SURMODICS INC
Form 10-K/A
May 10, 2016
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UNITED STATES

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, 2015

Commission file number 0-23837

SURMODICS, INC.

(Exact Name of Registrant as Specified in Its Charter)

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

(Registrant's Telephone Number, Including Area Code)

(952) 500-7000

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 x

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 x

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, 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 x 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. x

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 the definitions 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	x
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 x

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, 2015 was approximately $245 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 1, 2015 was 12,944,326.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant’s Proxy Statement for the Registrant’s 2016 Annual Meeting of Shareholders are incorporated by reference into Part III.

Explanatory Note

SurModics, Inc. (the “Company,” “we,” “us,” or “our”) is filing this Amendment No. 1 on Form 10-K/A (this “Amendment”) t its annual report on Form 10-K for the fiscal year ended September 30, 2015, which was originally filed on December 4, 2015 (the “Original Filing”), to amend and revise Item 9A of Part II, “Controls and Procedures,” with respect to (1) our conclusions regarding the effectiveness of our disclosure controls and procedures and our internal control over financial reporting and (2) Deloitte & Touche LLP’s (“Deloitte”) related attestation report due to a material weakness in our internal control over financial reporting identified subsequent to the issuance of our Original Filing. Item 15 of Part IV, “Exhibits and Financial Statement Schedules”, has also been amended to revise the reference to Deloitte’s opinion on our Internal Control Over Financial Reporting in its Report of Independent Registered Public Accounting Firm on our consolidated financial statements and financial statement schedule as of and for the three years in the period ended September 30, 2015.

As required by Rule 12b-15 under the Securities Exchange Act of 1934, as amended (the “Exchange Act”), new certifications of our principal executive officer and principal financial officer are also being filed as exhibits to this Amendment. This Amendment should be read in conjunction with the Original Filing, which continues to speak as of the date of the Original Filing. Except as specifically noted above, this Amendment does not modify or update disclosures in the Original Filing. Accordingly, this Amendment does not reflect events occurring after the filing of the Original Filing or modify or update any related or other disclosures.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.

None.

ITEM 9A. CONTROLS AND PROCEDURES.

1. Disclosure Controls and Procedures.

We maintain disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act that are designed to ensure that information required to be disclosed in our reports filed under the Exchange Act, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Our disclosure controls and procedures are designed to provide a reasonable level of assurance of reaching our desired disclosure control objectives.

We carried out an evaluation under the supervision and with the participation of management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of September 30, 2015, the end of the period covered by this report. Previously, based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of September 30, 2015. However, due to the material weakness in internal control over financial reporting described below, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were not effective as of September 30, 2015.

2. Internal Control over Financial Reporting.

(a) Management's Annual Report on Internal Control Over Financial Reporting (Revised)

The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting for the Company, as such term is defined in Exchange Act Rule 13a-15(f). In connection with the Original Filing, management conducted an evaluation of the design and operating effectiveness of our internal control over financial reporting based on the criteria established in Internal Control — Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). Based on its evaluation, management concluded internal control over financial reporting was effective as of September 30, 2015.

In April 2016, the Company became aware of royalty overpayments made by customers pursuant to license agreements for products incorporating certain of the Company's technologies no longer covered by an unexpired patent. The Company did not identify that certain amounts reported by the customers were not in accordance with the terms of the license agreement and should have been deferred or refunded to the customers, resulting in an overstatement of revenue. As a result of the identification of the overstatement of royalty revenue, management reevaluated the design and operating effectiveness of internal control over financial reporting and concluded that its internal control over financial reporting as of September 30, 2015 was not effective due to a material weakness in the design and operating effectiveness of its transactional and review controls related to recognition of royalty revenue. A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting such that there is reasonable possibility that a material misstatement of the Company's annual or interim financial statements will not be prevented or detected on a timely basis. Because the deficiencies related to the Company's controls over recognition of royalty revenue could result in a misstatement of royalty revenue and related accounts and disclosures that could be material to the annual or interim consolidated financial statements, such deficiencies represent a material weakness in our internal control over financial reporting. Accordingly, management has revised its report on internal control over financial reporting.

