SURMODICS INC
Form 10-Q
May 04, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2018

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
Commission File Number: 0-23837

Surmodics, Inc.

(Exact name of registrant as specified in its charter)

MINNESOTA	41-1356149
(State of incorporation)	(I.R.S. Employer Identification No.)

9924 West 74th Street

Eden Prairie, Minnesota 55344

(Address of principal executive offices) (Zip Code)

Registrant’s telephone number, including area code: (952) 500-7000

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer”, “smaller reporting company” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer		Accelerated filer
Non-accelerated filer	(Do not check if a smaller reporting company)	Smaller reporting company
		Emerging Growth Company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

The number of shares of the registrant’s Common Stock, $.05 par value per share, outstanding as of May 2, 2018 was 13,257,956.

TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION
Item 1. Unaudited Condensed Financial Statements 3
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations 21
Item 3. Quantitative and Qualitative Disclosures About Market Risk 30
Item 4. Controls and Procedures 30

PART II. OTHER INFORMATION
Item 1. Legal Proceedings 31
Item 1A. Risk Factors 31
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds 31
Item 3. Defaults Upon Senior Securities 31
Item 4. Mine Safety Disclosures 31
Item 5. Other Information 31
Item 6. Exhibits 32

SIGNATURES 33

PART I. FINANCIAL INFORMATION

Item 1. Unaudited Condensed Financial Statements

Surmodics, Inc. and Subsidiaries

Condensed Consolidated Balance Sheets

(in thousands, except share and per share data)	March 31, 2018 (Unaudited)	September 30, 2017
ASSETS		
Current Assets:		
Cash and cash equivalents	$27,712	$16,534
Restricted cash	350	—
Available-for-sale securities	38,330	31,802
Accounts receivable, net of allowance for doubtful accounts of $160 and $230 as of March 31, 2018 and September 30, 2017, respectively	7,216	7,211
Inventories, net	4,046	3,516
Income tax receivable	1,345	599
Prepaids and other	2,342	1,221
Total Current Assets	81,341	60,883
Available-for-sale securities	3,953	—
Deferred tax assets	3,326	4,027
Property and equipment, net	25,844	22,942
Intangible assets, net	19,725	20,562
Goodwill	27,933	27,282
Other assets	1,197	897
Total Assets	$163,319	$136,593
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	$2,012	$2,396
Accrued liabilities:		
Compensation	3,859	3,822
Accrued other	4,022	1,773
Deferred revenue	12,097	62
Contingent consideration	12,235	1,750
Total Current Liabilities	34,225	9,803
Contingent consideration, less current portion	1,110	13,114
Deferred revenue, less current portion	12,710	181
Other long-term liabilities	1,918	1,938
Total Liabilities	49,963	25,036
Commitments and Contingencies (Note 16)		
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; 13,247,068 and 13,094,988 shares issued and outstanding as of March 31, 2018 and September 30, 2017, respectively	662	655
Additional paid-in capital	5,431	5,413
Accumulated other comprehensive income	5,213	3,417
Retained earnings	102,050	102,072
Total Stockholders' Equity	113,356	111,557
Total Liabilities and Stockholders' Equity	$163,319	$136,593

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

Surmodics, Inc. and Subsidiaries

Condensed Consolidated Statements of Operations

(In thousands, except per share data)	Three Months Ended March 31, 2018 (Unaudited)	2017	Six Months Ended March 31, 2018 (Unaudited)	2017
Revenue:				
Product sales	$8,686	$7,936	$16,774	$15,637
Royalties and license fees	8,428	7,319	15,504	15,320
Research, development and other	1,944	2,248	3,793	4,307
Total revenue	19,058	17,503	36,071	35,264
Operating costs and expenses:				
Product costs	2,913	2,562	5,804	5,190
Research and development	10,774	8,208	18,605	14,178
Selling, general and administrative	6,440	5,076	11,628	9,938
Acquired intangible asset amortization	636	591	1,254	1,187
Contingent consideration gain	(2,230)	(611)	(1,112)	(174)
Total operating costs and expenses	18,533	15,826	36,179	30,319
Operating income (loss)	525	1,677	(108)	4,945
Other (loss) income:				
Investment income, net	142	85	263	170
Foreign exchange (loss) gain	(353)	(201)	(539)	473
Gain on strategic investment	—	—	177	—
Other (loss) income, net	(211)	(116)	(99)	643
Income (loss) before income taxes	314	1,561	(207)	5,588
Income tax benefit (provision)	1,220	(1,055)	185	(2,782)
Net income (loss)	$1,534	$506	$(22)	$2,806
Basic net income (loss) per share	$0.12	$0.04	$(0.00)	$0.21
Diluted net income (loss) per share	$0.11	$0.04	$(0.00)	$0.21
Weighted average number of shares outstanding:				
Basic	13,102	13,220	13,078	13,207
Diluted	13,465	13,428	13,078	13,415

