

**Bruce J Barclay**

President and Chief Operating Officer

**Dale R. Olseth**

Chairman and Chief Executive Officer

## To Our Shareholders:

Fiscal 2004 was a year of exciting change at SurModics. In the midst of this dynamic environment, we delivered record results. We also celebrated the company's 25th anniversary. Emanating from the vision of its founders, SurModics has grown and prospered and today stands as an established and proven leader in surface modification and site specific drug delivery. We are proud of SurModics' achievements and look fondly on its early years, which set the stage for today's accomplishments and instilled a spirit of innovation, dedication and optimism that still thrives.

SurModics built on its legacy of success in 2004, attaining a number of significant milestones. The company set a high-water mark for annual revenue, signed a record number of new licenses, saw an unprecedented number of new products launched by customers and posted record earnings before a non-cash charge. For the fifth consecutive year, SurModics made *Forbes* magazine's annual listing of "The 200 Best Small Companies," this year ranking 20th – the highest in our history.

### Enhancing the Business Model, Creating New Accountability

SurModics reorganized its corporate structure in 2004, a move designed to accelerate the company's technology leadership and focus more directly on customer needs. The effort organizes the company into five technology-centered business units, each led by a general manager who directs research and development, drives customer projects and coordinates initiatives with the company's operating and financial resources.

Individual business units help diversify our offerings, creating a wider range of products and technology – applicable to many different devices and treatments. Having agile business units also gives us the ability to provide customers with tailored services, a capability that most small companies don't have and most large companies can't duplicate in a timely manner.

To lead SurModics' new business units, we identified key personnel capable of motivating people, delighting customers and driving results. In November, we added the last of five business unit leaders, welcoming David Wood from Guidant Corporation; he now serves as vice president and general manager of the Drug Delivery unit. Under our improved corporate structure, Wood and other business unit leaders have dedicated resources and profit and loss responsibility; they have been given the freedom to make key decisions and pursue promising opportunities.

### TOTAL REVENUE

(in thousands)



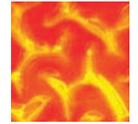
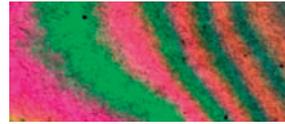
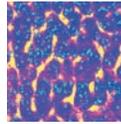
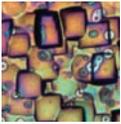
*"With improved product development and service capabilities, we can serve as a powerful product development partner – helping clients all the way from concept to optimization, through clinical trials."*

– Bruce J Barclay

### Bringing Urgency to Business Initiatives

SurModics' corporate reorganization has invigorated the company and strengthened our growth prospects by instilling a sense of urgency and excitement in individuals and teams throughout the organization. We've added a new business development group and expanded our sales presence in California, at headquarters and in Europe. One barometer of our progress: research and development revenue rose 37 percent in fiscal 2004 over the prior year.

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Transitioning away from contract manufacturing, we are freeing personnel and financial resources to focus on our core business strengths. As part of this effort, we announced plans in 2004 to sell our RiverBluff facility in suburban Minneapolis, consolidating activities at our headquarters in Eden Prairie, Minnesota.

### Delivering Results

In 2004, SurModics executed on many of the strategies laid out in last year's annual report. Bringing a strategic focus to the company's business and technology efforts, we worked diligently to generate results. The company posted three consecutive quarters of sequential growth in both R&D revenue and in revenue unrelated to Johnson & Johnson's Cordis stent, demonstrating our ability to develop new revenue sources and heralding a bright future. We developed and acquired new assets that enhance future growth:

- **Investing in new technologies**, by partnering with InnoRx, Inc. to develop a new ophthalmic application, in which a helical implant using SurModics' coating technology provides sustained delivery of therapeutic agents in the eye.
- **Developing and acquiring new polymers** that will help SurModics enter new markets and solidify its position as the leading provider of surface modification and drug delivery solutions.
- **Strengthening SurModics' portfolio of license agreements**, by signing a record 17 new agreements in fiscal 2004. At fiscal year-end, 77 SurModics-coated products were generating royalties, with 64 licensed products awaiting launch and an additional 73 potential commercial products in development. In addition, we now have 69 licensed customers.

### Building on Success, Seizing New Opportunities

SurModics' new business units are fostering relationships with high-quality clients – projects and partners that can help create revenue opportunities to sustain growth over the long term. While SurModics is proud of its proven business relationships – notably, the successful relationship with Johnson & Johnson – we continue to diversify our client base. To attract new quality clients, we will continue to

expand our technology portfolio, focusing particularly on drug delivery coatings. Our recent agreement with drug delivery and development company OctoPlus is an example of this effort, as we add vital new polymers to our already strong technology portfolio.

SurModics will also continue to build on its market expertise. With significant experience in the cardiovascular field, we're now enhancing our capabilities in other core markets, including orthopedics, ophthalmology and neurology. To broaden our knowledge in these large, attractive markets, we continue to look for prudent investments in companies and technologies where SurModics finds a strategic fit. As we identify these opportunities, we will put our strong balance sheet to work to add to our portfolio of intellectual property, find new strategic investments and consider acquisitions.

With our enlarged technology portfolio, improved organizational structure and renewed sense of urgency, we look confidently ahead. Today, companies from different sectors are seeking a partner with our capabilities. We are diversified, have an established distribution network and an unparalleled service capability. With dedicated employees and a deep commitment to ethics and sound business principles, SurModics will continue as a proven innovator and unmatched leader in its field.

Sincerely,

Dale R. Olseth  
Chairman and Chief Executive Officer

Bruce J. Barclay  
President and Chief Operating Officer

December 1, 2004



### Patrick E. Guire, Ph.D.

In late 2004, senior vice president and chief scientific officer Patrick E. Guire, Ph.D., announced his resignation from SurModics. One of the company's original founders, he has served as an officer and director of SurModics since 1980. As leader of SurModics' government-supported research, Dr. Guire's expertise and guidance have helped build a remarkable team of researchers and scientists, creating a pool of individuals who are ready today to build on Dr. Guire's solid record of success, helping lead SurModics to new opportunities and innovations. We gratefully acknowledge Dr. Guire's many positive contributions to the company's success over the past 25 years and wish him well in his future endeavors.