Management analyzed the impact of the overstatement of royalty revenue resulting from the identified material weakness and concluded that it did not have a material impact on our previously issued consolidated financial statements. Notwithstanding the material weakness in our internal control over financial reporting, we have concluded that the consolidated financial statements and other financial information included in the Original Filing, fairly present in all material respects our financial condition, results of operations and cash flows as of, and for, the periods presented.

The foregoing has been approved by our management, including our Chief Executive Officer and Chief Financial Officer, who have been involved with the reassessment and analysis of our internal control over financial reporting.

Deloitte & Touche LLP, the independent registered public accounting firm that audited the consolidated financial statements included in this Form 10-K/A, has issued the attestation report below regarding the Company's internal control over financial reporting.

(b) Attestation Report of the Independent Registered Public Accounting Firm.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of

SurModics, Inc.

Eden Prairie, Minnesota

We have audited the internal control over financial reporting of SurModics, Inc. and subsidiaries (the "Company") as of September 30, 2015, based on criteria established in Internal Control — Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management’s Annual Report on Internal Control Over Financial Reporting (Revised). Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit 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 effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our report dated December 4, 2015, we expressed an unqualified opinion on the effectiveness of the Company’s internal control over financial reporting. As described in the following paragraph, a material weakness was subsequently identified as a result of deficiency in the design and operation of the Company’s controls related to recognition of royalty revenue. Accordingly, management has revised its assessment about the effectiveness of the Company’s internal control over financial reporting and our present opinion on the effectiveness of the Company’s internal control over financial reporting as of September 30, 2015, as expressed herein, is different from that expressed in our previous report.

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis. The following material weakness has been identified and included in management's assessment: a material weakness in the design and operating effectiveness of its transactional and review controls related to recognition of royalty revenue. This material weakness was considered in determining the nature, timing, and extent of audit tests applied in our audit of the consolidated financial statements as of and for the year ended September 30, 2015, of the Company and this report does not affect our report on such financial statements and financial statement schedule.

In our opinion, because of the effect of the material weakness identified above on the achievement of the objectives of the control criteria, the Company has not maintained effective internal control over financial reporting as of September 30, 2015, based on the criteria established in Internal Control — Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements and financial statement schedule as of and for the year ended September 30, 2015 of the Company and our report dated December 4, 2015 expressed an unqualified opinion on those consolidated financial statements and financial statement schedule.

/s/ DELOITTE & TOUCHE LLP

Minneapolis, Minnesota

December 4, 2015 (May 10, 2016 as to the effects of the material weakness described in Management's Annual Report on Internal Control Over Financial Reporting (Revised))

c. Changes in Internal Controls Over Financial Reporting.

There were no changes in our internal control over financial reporting during the quarter ended September 30, 2015 that have materially affected, or are reasonable likely to materially affect, our internal control over financial reporting.

Plan for Remediation of Material Weakness

With oversight from the Audit Committee, the Company's management is in the process of developing and implementing remediation plans to address the material weakness described above.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES.

(a) The documents filed as part of this report on the pages indicated:

1. Financial Statements

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

2. Financial Statement Schedule. See Schedule II — "Valuation and Qualifying Accounts" in this section of this Form 10-K. 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 following exhibits which are filed with this report:

23 Consent of Deloitte & Touche LLP.**

24 Power of Attorney (included on signature page of this Form 10-K).**

31.1 Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.**

31.2 Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.**

32.1 Certification of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.**

32.2 Certification of Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.**

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.

By: /s/ Andrew D. C. LaFrence
Andrew D. C. LaFrence
Vice President of Finance and
Chief Financial Officer

Dated: May 10, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

EXHIBIT INDEX TO FORM 10-K

For the Fiscal Year Ended September 30, 2015

SURMODICS, INC.