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

Surmodics, Inc. and Subsidiaries

Condensed Consolidated Statements of Comprehensive Income

	Three Months Ended March 31,		Six Months Ended March 31,	
(In thousands)	2018 (Unaudited)	2017	2018 (Unaudited)	2017
Net income (loss)	$1,534	$506	$(22)	$2,806
Other comprehensive income (loss):				
Unrealized holding (losses) gains on available-for-sale securities, net of tax	(28)	4	(41)	50
Foreign currency translation adjustments	1,207	660	1,837	(1,594)
Other comprehensive income (loss)	1,179	664	1,796	(1,544)
Comprehensive income	$2,713	$1,170	$1,774	$1,262

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

Surmodics, Inc. and Subsidiaries

Condensed Consolidated Statements of Cash Flows

	Six Months Ended March 31,	
(in thousands)	2018	2017
	(Unaudited)	
Operating Activities:		
Net (loss) income	$(22)	$2,806
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Depreciation and amortization	3,106	2,610
Stock-based compensation	2,003	1,671
Contingent consideration gain	(1,112)	(174)
Unrealized foreign exchange loss (income)	518	(473)
Deferred taxes	701	525
Gain on strategic investment	(177)	—
Provision for bad debts	25	—
Other	92	(25)
Change in operating assets and liabilities:		
Accounts receivable	(15)	(223)
Inventories	(500)	132
Prepaids and other	(1,366)	(1,006)
Accounts payable and accrued liabilities	392	(1,959)
Income taxes	(776)	358
Deferred revenue	24,562	21
Net cash provided by operating activities	27,431	4,263
Investing Activities:		
Purchases of property and equipment	(4,020)	(2,866)
Purchases of available-for-sale securities	(43,517)	(40,051)
Maturities of available-for-sale securities	33,000	27,071
Cash proceeds from sales of property and equipment	4	—
Cash received from sale of strategic investment	177	—
Net cash used in investing activities	(14,356)	(15,846)
Financing Activities:		
Issuance of common stock	377	188
Payments for taxes related to net share settlement of equity awards	(1,132)	(2,127)
Payment of contingent consideration obligations	(925)	—
Payment of deferred financing costs	—	(97)
Net cash used in financing activities	(1,680)	(2,036)
Effect of exchange rate changes on cash and cash equivalents	133	(109)
Net change in cash and cash equivalents	11,528	(13,728)
Cash and Cash Equivalents:		
Beginning of period	16,534	24,987
End of period	$28,062	$11,259
Supplemental Information:		
Cash paid for income taxes	$782	$1,881
Noncash transactions from investing and financing activities:		
Acquisition of property and equipment on account	$329	$303

Accrued taxes related to net share settlement of equity awards	1,222	—

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

Surmodics, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

Period Ended March 31, 2018

(Unaudited)

1. Basis of Presentation

The accompanying unaudited interim condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("U.S.") ("GAAP") and, in the opinion of management, reflect all adjustments, consisting of normal recurring adjustments, needed to fairly present the financial results of Surmodics, Inc. and subsidiaries ("Surmodics" or the "Company") for the periods presented. These financial statements include amounts that are based on management's best estimates and judgments. These estimates may be adjusted as more information becomes available, and any adjustment could be significant. The impact of any change in estimates is included in the determination of net income (loss) in the period in which the change in estimate is identified. The results of operations for the three and six months ended March 31, 2018 are not necessarily indicative of the results that may be expected for the entire 2018 fiscal year.

In accordance with the rules and regulations of the U.S. Securities and Exchange Commission ("SEC"), the Company has omitted footnote disclosures that would substantially duplicate the disclosures contained in the audited consolidated financial statements of the Company. These unaudited condensed consolidated financial statements should be read together with the audited consolidated financial statements for the fiscal year ended September 30, 2017, and footnotes thereto included in the Company's Form 10-K as filed with the SEC on December 1, 2017.

