount of the impairment loss must be measured. The measurement of the impairment (Step 2 of the impairment test) is calculated by determining the implied fair value of a reporting unit s goodwill. In calculating the implied fair value of goodwill, the fair value of the reporting unit is allocated to all other assets and liabilities of that unit based on their fair values. The excess of the fair value of a reporting unit over the amount assigned to its other assets and liabilities is the implied fair value of goodwill. The goodwill impairment is measured as the excess of the carrying amount of goodwill over its implied fair value.

In determining the fair value of the SurModics Pharma reporting unit under the income approach, the SurModics Pharma expected cash flows are affected by various assumptions. Fair value on a discounted cash flow basis used forecasts over a ten year period with an estimation of residual growth rates thereafter. The Company uses its business plans and projections as the basis for expected future cash flows. The most significant assumptions incorporated in these forecasts for the most recent goodwill impairment tests included annual revenue changes based on current customer programs and expected progression of programs into different phases of development. A discount rate of 15 percent was used in the 2010 analysis to reflect the relevant risks of the higher growth assumed for this reporting unit. Given the significant difference between the reporting unit s fair value and carrying value any change in the discount rate would not have changed the evaluation of impairment.

In estimating the fair value of the Company under the market approach, management considered the relative merits of commonly applied market capitalization multiples based on the availability of data. Based on the analysis, the Company utilized the guideline public company method to support the valuation of the reporting units.

Based on the goodwill analysis performed as of August 31, 2010, goodwill in the SurModics Pharma reporting unit failed Step 1 of the impairment test and Step 2 of the impairment test indicated that goodwill was fully impaired. The indicated excess in fair value over carrying value of the Company s In Vitro Diagnostics reporting unit in Step 1 of the impairment test at August 31 2010 was approximately 82% and as such the $8.0 million of goodwill related to this reporting unit is not impaired. The SurModics drug delivery and hydrophilic coatings

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Notes to Consolidated Financial Statements (Continued)

operations does not have any goodwill and was included in the analysis to assist in reconciling the fair value of all reporting units to the Company s market capitalization at August 31, 2010.

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, intangible assets 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. See the Property and Equipment, Other Assets and Intangible Assets sections in Note 2 for further information on impairments that were recognized in fiscal 2010.

Revenue Recognition

The Company recognizes revenue 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. When there are additional performance requirements, revenue is recognized when all such requirements have been satisfied.

The Company s revenue is derived from three primary sources: (1) royalties and license fees from licensing its proprietary drug delivery and surface modification technologies 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 $0.1 million, $0.2 million and $0.3 million for the years ended September 30, 2010, 2009 and 2008, respectively.

Royalties and licenses 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. This revenue recognition model is similar to usage fee accounting. Minimum royalty fees are recognized in the period earned, provided that collectability is reasonably assured. For stand-alone license agreements, up-front license fees are recognized over the economic life of the technology.

Milestone payments. Revenue related to a performance milestone is recognized based 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 involved a significant degree of risk, and was not reasonably assured at the inception of the arrangement;

Accomplishment of the milestone involved substantial past effort/performance;

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

The milestone payment is reasonable in comparison to all of the deliverables and payment terms in the arrangement; and

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

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If these conditions have not been met, the milestone payment is deferred and recognized over the economic life of the technology.

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 agreement.

Arrangements with multiple deliverables. Prior to October 1, 2009, arrangements such as license and development agreements were analyzed to determine whether the deliverables, which often include a license and performance obligations such as research and development, could be separated, or whether they must be accounted for as a single unit of accounting in accordance with accounting guidance. If the fair value of the undelivered performance obligations could be determined, such obligations would then be accounted for separately. If the license was 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 could not 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 determined that an arrangement should be accounted for as a single unit of accounting, it recognized the related revenue on a time-based accounting model.

The Company had one significant multiple element arrangement prior to October 1, 2009 that was accounted for as a single unit of accounting resulting in deferral and recognition of all related payments received for license and research and development activities using a time-based model. This arrangement was terminated during the first quarter of fiscal 2009 as described in Note 1 above.

In October 2009, the accounting standards for multiple deliverable revenue arrangements were amended to:

(i) provide updated guidance on whether multiple deliverables exist, how the deliverables in an arrangement should be separated, and how the consideration should be allocated;

(ii) require an entity to allocate revenue in an arrangement using estimated selling prices (ESP) of deliverables if a vendor does not have vendor-specific objective evidence of selling price (VSOE) or third-party evidence of selling price (TPE); and

(iii) eliminate the use of the residual method and require an entity to allocate revenue using the relative selling price method.

The Company elected to early adopt this accounting guidance at the beginning of its first quarter of fiscal 2010, on a prospective basis, for applicable transactions originating or materially modified after October 1, 2009. In connection with the adoption of the amended accounting standard the Company also changed its policy prospectively for multiple

element arrangements, whereby the Company accounts for revenue using a multiple attribution model in which consideration allocated to research and development activities is recognized as performed, and milestone payments are recognized when the milestone events are achieved, when such activities and milestones are deemed substantive. Accordingly, in situations where a unit of accounting includes both a license and research and development activities, and when a license does not have stand-alone value, the Company applies a multiple attribution model in which consideration allocated to the license is recognized ratably, consideration allocated to research and development activities is recognized as performed and milestone payments are recognized when the milestone events are achieved, when such activities and milestones are deemed substantive.