Exhibit	
23*	Consent of Deloitte & Touche LLP.
24*	Power of Attorney (included on signature page of this Form 10-K).
31.1*	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2*	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1*	Certification of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2*	Certification of Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

*Filed herewith

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of

SurModics, Inc.

Eden Prairie, Minnesota

We have audited the accompanying consolidated balance sheets of SurModics, Inc. and subsidiaries (the "Company") as of September 30, 2015 and 2014, and the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows for each of the three years in the period ended September 30, 2015. Our audits also included the financial statement schedule listed in the Index at Item 15. These consolidated financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on the consolidated 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, 2015 and 2014, and the results of their operations and their cash flows for each of the three years in the period ended September 30, 2015, 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, 2015, based on the criteria established in Internal Control — Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated December 4, 2015, May 10, 2016 as to the effects of the material weakness described in Management’s Annual Report on Internal Control Over Financial Reporting (Revised), which expressed an adverse opinion on the Company's internal control over financial reporting because of a material weakness.

/s/ DELOITTE & TOUCHE LLP

Minneapolis, Minnesota

December 4, 2015

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SurModics, Inc. and Subsidiaries

Consolidated Balance Sheets

As of September 30

	2015	2014
	(In thousands, except share and per share data)	
ASSETS		
Current Assets:		
Cash and cash equivalents	$55,588	$43,511
Available-for-sale securities	—	3,040
Accounts receivable, net of allowance for doubtful accounts of $10 and $42 as of September 30, 2015 and 2014, respectively	7,478	4,751
Inventories	2,979	2,817
Deferred tax assets	546	394
Prepaids and other	1,198	751
Current assets of discontinued operations	—	16
Total Current Assets	67,789	55,280
Property and equipment, net	12,968	13,133
Available-for-sale securities	—	16,823
Deferred tax assets	6,704	6,718
Intangible assets, net	2,760	2,946
Goodwill	8,010	8,010
Other assets, net	479	1,979
Total Assets	$98,710	$104,889
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	$781	$1,028
Accrued liabilities:		
Compensation	2,772	2,061
Accrued other	1,099	881
Deferred revenue	48	52
Current liabilities of discontinued operations	—	45
Total Current Liabilities	4,700	4,067
Deferred revenue, less current portion	217	226
Other long-term liabilities	1,920	1,845
Total Liabilities	6,837	6,138
Commitments and Contingencies (Note 12)		
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; 12,945,157 and 13,606,545 shares issued and outstanding, respectively	647	680
Additional paid-in capital	3,060	2,662
Accumulated other comprehensive income	5	1,528
Retained earnings	88,161	93,881
Total Stockholders' Equity	91,873	98,751
Total Liabilities and Stockholders' Equity	$98,710	$104,889

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

SurModics, Inc. and Subsidiaries

Consolidated Statements of Income

For the Years Ended September 30

	2015	2014	2013
	(In thousands, except per share data)		
Revenue:			
Royalties and license fees	$31,763	$30,277	$29,774
Product sales	24,925	22,798	22,506
Research and development	5,210	4,364	3,852
Total revenue	61,898	57,439	56,132
Operating costs and expenses:			
Product costs	8,619	8,016	7,898
Research and development	16,165	15,550	15,079
Selling, general and administrative	15,525	15,297	13,859
Restructuring charges	—	—	476
Claim settlement	2,500	—	—
Total operating costs and expenses	42,809	38,863	37,312
Operating income from continuing operations	19,089	18,576	18,820
Other income (loss):			
Investment income, net	156	238	268
Impairment losses on strategic investments	(1,500)	(1,184)	(158)
Gains on sale of strategic investments	—	709	1,293
Other income, net	496	133	137
Other (loss) income	(848)	(104)	1,540
Income from continuing operations before income taxes	18,241	18,472	20,360
Income tax provision	(6,294)	(6,265)	(5,781)
Income from continuing operations	11,947	12,207	14,579
Discontinued operations:			
(Loss) income from discontinued operations, net of income taxes	—	(176)	588
Loss on sale of discontinued operations, net of income taxes	—	—	—
(Loss) Income from discontinued operations	—	(176)	588
Net income	$11,947	$12,031	$15,167
Basic income (loss) per share:			
Continuing operations	$0.92	$0.90	$1.01
Discontinued operations	(0.00)	(0.01)	0.04
Net income	$0.92	$0.88	$1.05
Diluted income (loss) per share:			
Continuing operations	$0.90	$0.88	$0.99
Discontinued operations	(0.00)	(0.01)	0.04
Net income	$0.90	$0.87	$1.03
Weighted average number of shares outstanding:			
Basic	13,029	13,632	14,464