2. New Accounting Pronouncements

Accounting Standards to be Adopted

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Codification ("ASC") Update No. 2014-09, Revenue from Contracts with Customers (ASC Topic 606). Principles of this guidance require entities to recognize revenue in a manner that depicts the transfer of goods or services to customers in amounts that reflect the consideration an entity expects to be entitled to in exchange for those goods or services. The guidance also requires expanded disclosures relating to the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. Additionally, qualitative and quantitative disclosures are required about customer contracts, significant judgments and changes in judgments, and assets recognized from the costs to obtain or fulfill a contract. This accounting standard will be effective for the Company beginning in the first quarter of fiscal year 2019 (October 1, 2018) using one of two prescribed retrospective methods. The Company is currently evaluating the impact that the adoption of this standard will have on the Company's business model and consolidated results of operations, cash flows and financial position. The Company currently plans to adopt the standard using the modified retrospective approach and expects the impact will be material to the consolidated financial statements due to an anticipated one-quarter acceleration of minimum license fees and royalty revenue earned under its hydrophilic license agreements, as well as several additional required financial statement footnote disclosures. Additionally, the Company is currently evaluating the effect of this standard on the recognition of revenue for the payments the Company may

earn under its agreement related to the Company's SurVeil® drug-coated balloon with Abbott Vascular, Inc. ("Abbott") entered into in fiscal 2018, which is disclosed in Note 3 to the condensed consolidated financial statements. Under the modified retrospective approach, the Company will apply the new revenue standard to all new revenue contracts initiated on or after the effective date, and, for contracts which have remaining obligations as of the effective date, the Company will adjust the beginning balance of retained earnings as of October 1, 2018.

In February 2016, the FASB issued Accounting Standards Update ASU 2016-02, Leases (ASC Topic 842). The new guidance primarily affects lessee accounting, while accounting by lessors will not be significantly impacted by the update. The update maintains two classifications of leases: finance leases, which replace capital leases, and operating leases. Lessees will need to recognize a right-of-use asset and a lease liability on the statement of financial position for those leases previously classified as operating leases under the old guidance. The liability will be equal to the present value of remaining contractual lease payments. The asset will be based on the liability, subject to adjustment, such as for direct costs. The accounting standard will be effective for the Company beginning the first quarter of fiscal year 2020 (October 1, 2019) and will be applied using a modified retrospective approach. The Company is currently evaluating the impact that the adoption of this standard will have on the Company's results of operations, cash flows and financial position. The Company believes the impact will be material due to the right-of-use assets and lease liabilities that will be recorded on the Company's consolidated balance sheets upon adoption of the standard.

In June 2016, the FASB issued ASU No 2016-13, Financial Instruments – Credit Losses (ASC Topic 326), Measurement of Credit Losses on Financial Statements. This ASU requires a financial asset (or a group of financial assets) measured at an amortized cost

basis to be presented at the net amount expected to be collected. The allowance for credit losses is a valuation account that is deducted from the amortized cost basis of the financial asset(s) to present the net carrying value at the amount expected to be collected on the financial asset. The accounting standard will be effective for the Company beginning in the first quarter of fiscal 2020 (October 1, 2019). Early adoption is permitted and the guidance will be applied using a modified retrospective approach. The Company is currently evaluating the impact that the adoption of this standard will have on the Company’s results of operations, cash flows and financial position.

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

3. Collaborative Arrangement

On February 26, 2018, the Company entered into an agreement with Abbott whereby Abbott will have exclusive worldwide commercialization rights for Surmodics' SurVeil® drug-coated balloon to treat the superficial femoral artery, which is currently being evaluated in a U.S. pivotal clinical trial. Separately, Abbott also received options to negotiate agreements for Surmodics' below-the-knee and arteriovenous (AV) fistula drug-coated balloon products, which are currently in pre-clinical development. Surmodics is responsible for conducting all necessary clinical trials and other activities required to achieve U.S. and European Union regulatory clearances for SurVeil, including completion of the ongoing TRANSCEND clinical trial. Abbott and Surmodics will participate on a joint development committee charged with providing guidance on the Company’s clinical and regulatory activities with regard to the SurVeil product.

The Company has received a $25 million upfront fee and may receive up to $67 million of additional payments upon achievement of various clinical and regulatory milestones. The upfront fee and potential milestone payments will be recognized as royalty and license fee revenue as the clinical and regulatory activities are performed on a proportional performance basis, relative to the expected total cost of each underlying unit of account. For the three and six-month periods ended March 31, 2018, the Company recognized revenue totaling $0.5 million from the Abbott arrangement. The remainder of the $25 million upfront payment received is included in deferred revenue as of March 31, 2018. Upon the regulatory approval of the SurVeil® drug-coated balloon, Surmodics will be responsible for the manufacture and supply of clinical and commercial quantities of the product and will realize revenue based on initial product sales to Abbott as well as a share of net profits resulting from third-party sales by Abbott.