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The Company enters into license and development arrangements that may consist of multiple deliverables which could include a license(s) to SurModics technology, research and development activities, manufacturing services, and product sales based on the needs of its customers. For example, a customer may enter into an arrangement to obtain a license to SurModics intellectual property which may also include research and development activities, and supply of products manufactured by SurModics. For these services provided, SurModics could receive upfront license fees upon signing of an agreement and granting the license, fees for research and development activities as such activities are performed, milestone payments contingent upon advancement of the product through development and clinical stages to successful commercialization, fees for manufacturing services and supply of product, and royalty payments based on customer sales of product incorporating SurModics technology. The Company s license and development arrangements generally do not have refund provisions if the customer cancels or terminates the agreement. Typically all payments made are non-refundable.

The Company evaluates each deliverable in a multiple element arrangement for separability. The Company is then required to allocate revenue to each separate deliverable using a hierarchy of VSOE, TPE, or ESP. In certain instances, the Company is not able to establish VSOE for all deliverables in an arrangement with multiple elements which may be a result of the Company infrequently selling each element separately. When VSOE cannot be established, the Company establishes a selling price of each element based on TPE. TPE is determined based on competitor prices for similar deliverables when sold separately.

When the Company is unable to establish a selling price using VSOE or TPE, the Company uses ESP in its allocation of arrangement consideration. The objective of ESP is to determine the price at which the Company would transact a sale if the product or service were sold on a stand-alone basis. ESP is generally used for highly customized offerings.

The Company determines ESP for undelivered elements by considering multiple factors including, but not limited to, market conditions, competitive landscape and past pricing arrangements with similar characteristics.

Net sales as reported and pro forma net sales that would have been reported for the year ended September 30, 2010, if the transactions entered into or materially modified after September 30, 2009 were subject to the Company s accounting policies under the previous accounting guidance, are shown in the following table (*in thousands*):

	As Reported	Pro Forma Basis as if the Previous Accounting Guidance Were in Effect
Total multiple element arrangement revenue	$ 4,232	$ 378

The impact to revenue for the fiscal year ended September 30, 2010 associated with adoption of the new accounting guidance was primarily related to research and development activities. The Company s accounting policies under the previous accounting guidance would have resulted in partial recognition of the research and development revenue in the current periods with the remainder deferred and recognized over the economic life of the technology. Under the new accounting guidance, the Company is recognizing research and development revenue as the activities are performed. The Company notes that this new accounting guidance will result in current revenue recognition of

research and development activities in the period the activities are performed with the revenue generated changing from period to period based on the stage of project development. The amount of revenue that is recognized could be material in any reporting period.

In April 2010, the FASB issued updated authoritative accounting guidance which provides a consistent framework for applying the milestone method of revenue recognition in arrangements that include research or development deliverables. The amendments are effective on a prospective basis for milestones achieved in fiscal years, and interim periods within those years, beginning on or after June 15, 2010 with early adoption permitted. The Company is evaluating the guidance and does not expect the adoption to have a material impact on the Company s consolidated financial statements.

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Notes to Consolidated Financial Statements (Continued)

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.

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.

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, prior to termination of the contract.

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, 2010 and 2009, the Company had deferred revenue of $4.2 million and $1.5 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

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 operations 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.

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Notes to Consolidated Financial Statements (Continued)

New Accounting Pronouncements

No 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

The accounting guidance on fair value measurements 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

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.

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.

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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, 2010 *(in thousands)*:

	Quoted Prices in Active Markets for Identical Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Fair Value as of September 30, 2010
Assets:				
Cash equivalents	$	$ 10,128	$	$ 10,128
Available for sale debt securities				
US government obligations		25,626	704	26,330
Mortgage backed securities		4,757	69	4,826
Municipal bonds		3,150		3,150
Asset backed securities		1,113		1,113
Corporate bonds		5,852		5,852
Other assets	2,624			2,624
Total assets measured at fair value	$ 2,624	$ 50,626	$ 773	$ 54,023

Short-term and long-term investments disclosed in the consolidated balance sheets include held-to-maturity investments totaling $4.1 million as of September 30, 2010. Held-to-maturity investments are carried at amortized cost.

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
Available for sale debt securities				
US government obligations		9,960	1,130	11,090
Mortgage backed securities		7,935	73	8,008
Municipal bonds		7,443		7,443
Asset backed securities		2,256		2,256
Corporate bonds		1,184		1,184
Other assets	3,700			3,700
Total assets measured at fair value	$ 3,700	$ 37,886	$ 1,203	$ 42,789

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Notes to Consolidated Financial Statements (Continued)

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

The following tables (*in thousands*) provide a reconciliation of fiscal 2010 and 2009 financial assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3). Transfers of instruments into and out of Level 3 are based on beginning of year values.