Diluted	13,289	13,876	14,731

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

SurModics, Inc. and Subsidiaries

Consolidated Statements of Comprehensive Income

For the Years Ended September 30

	2015	2014	2013
	(In thousands)		
Net income	$11,947	$12,031	$15,167
Other comprehensive (loss) income, net of tax:			
Unrealized holding (losses) gains on available-for-sale securities arising during the period	(1,208)	1,559	235
Reclassification adjustment for realized gains included in net income	(315)	(89)	(217)
Other comprehensive (loss) income	(1,523)	1,470	18
Comprehensive income	$10,424	$13,501	$15,185

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

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Accumulated Other Comprehensive Income	Retained Earnings	Total Stockholders' Equity
	(In thousands)					
Balance at September 30, 2012	14,657	$ 733	$ 18,346	$ 40	$ 75,869	$ 94,988
Net income	—	—	—	—	15,167	15,167
Other comprehensive income, net of tax	—	—	—	18	—	18
Issuance of common stock	20	1	274	—	—	275
Common stock repurchased	(796)	(40)	(18,769)	—	—	(18,809)
Common stock options exercised, net	10	1	143	—	—	144
Purchase of common stock to pay employee taxes	—	—	(41)	—	—	(41)
Reduction of excess tax benefit from stock-based compensation plans	—	—	(477)	—	—	(477)
Stock-based compensation	—	—	2,552	—	—	2,552
Balance at September 30, 2013	13,891	695	2,028	58	91,036	93,817
Net income	—	—	—	—	12,031	12,031
Other comprehensive income, net of tax	—	—	—	1,470	—	1,470
Issuance of common stock	163	8	261	—	—	269
Common stock repurchased	(485)	(25)	(2,330)	—	(9,186)	(11,541)
Common stock options exercised, net	38	2	241	—	—	243
Purchase of common stock to pay employee taxes	—	—	(1,111)	—	—	(1,111)
Excess tax benefit from stock-based compensation plans	—	—	236	—	—	236
Stock-based compensation	—	—	3,337	—	—	3,337
Balance at September 30, 2014	13,607	680	2,662	1,528	93,881	98,751
Net income	—	—	—	—	11,947	11,947
Other comprehensive loss, net of tax	—	—	—	(1,523)	—	(1,523)
Issuance of common stock	139	7	272	—	—	279
Common stock repurchased	(848)	(42)	(2,485)	—	(17,473)	(20,000)
Common stock options exercised, net	47	2	429	—	—	431

Purchase of common stock to pay employee taxes	—	—	(631)	—	(194)	(825)
Excess tax benefit from stock-based compensation plans	—	—	432	—	—	432
Stock-based compensation	—	—	2,381	—	—	2,381
Balance at September 30, 2015	12,945	$ 647	$ 3,060	$ 5	$ 88,161	$ 91,873

