THORATEC CORP
Form 10-Q
August 06, 2008

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U.S. SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

(Mark one)

þ **Quarterly report pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934**
For the quarterly period ended June 28, 2008

Or

o **Transition report pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934**
For the transition period from __________ to __________

COMMISSION FILE NUMBER: 000-49798
THORATEC CORPORATION
(Exact name of registrant as specified in its charter)

California	**94-2340464**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
6035 Stoneridge Drive, Pleasanton, California	**94588**
(Address of principal executive offices)	**(Zip Code)**

(925) 847-8600
(Registrant s telephone number, including area code)

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

Indicate by check mark whether the registrant 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 þ	Accelerated filer o	Non-accelerated filer o	Smaller reporting company o
		(Do not check if a smaller reporting company)	

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

As of July 26, 2008, the registrant had 54,648,929 shares of common stock outstanding.

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PART I. FINANCIAL INFORMATION
ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

THORATEC CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(unaudited)
(in thousands)

	June 28, 2008	December 29, 2007
ASSETS		
Current assets:		
Cash and cash equivalents	$ 61,106	$ 20,689
Short-term available-for-sale investments	135,018	197,661
Receivables, net of allowances of $647 and $861, respectively	55,710	45,368
Inventories	56,000	54,935
Short-term deferred tax assets	6,077	6,077
Prepaid expenses and other assets	7,613	6,379
Total current assets	321,524	331,109
Property, plant and equipment, net	46,035	46,477
Goodwill	98,368	98,368
Purchased intangible assets, net	115,175	121,767
Long-term deferred tax assets	2,112	62
Income tax receivable	2,800	2,755
Long-term available-for-sale investments	31,863	
Other assets	12,793	13,181
Total Assets	$ 630,670	$ 613,719
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 9,536	$ 9,770
Accrued compensation	15,666	14,314
Accrued income taxes	2,566	
Other accrued liabilities	9,125	5,289
Total current liabilities	36,893	29,373
Senior subordinated convertible notes	143,750	143,750
Long-term deferred tax liability	33,485	35,953
Other	6,673	6,614
Total Liabilities	220,801	215,690
Shareholders equity:		
Common shares: no par, authorized 100,000; issued and outstanding 54,633 and 54,108 as of June 28, 2008 and December 29, 2007, respectively		

Additional paid-in capital	464,900	458,383
Accumulated deficit	(53,073)	(61,577)
Accumulated other comprehensive (loss) income:		
Unrealized (loss) gain on investments	(2,838)	317
Cumulative translation adjustments	880	906
Total accumulated other comprehensive (loss) income	(1,958)	1,223
Total Shareholders Equity	409,869	398,029
Total Liabilities and Shareholders Equity	$ 630,670	$ 613,719

See notes to condensed consolidated financial statements.

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THORATEC CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(unaudited)
(in thousands, except per share data)

	Three Months Ended		Six Months Ended	
	June 28, 2008	June 30, 2007	June 28, 2008	June 30, 2007
Product sales	$ 82,648	$ 57,333	$ 147,075	$ 114,643
Cost of product sales	31,825	23,648	60,415	46,445
Gross profit	50,823	33,685	86,660	68,198
Operating expenses:				
Selling, general and administrative	23,857	19,134	44,493	41,079
Research and development	12,839	10,767	25,358	21,660
Amortization of purchased intangible assets	3,296	3,143	6,592	6,296
Total operating expenses	39,992	33,044	76,443	69,035
Income (loss) from operations	10,831	641	10,217	(837)
Other income and (expense):				
Interest expense	(1,131)	(1,074)	(2,021)	(2,142)
Interest income and other	2,281	1,766	4,459	3,953
Income before income taxes	11,981	1,333	12,655	974
Income tax (expense) benefit	(3,330)	(80)	(3,655)	4
Net income	$ 8,651	$ 1,253	$ 9,000	$ 978
Net income per share:				
Basic	$ 0.16	$ 0.02	$ 0.17	$ 0.02
Diluted	$ 0.15	$ 0.02	$ 0.16	$ 0.02
Shares used to compute net income per share:				
Basic	54,556	53,370	54,389	53,055
Diluted	62,624	54,728	62,396	54,421

See notes to condensed consolidated financial statements.