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3) For the Year Ended September 30, 2010 Available-for-Sale Debt Securities		
	U.S. Government Obligations	Mortgage Backed	Total
Balance, September 30, 2009	$ 1,130	$ 73	$ 1,203
Transfers into Level 3		148	148
Transfers out of Level 3	(36)	(145)	(181)
Total realized and unrealized gains (losses):			
Included in other comprehensive (loss) income	(33)	3	(30)
Purchases, issuances, sales and settlements, net	(357)	(10)	(367)
Balance, September 30, 2010	$ 704	$ 69	$ 773

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3) For the Year Ended September 30, 2009 Available-for-Sale Debt Securities			
	U.S. Government Obligations	Corporate	Mortgage Backed	Total
Balance, September 30, 2008	$ 74	$ 190	$	$ 264
Transfers into Level 3	1,273		79	1,352
Transfers out of Level 3	(581)	(199)		(780)
Total realized and unrealized gains (losses):				
Included in other comprehensive income (loss)	15	9	1	25
Purchases, issuances, sales and settlements, net	349		(7)	342
Balance, September 30, 2009	$ 1,130	$	$ 73	$ 1,203

As of September 30, 2010, marketable securities measured at fair value using Level 3 inputs were comprised of $0.7 million of an Other U.S. government security and $0.1 million of a mortgage-backed security 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 method as the Company does not exert significant influence over the investees operating or financial activities. 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

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Notes to Consolidated Financial Statements (Continued)

which the investee is using its cash and the investee s need for possible additional funding at a potentially 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. The Company wrote down three investments totaling $7.9 million in the year ended September 30, 2010, as the investments were deemed to be other-than-temporarily impaired. A pending round of financing at a substantially lower valuation at one of the private companies resulted in impairment loss of $2.4 million. Another company sold off assets in light of current market conditions and this action resulted in impairment loss of $0.2 million. In addition, an impairment loss of $5.3 million was recognized related to a third company, which continues to face operational and financing difficulties and potential rounds of financing at lower valuations. Management utilized Level 3 inputs which included information about pending financings as well as market input to determine the fair value of these investments.

The Company also incurred long-lived asset impairment charges totaling $4.9 million in fiscal 2010. Fair value measurements used in the impairment reviews of property and equipment and intangible assets are Level 3 measurements that require management judgment. The Company recorded a $1.9 million asset impairment charge associated with writing down one of its facilities in Alabama to fair value based on a decision to sell the facility, which decision was reversed later in fiscal 2010. The $2.1 million carrying value of this facility is based on a real estate market appraisal obtained during the Company s negotiations.

The Company also recorded a $1.3 million asset impairment charge associated with certain long-lived assets where very limited business is expected in the near term based on current market conditions. Furthermore, a $1.3 million asset impairment charge associated with certain fixed asset costs located in Minnesota and a $0.4 million asset impairment charge associated with prototypes and other equipment related to a development project for which very limited business is expected in the near term in light of current market conditions were also recognized. The assets associated with these charges had limited remaining value and as such were written down to zero value.

See Note 2 for additional information related to these impairments

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

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 had a life of less than one year and were fully amortized in fiscal 2009. As part of the acquisition, the

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Notes to Consolidated Financial Statements (Continued)

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 each project and discounting the net cash flows back to their present values. The discount rate used was determined at the time of acquisition in accordance with accepted valuation methods. These methodologies include consideration of the risk of the project not achieving commercial feasibility. The research efforts ranged from 5% to 50% complete at the date of acquisition. The Company used the Relief from Royalty valuation method to assess the fair value of the projects with a risk-adjusted discount rate of 25%. The Company determined the method was appropriate based on the nature of the projects and future cash flow streams. The research and development work performed is billed to customers, in most cases, using standard commercial billing rates which include a reasonable markup. Accordingly, the Company has no fixed cost obligations to carry projects forward. There have been no significant changes to the development plans for the acquired incomplete projects. Significant net cash inflows would commence with the commercial launch of customer products that are covered by the intellectual property rights and related agreements acquired from PR Pharma.

5. Revolving Credit Facility

In February 2009, the Company entered into a two-year $25.0 million unsecured revolving credit facility. Borrowings under the credit facility, if any, will bear interest at a benchmark rate plus an applicable margin based upon the Company s funded debt to EBITDA ratio. In connection with the credit facility, the Company is required to maintain certain financial and nonfinancial covenants. As of September 30, 2010, the Company had no debt outstanding and was not in compliance with certain covenants. The Company is working with the bank to obtain waivers and expects to complete these activities by the end of the second quarter of fiscal 2011. The Company believes that noncompliance will not cause liquidity issues given the Company s investment holdings and cash flow generated by operations.