4. 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 financial liabilities and for all nonfinancial assets and nonfinancial 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 did not have any Level 1 assets as of March 31, 2018 and September 30, 2017.

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 as of March 31, 2018 and September 30, 2017 consisted of money market funds, commercial paper instruments and corporate bonds.

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.

Level 3 liabilities as of March 31, 2018 and September 30, 2017 consist of contingent consideration obligations related to the fiscal 2016 acquisitions of Creagh Medical Ltd. ("Creagh Medical") and NorMedix, Inc. ("NorMedix"). Consideration owed to the sellers of Creagh Medical upon achievement of revenue and value-creating milestones through September 30, 2018, is due to be paid during the quarter ending December 31, 2018. Consideration owed to the sellers of NorMedix upon achievement of revenue and value-creating milestones through September 30, 2019, is due to be paid within sixty days following the quarter in which each milestone is achieved. Contingent consideration included in current liabilities of $12.2 million and $1.8 million as of March 31, 2018 and September 30, 2017, respectively, represents the Company's estimated fair value of amounts expected to be paid within one year of each respective balance sheet date. During the three months ended March 31, 2018, the Company paid contingent consideration obligations related to the NorMedix acquisition totaling $0.9 million, which are included in cash flows used in financing activities on the condensed consolidated statement of cash flows.

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

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 assets and liabilities measured at fair value on a recurring basis as of March 31, 2018:

(Dollars 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 March 31, 2018
Assets				
Cash equivalents	$ —	$ 21,432	$ —	$21,432
Available-for-sale securities	—	42,283	—	42,283
Total assets	$ —	$ 63,715	$ —	$63,715
Liabilities				
Contingent consideration	$ —	$ —	$ (13,345)	$(13,345)
Total liabilities	$ —	$ —	$ (13,345)	$(13,345)

The following table presents information about the Company's assets and liabilities measured at fair value on a recurring basis as of September 30, 2017:

(Dollars 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, 2017
Assets				
Cash equivalents	$ —	$ 6,639	$ —	$ 6,639
Available-for-sale securities	—	31,802	—	$ 31,802
Total assets	$ —	$ 38,441	$ —	$ 38,441
Liabilities				
Contingent consideration	$ —	$ —	$ (14,864)	$ (14,864)
Total liabilities	$ —	$ —	$ (14,864)	$ (14,864)

The following table summarizes the changes in the contingent consideration liabilities measured at fair value using Level 3 inputs for the three and six months ended March 31, 2018 and 2017:

	Three Months Ended March 31,		Six Months Ended March 31,	
(Dollars in thousands)	2018	2017	2018	2017
Beginning balance	$16,162	$14,291	$14,864	$14,517
Additions	—	—	—	—
Fair value adjustments	(2,317)	(1,159)	(1,298)	(1,159)
Settlements	(925)	—	(925)	—
Interest accretion	87	548	186	985
Foreign currency translation loss (gain)	338	190	518	(473)
Ending balance	$13,345	$13,870	$13,345	$13,870

There were no transfers of assets or liabilities between amounts measured using Level 1, Level 2, or Level 3 fair value measurements during fiscal 2018 to date or fiscal 2017.

Valuation Techniques

The valuation techniques used to measure the fair value of assets are as follows:

Cash equivalents — These assets are classified as Level 2 and are carried at historical cost which is a reasonable estimate of fair value because of the relatively short time between origination of the instrument and its expected realization.

Available-for-sale securities — Fair market values for these assets are based on quoted vendor prices and broker pricing in active markets underlying the securities where all significant inputs are observable. To ensure the accuracy of quoted vendor prices and broker pricing, the Company performs regular reviews of investment returns to industry benchmarks and sample tests of individual securities to validate quoted vendor prices with other available market data.