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

SurModics, Inc. and Subsidiaries

Consolidated Statements of Cash Flows

For the Years Ended September 30

	2015	2014	2013
	(In thousands)		
Operating Activities:			
Net income	$11,947	$12,031	$15,167
Adjustments to reconcile net income to net cash provided by operating activities from continuing operations:			
Loss (income) from discontinued operations	—	176	(588)
Depreciation and amortization	2,805	2,715	2,886
Gains on sales of available-for-sale securities, net and strategic investments	(492)	(842)	(1,430)
Impairment losses on strategic investments	1,500	1,184	158
Stock-based compensation	2,381	3,337	2,552
Deferred taxes	93	(352)	(492)
Excess tax (benefit) deficiency from stock-based compensation plans	(432)	(236)	477
(Gain) loss on disposals of property and equipment	(39)	2	(62)
Change in operating assets and liabilities, excluding the impact of discontinued operations:			
Accounts receivable	(2,727)	581	(263)
Inventories	(162)	511	196
Prepaids and other	141	(23)	(40)
Accounts payable and accrued liabilities	373	(738)	238
Income taxes	(309)	116	(989)
Deferred revenue	(13)	75	(29)
Net cash provided by operating activities from continuing operations	15,066	18,537	17,781
Investing Activities:			
Purchases of property and equipment	(1,877)	(2,278)	(1,919)
Cash proceeds from sale of property and equipment	42	—	77
Purchases of available-for-sale securities	(3,376)	(138,363)	(45,053)
Sales and maturities of available-for-sale securities	22,199	162,673	44,853
Business combination	(270)	—	—
Cash received from sale of strategic investments	21	709	2,236
Cash transferred to discontinued operations	(45)	(354)	(116)
Net cash provided by investing activities from continuing operations	16,694	22,387	78
Financing Activities:			
Excess tax benefit (deficiency) from stock-based compensation plans	432	236	(477)
Issuance of common stock	710	512	419
Repurchase of common stock	(20,000)	(12,545)	(17,805)
Purchases of common stock to pay employee taxes	(825)	(1,111)	(41)
Net cash used in financing activities from continuing operations	(19,683)	(12,908)	(17,904)
Net cash provided by (used in) continuing operations	12,077	28,016	(45)
Discontinued Operations:			

Net cash used in operating activities	(45)	(354)	(116)
Net cash provided by investing activities	—	—	—
Net cash provided by financing activities	45	354	116
Net cash provided by discontinued operations	—	—	—
Net change in cash and cash equivalents	12,077	28,016	(45)
Cash and Cash Equivalents:			
Beginning of year	43,511	15,495	15,540
End of year	$55,588	$43,511	$15,495
Supplemental Information:			
Cash paid for income taxes	$6,510	$6,295	$7,115
Noncash financing and investing activities:			
Acquisition of property and equipment on account	$22	$11	$26
Share repurchase accrual	$—	$—	$1,004
Issuance of performance shares, restricted and deferred stock units	$2,250	$3,007	$—
Accrual of business combination contingent consideration	$305	$—	$—

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

SurModics, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

1. Description

SurModics, Inc. and subsidiaries ("SurModics" or "the Company") is a leading provider of medical device and in vitro diagnostic technologies to the healthcare industry. The Company derives its revenue from three primary sources: (1) royalties and license fees from licensing its proprietary drug delivery and surface modification technologies and in vitro diagnostic formats to customers; (2) the sale of reagent chemicals to licensees and the sale of stabilization products, antigens, substrates and surface coatings to the diagnostic and biomedical research markets; and (3) research and development fees generated on customer projects.

Effective with the acquisition of Creagh Medical Ltd. ("Creagh") on November 20, 2015, and subsequent to the fiscal year end 2015, the Company will be engaged in contract research and development, as well as manufacturing of balloon catheters used in a variety of interventional cardiology applications.

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 ("U.S.") ("GAAP"). All inter-company transactions have been eliminated.

2. Summary of Significant Accounting Policies and Select Balance Sheet Information

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 and may include money market instruments, certificates of deposit, repurchase agreements and commercial paper instruments.

Investments

Investments consist principally of U.S. government and government agency obligations, mortgage-backed securities and corporate and municipal debt securities and were classified as available-for-sale at September 30, 2014. Available-for-sale securities are reported at fair value with unrealized gains and losses, net of tax, excluded from the consolidated statements of income and reported in the consolidated statements of comprehensive income as well as a separate component of stockholders' equity in the consolidated balance sheets, except for other-than-temporary impairments, which are reported as a charge to current earnings. 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 for which management has the intent and ability to hold to maturity are classified as held-to-maturity and reported at amortized cost. When an other-than-temporary impairment in the fair value of any individual security classified as held-to-maturity occurs, the Company writes down the security to fair value with a corresponding adjustment to other income (loss). Interest earned on debt securities, including amortization of premiums and accretion of discounts, is 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.