6. Stockholders Equity

The Company has stock-based compensation plans under which it grants stock options, restricted stock awards and performance share awards. Accounting guidance requires all share-based payments to be recognized as an operating expense, based on their fair values, over the requisite service period. The Company s stock-based compensation expenses for the years ended September 30 were allocated to the following expense categories *(in thousands):*

	2010	2009	2008
Product	$ 139	$ 87	$ 161
Customer research and development	772	815	1,794
Other research and development	2,399	2,806	1,999
Selling, general and administrative	2,565	3,145	5,698
Total	$ 5,875	$ 6,853	$ 9,652

As of September 30, 2010, approximately $4.8 million of total unrecognized compensation costs related to non-vested awards is expected to be recognized over a weighted average period of approximately 2.4 years. The unrecognized compensation costs above exclude $1.2 million associated with performance share awards that are currently not anticipated to be fully expensed because the performance conditions are not expected to be met.

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Stock Option Plans

The Company uses the Black-Scholes option pricing model to determine the weighted average grant date fair value of stock options granted. The weighted average per share fair value of stock options granted during fiscal 2010, 2009, and 2008 was $6.78, $8.95, and $14.85, respectively. The assumptions used as inputs in the model for the years ended September 30 were as follows:

	2010	2009	2008
Risk-free interest rates	1.95%	2.30%	2.80%
Expected life	4.8 years	4.8 years	4.6 years
Expected volatility	41%	40%	37%
Dividend yield	0%	0%	0%

The risk-free interest rate assumption was based on the U.S. Treasury s rates for U.S. Treasury zero-coupon bonds with maturities similar to those of the expected term of the award. The expected life of options granted is determined based on the Company s experience. Expected volatility is based on the Company s stock price movement over a period approximating the expected term. Based on management s judgment, dividend rates are expected to be zero for the expected life of the options. The Company also estimates forfeitures of options granted, which are based on historical experience.

The Company s Incentive Stock Options (ISO) are granted at a price of at least 100% of the fair market value of the common stock of the Company on the date of the grant or 110% with respect to optionees who own more than 10% of the total combined voting power of all classes of stock. ISOs generally expire in seven years or upon termination of employment and generally are exercisable at a rate of 20% per year commencing one year after the date of grant. Non-qualified stock options are granted at fair market value on the date of grant. Non-qualified stock options expire in 7 to 10 years or upon termination of employment or service as a Board member. Non-qualified stock options granted prior to May 2008 generally become exercisable with respect to 20% of the shares on each of the first five anniversaries following the grant date, and nonqualified stock options granted subsequent to May 2008 generally become exercisable with respect to 25% on each of the first four anniversaries following the grant date. Shareholders approved the 2009 Equity Incentive Plan (2009 Plan) at the February 8, 2010 Annual Meeting of Shareholders. The 2009 Plan has 1,500,000 shares authorized, plus the number of shares that have not yet been awarded under the 2003 Equity Incentive Plan, or were awarded and subsequently returned to the pool of available shares under the 2003 Equity Incentive Plan pursuant to its terms. At September 30, 2010, there were 1,819,000 shares available for future awards. As of September 30, 2010, the aggregate intrinsic value of the option shares outstanding and option shares exercisable was not meaningful, as the Company s stock price of $11.92 per share on September 30, 2010 was below the value of option shares outstanding and exercisable. At September 30, 2010, the average remaining contractual life of options outstanding and options exercisable was 4.3 and 3.3 years, respectively. There was no intrinsic value associated with options exercised during fiscal 2010 as the Company s stock price of $11.92 per share on September 30, 2010 was below the value of options exercised. The intrinsic value of options exercised during fiscal 2009 and 2008 was $0.2 million and $2.9 million, respectively.

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	Number of Shares	Weighted Average Exercise Price
Outstanding at September 30, 2007	1,401,420	$ 31.29
Granted	392,917	41.86
Exercised	(163,297)	27.45
Forfeited	(108,250)	33.59
Outstanding at September 30, 2008	1,522,790	$ 34.26
Granted	268,700	24.06
Exercised	(17,600)	8.82
Forfeited	(104,320)	35.33
Outstanding at September 30, 2009	1,669,570	$ 32.82
Granted	388,635	22.88
Exercised	(20,350)	20.74
Forfeited	(545,534)	30.58
Outstanding at September 30, 2010	1,492,321	$ 31.22
Exercisable at September 30, 2010	843,112	$ 33.10

Restricted Stock Awards

The Company has entered into restricted stock agreements with certain key employees, covering the issuance of common stock (Restricted Stock). Under accounting guidance these shares are considered to be non-vested shares. The Restricted Stock will be released to the key employees if they are employed by the Company at the end of the vesting period. Compensation has been recognized for the estimated fair value of the 41,072 common shares and is being charged to income over the vesting term. The stock-based compensation table includes the Restricted Stock expenses recognized related to these awards, which totaled $1.0 million, $1.8 million and $2.2 million during fiscal 2010, 2009 and 2008, respectively.