Contingent consideration — The contingent consideration liabilities were determined based on discounted cash flow analyses that included revenue estimates, probability of strategic milestone achievement and a discount rate, which are considered significant unobservable inputs. For the NorMedix revenue-based milestones, the Company discounted forecasted revenue by 23.0%, which represents the Company's weighted average cost of capital for this transaction, adjusted for the short-term nature of the cash flows. The present value of forecasted revenue was used as an input into an option pricing approach, which also considered the Company's risk of non-payment of the NorMedix revenue-based milestones. Expected payments of the Creagh Medical revenue milestones were discounted using the Company's estimated cost of debt at March 31, 2018. Non-revenue milestones for the Creagh Medical and NorMedix acquisitions that have not already been achieved were projected to have a 0-90% probability of achievement and expected payments were discounted using the Company's estimated cost of debt, or 2.3% to 4.5%. To the extent that actual

results differ from these estimates, the fair value of the contingent consideration liabilities could change significantly. Accretion expense is recorded as an increase to the contingent consideration liabilities due to the passage of time. Fair value adjustments represent changes in the value of the obligations related to adjustments to forecasted revenue and probability of strategic milestone completion. The contingent consideration liability related to the Creagh Medical acquisition is denominated in Euros and is not hedged. Foreign currency translation and losses are recorded as this obligation is marked to period-end exchange rates.

5. Investments

Investments consisted principally of commercial paper and corporate bond securities and are classified as available-for-sale as of March 31, 2018 and September 30, 2017. Available-for-sale securities are reported at fair value with unrealized gains and losses, net of tax, excluded from the condensed consolidated statements of operations and reported in the condensed consolidated statements of comprehensive income as well as a separate component of stockholders' equity in the condensed 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 (loss) income. This adjustment results in a new cost basis for the investment. Interest earned on debt securities, including amortization of premiums and accretion of discounts, is included in investment income, net within other (loss) income. Realized gains and losses from the sales of debt securities, which are included in other (loss) income, are determined using the specific identification method. Investment purchases are accounted for on the date the trade is executed, which may not be the same as the date the transaction is cash settled.

The amortized cost, unrealized holding gains and losses, and fair value of available-for-sale securities were as follows:

	March 31, 2018			
(Dollars in thousands)	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Short-term commercial paper and corporate bonds	$38,371	$ —	$ (41)	$ 38,330
Long-term corporate bonds	3,964	—	(11)	3,953
Total	$42,335	$ —	$ (52)	$ 42,283

	September 30, 2017			
(Dollars in thousands)	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Commercial paper and corporate bonds	$31,817	$ —	$ (15)	$ 31,802
Total	$31,817	$ —	$ (15)	$ 31,802

6. Inventories

Inventories are principally stated at the lower of cost or market using the specific identification method and include direct labor, materials and overhead, with cost of product sales determined on a first-in, first-out basis. Inventories consisted of the following components:

(Dollars in thousands)	March 31, 2018	September 30, 2017
Raw materials	$2,002	$ 1,603
Work-in process	843	659
Finished products	1,201	1,254
Total	$4,046	$ 3,516

7. Other Assets

Other assets consist of the following:

(Dollars in thousands)	March 31, 2018	September 30, 2017
ViaCyte, Inc.	$479	$ 479
Other noncurrent assets	718	418
Other assets, net	$1,197	$ 897

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. The balance of the investment of $0.5 million, which is net of previously recorded other-than-temporary impairments of $4.8 million, is accounted for under the cost method and represents less than a 1% ownership interest. The Company does not exert significant influence over ViaCyte’s operating or financial activities.

The carrying value of each cost method investment 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 effect on the fair value of the investment.

8. Intangible Assets

Intangible assets consist principally of acquired patents and technology, customer lists and relationships, licenses and trademarks. The Company recorded amortization expense of $0.7 million and $0.6 million for the three months ended March 31, 2018 and 2017, respectively. The Company recorded amortization expense of $1.4 million and $1.3 million for the six months ended March 31, 2018 and 2017, respectively.

Intangible assets consisted of the following:

	March 31, 2018			
(Dollars in thousands)	Weighted Average Original Life (Years)	Gross Carrying Amount	Accumulated Amortization	Net
Definite-lived intangible assets:				
Customer lists and relationships	8.9	$ 18,832	$ (8,777)	$ 10,055
Developed technology	11.5	9,829	(1,950)	7,879
Non-compete	5.0	230	(127)	103
Patents and other	16.5	2,321	(1,496)	825
Subtotal		31,212	(12,350)	18,862

Unamortized intangible assets:			
In-process research and development	283	—	283
Trademarks and trade names	580	—	580
Total	$ 32,075	$ (12,350)	$ 19,725