During the quarter ended June 30, 2015, the Company liquidated its investment portfolio to support corporate initiatives, as a result the ending balance of available-for-sale investments as of September 30, 2015 was zero. The amortized cost, unrealized holding gains and losses, and fair value of available-for-sale securities as of September 30, 2014 were as follows (in thousands):

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
U.S. government and government agency obligations	$ 7,397	$ 12	$ (15)	$7,394
Mortgage-backed securities	5,576	43	(74)	5,545
Municipal bonds	1,173	5	(3)	1,175
Asset-backed securities	2,370	3	(4)	2,369
Corporate bonds	1,829	6	(5)	1,830
Equity securities	2	1,548	—	1,550
Total	$ 18,347	$ 1,617	$ (101)	$19,863

As of September 30, 2014, the Company concluded that the unrealized losses related to the available-for-sale securities shown above were not other-than-temporary as the Company did not have the intent to sell, nor was is it more likely than not that the Company would be required to sell such securities, before recovery of their amortized cost.

The following table summarizes sales of available-for-sale securities for the years ended September 30, 2015, 2014 and 2013 (in thousands):

	2015	2014	2013
Proceeds from sales	$22,199	$162,673	$44,853
Gross realized gains	$548	$134	$179
Gross realized losses	$(73)	$(1)	$(43)

There were no held-to-maturity debt securities at September 30, 2015 or 2014.

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 components as of September 30 (in thousands):

	2015	2014
Raw materials	$1,264	$1,056
Finished products	1,715	1,761
Total	$2,979	$2,817

Property and Equipment

Property and equipment are stated at cost, less any impairment, and are depreciated using the straight-line method over the estimated useful lives of the assets. The Company recorded depreciation expense of $2.0 million, $2.0 million and $2.1 million for the years ended September 30, 2015, 2014 and 2013, respectively.

The September 30, 2015 and 2014 balances in construction-in-progress include the cost of enhancing the capabilities of the Company’s Eden Prairie, Minnesota facility. 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.

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

	Useful Life (In years)	2015	2014
Land	N/A	$4,359	$4,359
Laboratory fixtures and equipment	3 to 10	12,941	12,858
Buildings and improvements	3 to 20	16,444	16,114
Office furniture and equipment	3 to 10	3,473	3,060
Construction-in-progress		1,168	1,158
Less accumulated depreciation		(25,417)	(24,416)
Property and equipment, net		$12,968	$13,133

Other Assets

Other assets consisted principally of strategic investments as of September 30 as follows (in thousands):

	2015	2014
CeloNova BioSciences, Inc.	$—	$1,500
ViaCyte, Inc.	479	479
Other assets, net	$479	$1,979

In February 2011, the stent technology of Nexeon MedSystems, Inc. (“Nexeon”) was acquired by CeloNova BioSciences, Inc. (“CeloNova”). Prior to the acquisition by CeloNova, Nexeon created a wholly-owned subsidiary, Nexeon Stent, to hold the company’s stent-related assets. Nexeon distributed to its stockholders the Nexeon Stent stock which was exchanged for Series B-1 preferred shares of CeloNova. CeloNova is a privately-held Texas-based medical technology company that is marketing a variety of medical products. The Company’s investment in CeloNova, which is accounted for under the cost method, represents less than a 2% ownership interest. The Company does not exert significant influence over CeloNova’s operating or financial activities.

On November 10, 2015 Boston Scientific Corporation announced its intent to acquire CeloNova’s interventional radiology portfolio for $70 million plus potential milestone payments. This acquisition is expected to close by December 31, 2015. The Company recognized an other-than-temporary impairment loss of $1.5 million related to its investment in CeloNova in the fourth quarter fiscal 2015 based on the indicated value of this transaction.