	Number of Shares	Weighted Average Grant Price
Balance at September 30, 2007	206,191	$ 35.89
Granted	12,383	42.18
Vested	(40,336)	38.76
Forfeited	(21,109)	32.83
Balance at September 30, 2008	157,129	$ 36.06
Granted	7,700	23.93

Vested	(59,047)	34.44
Forfeited	(4,887)	41.91
Balance at September 30, 2009	100,895	$ 35.80
Granted	30,440	18.49
Vested	(83,195)	36.32
Forfeited	(7,068)	33.39
Balance at September 30, 2010	41,072	$ 22.33

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Performance Share Awards

The Company has entered into Performance Share agreements with certain key employees, covering the issuance of common stock (Performance Shares). The Performance Shares vest upon the achievement of all or a portion of certain performance objectives, which must be achieved during the performance period. Compensation is recognized in each period based on management s best estimate of the achievement level of the grants specified performance objectives and the resulting vesting amounts. In fiscal 2010, the Company recognized expense of $32,000 related to specific performance objectives achieved by certain individuals. In fiscal 2009, the Company reversed expenses previously recognized of $207,000 relating to three-year Performance Shares awarded in May 2008 and one-year Performance Shares awarded in September 2008, which was partially offset by an expense of $164,000 related to the estimated value of Performance Shares awarded to individuals based on likely achievement of specific performance objectives. The Company recorded compensation expense of $1.9 million in fiscal 2008 related to 30,552 one-year Performance Shares and 30,552 three-year Performance Shares awarded in May 2008 and 7,600 Performance Shares that vested for certain individuals that met various specific performance objectives. The stock-based compensation table includes the Performance Shares expenses.

1999 Employee Stock Purchase Plan

Under the 1999 Employee Stock Purchase Plan (Stock Purchase Plan), the Company is authorized to issue up to 400,000 shares of common stock. The number of authorized shares was increased by 200,000 effective with shareholder approval at the February 8, 2010 Annual Meeting. All full-time and part-time employees can choose to have up to 10% of their annual compensation withheld, with a limit of $25,000, to purchase the Company s common stock at purchase prices defined within the provision of the Stock Purchase Plan. As of September 30, 2010 and 2009, there were $321,000 and $376,000 of employee contributions, respectively, included in accrued liabilities in the accompanying consolidated balance sheets. Stock compensation expense recognized related to the Stock Purchase Plan totaled $250,000, $265,000, and $199,000 during fiscal 2010, 2009, and 2008, respectively. The stock-based compensation table includes the Stock Purchase Plan expenses.

7. Restructuring Charges

In March 2010, the Company announced an organizational change designed to support future growth by better meeting customer needs, leveraging its multiple competencies across the organization, and building on its pharmaceutical industry experience. As a result of the reorganization, the Company eliminated 11 positions, or approximately 4% of the Company s workforce. These employee terminations occurred across various functions and the reorganization plan was completed by the end of the third quarter of fiscal 2010. The Company also announced that it was vacating its leased sales office in Irvine, California and a leased warehouse in Birmingham, Alabama, as part of the reorganization plan. Both leased spaces were vacated by March 31, 2010.

The Company recorded total restructuring charges of approximately $1.3 million in connection with the fiscal 2010 reorganization. These pre-tax charges consisted of $0.8 million of severance pay and benefits expenses and $0.5 million of facility-related costs.

In November 2008, the Company announced a functional reorganization to allow the Company to better serve its customers and improve its operating performance. As a result of the reorganization, the Company eliminated 15 positions, or approximately five percent of the Company s workforce. These employee terminations occurred across

various functions and the reorganization plan was completed by the end of the first quarter of fiscal 2009. The Company also vacated a leased facility in Eden Prairie, Minnesota, consolidating into its owned office and research facility also in Eden Prairie, as part of the reorganization plan.

The Company recorded total restructuring charges of approximately $1.8 million in connection with the reorganization. These pre-tax charges consisted of $0.5 million of severance pay and benefits expenses and

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Notes to Consolidated Financial Statements (Continued)

$1.3 million of facility-related costs which were recorded in fiscal 2009. The restructuring was expected to result in approximately $2.0 million in annualized cost savings.

Cash payments related to both restructuring events totaled $1.1 million in fiscal 2010, resulting in a balance of $1.2 million at September 30, 2010.

The following table summarizes the restructuring accrual activity for fiscal 2010 *(in thousands)*:

	Employee Severance and Benefits	Facility-Related Costs	Total
Balance at September 30, 2008	$	$	$
Accruals during the year	513	1,250	1,763
Cash payments	(513)	(295)	(808)
Balance at September 30, 2009	$	$ 955	$ 955
Accruals during the year	818	488	1,306
Cash payments	(814)	(264)	(1,078)
Balance at September 30, 2010	$ 4	$ 1,179	$ 1,183

The charges above have been shown separately as restructuring charges on the consolidated statements of operations. The remaining accrual for both the fiscal 2010 and 2009 restructurings is expected to be paid within the next 39 months. As such, the current portion totaling $1.0 million is recorded as a current liability within other accrued liabilities and the long-term portion totaling $0.2 million is recorded as a long-term liability within other long-term liabilities on the consolidated balance sheets.