(Dollars in thousands)	September 30, 2017 Weighted Average Original Life (Years)	Gross Carrying Amount	Accumulated Amortization	Net
Definite-lived intangible assets:				
Customer lists and relationships	8.9	$ 18,293	$ (7,834)	$ 10,459
Developed technology	11.7	9,297	(1,478)	7,819
Non-compete	5.0	230	(103)	127
Patents and other	16.5	2,321	(1,423)	898
Subtotal		30,141	(10,838)	19,303
Unamortized intangible assets:				
In-process research and development		679	—	679
Trademarks and trade names		580	—	580
Total		$ 31,400	$ (10,838)	$ 20,562

Based on the intangible assets in service as of March 31, 2018, excluding any possible future amortization associated with acquired in-process research and development (“IPR&D”), which has not met technological feasibility as of March 31, 2018, estimated amortization expense for the remainder of fiscal 2018 and each of the next five fiscal years is as follows (in thousands):

Remainder of 2018	$ 1,398
2019	2,795
2020	2,620
2021	2,481
2022	2,441
2023	1,807

Future amortization amounts presented above are estimates. Actual future amortization expense may be different as a result of future acquisitions, impairments, completion or abandonment of IPR&D intangible assets, changes in amortization periods, or other factors.

The Company defines IPR&D as the value of technology acquired for which the related projects have substance and are incomplete. IPR&D acquired in a business acquisition is recognized at fair value and requires the IPR&D to be capitalized as an indefinite-lived intangible asset until completion of the IPR&D project or abandonment. Upon completion of the development project (generally when regulatory approval to market the product is obtained), an impairment assessment is performed prior to amortizing the asset over its estimated useful life. If the IPR&D projects are abandoned, the related IPR&D assets would be written off. During the second quarter of fiscal 2018, we reclassified $0.4 million of acquired IPR&D to developed technology as the technology was commercialized.

9. Goodwill

Goodwill represents the excess of the cost of an acquired entity over the fair value assigned to the assets purchased and liabilities assumed in connection with a business acquisition. Goodwill is not amortized but is subject, at a

minimum, to annual tests for impairment in accordance with accounting guidance for goodwill. 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.

Goodwill as of March 31, 2018 and September 30, 2017 totaled $27.9 million and $27.3 million, respectively. Goodwill in the Medical Device reporting unit represents the gross value from the fiscal 2016 acquisitions of Creagh Medical and NorMedix. Goodwill in the In Vitro Diagnostics reporting unit represents the gross value from the acquisition of BioFX Laboratories, Inc. (“BioFX”) in fiscal 2007.

Goodwill was not impaired in either reporting unit based on the outcome of the fiscal 2017 annual impairment test, and there have been no events or circumstances that have occurred in the first six months of fiscal 2018 to indicate that goodwill has been impaired.

The change in the carrying amount of goodwill by segment for the six months ended March 31, 2018 was as follows:

(Dollars in thousands)	In Vitro Diagnostics	Medical Device	Total
Balance as of September 30, 2017	$ 8,010	$19,272	$27,282
Currency translation adjustment	—	651	651
Balance as of March 31, 2018	$ 8,010	$19,923	$27,933

10. Accrued Liabilities

Accrued liabilities consisted of the following:

	March 31, 2018	September 30, 2017
Accrued professional fees	$362	$ 501
Accrued clinical study expense	1,424	411
Accrued inventory purchases	692	596
Construction in progress	198	—
Customer claim	1,000	—
Other	346	265
Total	$4,022	$ 1,773

11. Stock-based Compensation

The Company has stock-based compensation plans under which it grants stock options, restricted stock awards, performance share awards, restricted stock units and deferred stock units. 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 were allocated to the following expense categories:

	Three Months Ended March 31,		Six Months Ended March 31,	
(Dollars in thousands)	2018	2017	2018	2017
Product costs	$23	$37	$17	$50
Research and development	179	123	337	248
Selling, general and administrative	899	722	1,649	1,373
Total	$1,101	$882	$2,003	$1,671

As of March 31, 2018, approximately $7.6 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 include $1.0 million, remaining to be expensed over the life of the awards, based on payout levels associated with performance share awards that are currently anticipated to be fully expensed because the performance conditions are expected to exceed minimum threshold levels.

Stock Option Awards

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 values of stock options granted during the three months ended March 31, 2018 and 2017 were $9.00 and $7.59, respectively, and $10.32 and $7.59 during the six months ended March 31, 2018 and 2017, respectively.

	Three Months Ended March 31,		Six Months Ended March 31,	
	2018	2017	2018	2017
Risk-free interest rates	2.6 %	1.9 %	2.1 %	1.7 %
Expected life (years)	4.8	4.7	4.8	4.6
Expected volatility	33.0%	34.1%	33.0%	34.4%
Dividend yield	0.0 %			