The Company has invested a total of $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 does not exert significant influence over ThermopeutiX’s operating or financial activities. In the fourth quarter of fiscal 2014, the Company recognized an other-than-temporary impairment loss of $1.2 million based on capital funding initiatives and current operating conditions of ThermopeutiX.

The Company has invested a total of $5.3 million in ViaCyte, Inc. (“ViaCyte”), 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 that its investment in ViaCyte was impaired and that the impairment was other-than-temporary. Accordingly, the Company recorded an impairment loss of $4.7 million. In the second quarter of fiscal 2013, the Company recorded an additional other-than-temporary impairment loss on this investment totaling $0.1 million based on a financing round and market valuations. The balance of the investment of $0.5 million, which is accounted for under the cost method, represents less than a 1% ownership interest. The Company does not exert significant influence over ViaCyte’s operating or financial activities.

The Company had invested a total of $2.5 million in Vessix Vascular, Inc. (“Vessix”) and recognized an other-than-temporary impairment loss on this investment totaling $2.4 million in fiscal 2010, based on market valuations and a pending financing round for Vessix. Vessix was purchased by Boston Scientific Corporation in November 2012. The Company recorded a gain of approximately $1.2 million in the consolidated statements of income gains on sale of strategic investments line, on the sale of this investment in the first quarter of fiscal 2013. In fiscal 2014, the Company recorded a $0.7 million gain upon achievement by Vessix of a clinical milestone and a sales milestone for calendar 2013. Total potential maximum additional proceeds of $3.3 million may be received in fiscal 2016 through fiscal 2017 depending on Vessix’s achievement of future sales milestones. No amounts have been recorded associated with these future milestones given the level of uncertainty that exists. Any potential additional income will be recognized once the milestones are achieved.

The Company transferred its original investment of $2,000 in Intersect ENT, Inc. (“Intersect ENT”) out of other assets to short-term available-for-sale investments upon completion of Intersect ENT’s initial public offering (“IPO”) in July 2014. The Company recognized a gain on this investment in other income of $0.5 million during the year ended

September 30, 2015 as the investment was sold.

The Company has invested a total of $6.5 million in Nexeon, a privately-held West Virginia-based medical technology company, commencing in July 2007 and has recognized losses under the equity method of accounting as well as other-than-temporary impairment losses of $4.1 million in fiscal 2010 and less than $0.1 million in fiscal 2013. In the fourth quarter of fiscal 2013, the Company recognized an other-than-temporary impairment loss based on Nexeon's capital funding initiatives of approximately $1.0 million. The carrying value of this investment was zero as of September 30, 2015 and 2014.

The total carrying value of cost method investments is reviewed quarterly for changes in circumstances or the occurrence of events that suggest the Company's investment may not be recoverable. The fair value of cost method investments is not adjusted if there are no identified events or changes in circumstances that may have a material adverse effect on the fair value of the investment.

In the fiscal years ended September 30, 2015 and 2014, the Company recognized revenue of less than $0.1 million in each period and in the fiscal year ended September 30, 2013 the Company recognized revenue of $0.1 million 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 $0.8 million, $0.7 million and $0.7 million for the years ended September 30, 2015, 2014 and 2013, respectively. During the year ended September 30, 2015, the Company acquired certain assets from ImmunO4, LLC resulting in an increase in customer lists, non-compete and other intangible assets of $0.3 million, $0.2 million and $0.1 million, respectively.

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

	2015 Weighted Average Original Life (Years)	Gross Carrying Amount	Accumulated Amortization	Net
Definite-lived intangible assets:				
Customer lists	9.0	$ 5,132	$ (4,363)	$ 769
Core technology	8.0	530	(530)	0
Non-compete	5.0	230	(12)	218
Patents and other	16.8	2,321	(1,128)	1,193
Subtotal		8,213	(6,033)	2,180
Unamortized intangible assets:				
Trademarks		580		