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8. Income Taxes

The Company accounts for income taxes under the asset and liability method prescribed in accounting guidance. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. A valuation allowance is provided when it is more likely than not that some portion or all of a deferred tax asset will not be realized. The ultimate realization of deferred tax assets depends on the generation of future taxable income during the period in which related temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income and tax planning strategies in this assessment. Deferred tax assets and liabilities are measured using the enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date of such change.

Income taxes in the accompanying consolidated statements of operations for the fiscal years ended September 30 are as follows *(in thousands):*

	2010	2009	2008
Current provision:			
Federal	$ (331)	$ 12,257	$ 13,534
State and foreign	277	1,362	1,516
Total current provision	(54)	13,619	15,050
Deferred provision (benefit):			
Federal	1,019	7,483	(2,832)
State	(535)	872	(65)
Total deferred provision (benefit)	484	8,355	(2,897)
Total provision	$ 430	$ 21,974	$ 12,153

The reconciliation of the difference between amounts calculated at the statutory federal tax rate for the fiscal years ended September 30 and the Company s effective tax rate is as follows *(in thousands):*

	2010	2009	2008
Amount at statutory federal income tax rate	$ (7,231)	$ 20,833	$ 9,387
Change because of the following items:			
State taxes	(209)	1,206	715
Other	(20)	(481)	223
Stock-based compensation	276	416	239

Valuation allowance	2,780		1,589
Goodwill impairment	4,834		
Income tax provision	$ 430	$ 21,974	$ 12,153

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The components of deferred income taxes consisted of the following as of September 30 and result from differences in the recognition of transactions for income tax and financial reporting purposes *(in thousands):*

	2010	2009
Depreciable assets	$ (5,795)	$ (2,951)
Deferred revenue	1,666	261
Accruals and reserves	780	526
Stock options	5,947	5,258
Impaired investments	6,130	3,264
Unrealized losses on investments	(563)	(962)
Other	1,211	844
Valuation allowance	(6,523)	(3,339)
Total deferred tax asset	2,853	2,901
Less current deferred tax asset	(247)	(353)
Noncurrent deferred tax asset	$ 2,606	$ 2,548

In fiscal 2010, the Company recorded a $3.1 million valuation allowance which primarily relates to potential capital losses created by the impairment of the Company s investments in Nexeon and two additional medical technology companies (see Note 3 for further information). The valuation allowance was recorded because the Company does not currently foresee future capital gains within the allowable carryforward and carryback periods to offset these capital losses when they were recognized. As such, no tax benefit has been recorded in the consolidated statements of operations.

On October 1, 2007, the Company adopted new accounting guidance on the accounting for uncertainty in income taxes. Unrecognized tax benefits are the differences between a tax position taken, or expected to be taken in a tax return, and the benefit recognized for accounting purposes pursuant to accounting guidance. A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows *(in thousands):*

	2010	2009	2008
Beginning of fiscal year	$ 2,042	$ 1,540	$ 1,120
Increase in tax positions for prior years		280	194
Decrease in tax positions for prior years	(104)	(7)	
Increases in tax positions for current year	92	260	237
Settlements with taxing authorities			
Lapse of the statute of limitations	(82)	(31)	(11)
End of fiscal year	$ 1,948	$ 2,042	$ 1,540

The total amount of unrecognized tax benefits including interest and penalties that, if recognized, would affect the effective tax rate as of September 30, 2010, 2009 and 2008, respectively, are $1.9 million, $2.0 million and $1.5 million. Currently, the Company does not expect the liability for unrecognized tax benefits to change significantly in the next twelve months with the above balances classified on the consolidated balance sheets as a part of long-term liabilities. Interest and penalties related to unrecognized tax benefits are recorded in income tax expense. As of September 30, 2010, 2009 and 2008, a gross balance of $0.7 million, $0.6 million and $0.4 million, respectively, has been accrued related to the unrecognized tax benefits balance for interest and penalties.

The Company files tax returns, including returns for its subsidiaries, in the United States (U.S.) federal jurisdiction and in various state jurisdictions. Uncertain tax positions are related to tax years that remain subject to examination. The Internal Revenue Service has commenced an examination of the Company s U.S. income tax return for fiscal 2009 in the first quarter of fiscal 2011. Fiscal years 2007 and 2008 remain subject to examination by

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federal tax authorities. Tax returns for state and local jurisdictions for fiscal years ended September 30, 2003 through 2009 remain subject to examination by state and local tax authorities.

9. Commitments and Contingencies

Litigation. From time to time, the Company has been, and may become, involved in various legal actions involving its operations, products and technologies, including intellectual property and employment disputes. The outcomes of these legal actions are not within the Company s complete control and may not be known for prolonged periods of time. In some actions, the claimants seek damages, as well as other relief, including injunctions barring the sale of products that are the subject of the lawsuit, which, if granted, could require significant expenditures or result in lost revenues. The Company records a liability in the consolidated financial statements for these actions when a loss is known or considered probable and the amount can be reasonably estimated. If the reasonable estimate of a known or probable loss is a range, and no amount within the range is a better estimate, the minimum amount of the range is accrued. If a loss is possible but not known or probable, and can be reasonably estimated, the estimated loss or range of loss is disclosed. In most cases, significant judgment is required to estimate the amount and timing of a loss to be recorded.

SRI Litigation. On July 31, 2009, the Company s SurModics Pharmaceuticals subsidiary was named as a defendant in litigation pending in the circuit court of Jefferson County, Alabama, between SRI and two of SRI s former employees (the Plaintiffs). In the litigation, the Plaintiffs allege that they contributed to or invented certain intellectual property while they were employed at SRI, and pursuant to SRI s policies then in effect, they are entitled to, among other things, a portion of the purchase price consideration paid by the Company to SRI as part the Company s acquisition of Brookwood Pharmaceuticals, Inc., pursuant to a stock purchase agreement made effective on July 31, 2007 (the Stock Purchase Agreement). A trial has not yet been scheduled. Pursuant to the Stock Purchase Agreement, the Company has certain rights of indemnification against losses (including without limitation, damages, expenses and costs) incurred as a result of the litigation. The Company s consolidated financial statements do not include any expenses or liabilities related to the above litigation as the probability of the outcome is currently not determinable and any potential loss is not estimable. The Company believes that it has meritorious defenses to the Plaintiff s claims and will vigorously defend and prosecute this matter.

InnoRx, Inc. In January 2005, the Company entered into a merger agreement whereby SurModics acquired all of the assets of InnoRx, Inc. (InnoRx), an early stage company developing drug delivery devices and therapies for the ophthalmology market. SurModics will be required to issue up to approximately 480,059 additional shares of its common stock to the stockholders of InnoRx upon the successful completion of the remaining development and commercial milestones involving InnoRx technology acquired in the transaction.

BioFX Laboratories, Inc. In August 2007, the Company acquired 100% of the capital stock of BioFX Laboratories, Inc. (BioFX), a provider of substrates to the *in vitro* diagnostics industry. The sellers of BioFX are still eligible to receive up to $3.5 million in additional consideration based on specific revenue targets through calendar 2011.

SurModics Pharmaceuticals, Inc. In July 2007, the Company acquired 100% of the capital stock of Brookwood Pharmaceuticals Inc. (now known as SurModics Pharmaceuticals, Inc.) (SurModics Pharmaceuticals), a drug delivery company that provides proprietary polymer-based technologies to companies developing pharmaceutical products. The sellers of SurModics Pharmaceuticals are still eligible to receive up to $16.3 million in additional consideration based on successful achievement of specific milestones through calendar 2011. A project milestone event was

achieved in the first quarter of fiscal 2011 and as such an obligation of $0.8 million was recognized.

Alabama Jobs Commitment. In April 2008, the Company purchased a 286,000 square foot office and warehouse facility to support cGMP manufacturing needs of customers. At the same time, SurModics Pharmaceuticals entered into an agreement with various governmental authorities to obtain financial incentives associated with creation of jobs in Alabama. Some of the governmental agencies have recapture rights in connection with the financial incentives if the number of full-time employees are not hired by June 2012, with an extension to June 2013

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if circumstances or events occur that are beyond the control of SurModics Pharmaceuticals or could not have been reasonably anticipated by SurModics Pharmaceuticals. As of September 30, 2010, SurModics Pharmaceuticals has received $1.7 million in connection with the agreement, and the Company has recorded the payment in other long-term liabilities.

Operating Leases. The Company leases certain facilities under noncancelable operating lease agreements. Rent expense for the years ended September 30, 2010, 2009, and 2008 was $0.3 million, $1.0 million, and $0.8 million, respectively. Annual commitments pursuant to operating lease agreements are as follows:

Year Ended September 30,	
2011	$ 258,000
2012	57,000
2013	60,000
2014	62,000
2015	62,000
Thereafter	16,000
Total minimum lease payments	$ 515,000

10. Defined Contribution Plans

The Company has a 401(k) retirement and savings plan for the benefit of qualifying employees. The Company matches 50% of employee contributions on the first 6% of eligible compensation. Effective April 1, 2009, the Company changed its matching contribution to a discretionary approach and the Company ceased matching contributions. Effective April 1, 2010, the Company re-instated its matching contribution at the previous level. Company contributions totaling $0.2 million, $0.2 million, and $0.5 million have been expensed for the years ended September 30, 2010, 2009, and 2008, respectively.

11. Operating Segments

Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker, or decision making group, in deciding how to allocate resources and in assessing performance. In October 2010, the Company announced it was changing its operational structure to renew focus on business units and the Company will now be organized into three business units: Medical Device, Pharmaceuticals and In Vitro Diagnostics (IVD). Beginning in the first quarter of fiscal 2011, the Company will describe its business under the new reporting structure.

In March 2010, prior to the fiscal 2011 change noted above, the Company announced it changed its organizational structure to better align functional expertise, which also resulted in the elimination of the company s business units. The Company evaluates revenue results and opportunities on the basis of the clinical market areas in which the Company s customers participate as noted in the table below. The Therapeutic market includes revenue from: (1) Cardiovascular, which provides drug delivery and surface modification technologies to customers in the

cardiovascular market; (2) Ophthalmology, which is focused on the advancement of treatments for eye diseases, such as age-related macular degeneration (AMD) and diabetic macular edema (DME), two of the leading causes of blindness; and (3) Other Markets, which is focused on a variety of clinical markets principally in the pharmaceutical and biotechnology industries. The Diagnostic market includes revenue from the Company s microarray slide technologies, stabilization products, antigens and substrates for immunoassay diagnostics tests, and its *in vitro* diagnostic format technology.

For fiscal years ended September 30, 2010, 2009, and 2008, the Company s results are aggregated into one reportable segment, as the Company manages its expenses on a company-wide basis, as well as its sales and marketing efforts.

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The table below presents revenue from the markets identified above, with Therapeutic broken out further by focus area, for the years ended September 30, as follows (*in thousands*):

	2010	2009	2008
Therapeutic			
Cardiovascular	$ 40,155	$ 39,841	$ 47,675
Ophthalmology	7,617	52,102	10,252
Other Markets	10,932	13,114	17,875
Total Therapeutic	58,704	105,057	75,802
Diagnostic	11,194	16,477	21,249
Total revenue	$ 69,898	$ 121,534	$ 97,051

Major Customers

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

	2010	2009	2008
Johnson & Johnson	17%	11%	20%
Medtronic, Inc.	14%	**	**
Merck & Company	**	37%	**
Abbott Laboratories	**	**	10%

** - less than ten percent

The revenue from the customers listed is derived from all three primary sources: licensing, product sales, and research and development.

Geographic Revenue

Geographic revenue was as follows for the years ended September 30:

	2010	2009	2008
Domestic	78%	84%	79%
Foreign	22%	16%	21%

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Notes to Consolidated Financial Statements (Continued)

12. Quarterly Financial Data (Unaudited)

The following is a summary of the unaudited quarterly results for the years ended September 30, 2010, 2009, and 2008 *(in thousands, except per share data).*

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Fiscal 2010				
Revenue	$ 17,381	$ 18,360	$ 18,608	$ 15,549
Income (loss) from operations	2,768	(952)	2,220	(18,089)
Net income (loss)	1,917	(427)	(916)	(21,663)
Net income (loss) per share(1):				
Basic	0.11	(0.02)	(0.05)	(1.25)
Diluted	0.11	(0.02)	(0.05)	(1.25)
Fiscal 2009				
Revenue	$ 63,216	$ 20,925	$ 18,186	$ 19,207
Income from operations	42,667	6,200	4,661	3,973
Net income	27,085	4,216	3,539	2,710
Net income per share(1):				
Basic	1.53	0.24	0.20	0.16
Diluted	1.53	0.24	0.20	0.16
Fiscal 2008				
Revenue	$ 23,829	$ 25,707	$ 24,276	$ 23,239
Income from operations	7,571	7,181	7,184	5,325
Net income (loss)	5,646	5,107	4,800	(814)
Net income (loss) per share(1):				
Basic	0.31	0.28	0.27	(0.05)
Diluted	0.31	0.28	0.26	(0.05)

(1) The sum of the quarterly earnings per share may not equal the annual earnings per share because of changes in the average shares outstanding.

In the second quarter of fiscal 2010, the Company recorded a restructuring charge of $1.3 million, associated with a functional reorganization and an asset impairment charge of $2.1 million, associated with consolidation of the Company s multiple facilities in Birmingham, Alabama.

In the third quarter of fiscal 2010, the Company recorded a $2.6 million non-cash impairment loss on its investment in two private medical technology companies and adjusted the asset impairment charge associated with the Birmingham, Alabama facilities by $0.2 million

In the fourth quarter of fiscal 2010, the Company recorded a $0.4 million non-cash inventory impairment charge, a $1.3 million in non-cash asset impairment charge associated with long-lived assets, a $1.3 million non-cash asset

impairment loss associated with certain fixed assets costs in Minnesota, a $13.8 million non-cash goodwill impairment charge associated with the Company s SurModics Pharmaceuticals reporting unit, and a $5.3 million non-cash impairment loss on its investment in Nexeon MedSystems.

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SurModics, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Continued)

In the first quarter of fiscal 2009, the Company recorded income that had previously been deferred of $34.8 million associated with the Merck contract termination, a $9 million milestone payment from Merck associated with the termination of the triamcinolone acetonide development program, a $3.2 million charge for in-process research and development acquired in connection with the purchase of certain contracts and assets of PR Pharma, as well as a $1.8 million restructuring charge associated with a functional reorganization.

In the fourth quarter of fiscal 2009, the Company recorded $1.3 million in royalty income in connection with the settlement of previously disclosed litigation involving Abbott Laboratories and Church & Dwight Co, Inc.

In the fourth quarter of fiscal 2008, the Company recorded a $4.3 million non-cash impairment loss on its investment in OctoPlus.