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THORATEC CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)
(in thousands)

	Six Months Ended	
	June 28, 2008	**June 30, 2007**
Cash flows from operating activities:		
Net income	$ 9,000	$ 978
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	11,565	10,755
Investment premium amortization (net)	634	369
Write-down of investment		215
Non-cash interest and other expenses	165	542
Tax benefit related to stock options		1,961
Share-based compensation expense	5,493	6,231
Excess tax benefits from share-based compensation	(68)	(1,147)
Loss on disposal of assets	384	50
Change in net deferred tax liability	(2,412)	(925)
Changes in assets and liabilities:		
Receivables	(11,028)	538
Inventories	(2,950)	(10,094)
Prepaid expenses and other assets	(793)	(1,240)
Accounts payable and other liabilities	4,933	(5,172)
Accrued income taxes, net	3,045	(4,137)
Net cash provided by (used in) operating activities	17,968	(1,076)
Cash flows from investing activities:		
Purchases of available-for-sale investments	(98,548)	(202,283)
Sales of available-for-sale investments	78,670	144,375
Maturities of available-for-sale investments and restricted investments	44,765	1,712
Purchases of property, plant and equipment	(3,251)	(3,408)
Net cash provided by (used in) investing activities	21,636	(59,604)
Cash flows from financing activities:		
Excess income tax deficit on stock options exercises	(111)	
Proceeds from stock option exercises	871	8,612
Proceeds from stock issued under employee stock purchase plan	1,050	1,084
Excess tax benefits from share-based compensation	68	1,147
Repurchase and retirement of common shares	(1,092)	(775)
Net cash provided by financing activities	786	10,068
Effect of exchange rate changes on cash and cash equivalents	27	48
Net increase (decrease) in cash and cash equivalents	40,417	(50,564)

Cash and cash equivalents at beginning of period	20,689	67,453
Cash and cash equivalents at end of period	$ 61,106	$ 16,889
Supplemental disclosure of cash flow information:		
Cash paid for taxes	$ 3,507	$ 3,600
Cash paid for interest	$ 1,707	$ 1,707
Supplemental disclosure of non-cash investing and financing activities:		
Transfers of equipment from inventory to property, plant and equipment	$ 1,685	$ 1,977

See notes to condensed consolidated financial statements.

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THORATEC CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(unaudited)
(in thousands)

	Three Months Ended		Six Months Ended	
	June 28, 2008	June 30, 2007	June 28, 2008	June 30, 2007
Net income	$ 8,651	$ 1,253	$ 9,000	$ 978
Other net comprehensive income (loss):				
Unrealized loss on investments (net of taxes of $269 and $55 for the three months ended and $2,103 and $55 for the six months ended June 28, 2008 and June 30, 2007, respectively)	(403)	(83)	(3,155)	(82)
Foreign currency translation adjustments	(194)	225	(26)	240
Comprehensive income	$ 8,054	$ 1,395	$ 5,819	$ 1,136

See notes to condensed consolidated financial statements.

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THORATEC CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

1. Basis of Presentation

The interim condensed consolidated financial statements of Thoratec Corporation (we, our, Thoratec, or the Company) have been prepared and presented in accordance with accounting principles generally accepted in the United States of America and the rules and regulations of the Securities and Exchange Commission (SEC), without audit, and reflect all adjustments necessary (consisting only of normal recurring adjustments) to present fairly our financial position, results of operations and cash flows. Certain information and footnote disclosures normally included in our annual financial statements, prepared in accordance with accounting principles generally accepted in the United States of America, have been condensed or omitted. The accompanying financial statements should be read in conjunction with our fiscal 2007 consolidated financial statements, and the accompanying notes thereto, filed with the SEC in our Annual Report on Form 10-K (the 2007 Annual Report). The operating results for any interim period are not necessarily indicative of the results that may be expected for any future period.

The preparation of our condensed consolidated financial statements necessarily requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the condensed consolidated balance sheet dates and the reported amounts of revenues and expenses for the periods presented.

2. Fair Value Measurement

We adopted Statement of Financial Accounting Standards (SFAS) No. 157, *Fair Value Measurements*, as of December 30, 2007 to measure the fair value of certain of our financial assets and financial liabilities required to be measured on a recurring basis. Under SFAS No. 157, based on the observability of the inputs used in the valuation of such assets and liabilities, we are required to provide the fair value according to the fair value hierarchy. The fair value hierarchy ranks the quality and reliability of the information used to determine fair values. Financial assets and liabilities carried at fair value will be classified and disclosed in one of the following three categories:

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

Level 2: Directly or indirectly observable market based inputs used in models or other valuation methodologies.

Level 3: Unobservable inputs that are not corroborated by market data which require significant management judgment or estimation.

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The following table represents the fair value hierarchy for our financial assets and financial liabilities measured at fair value on a recurring basis:

	As of June 28, 2008			
	Total	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
	(in thousands)			
Assets				
Cash and cash equivalents	$ 61,106	$ 61,106	$	$
Short term investments municipal bonds	135,018		135,018	
Long term investments auction rate securities	31,863			31,863
Convertible debenture (fair value for purposes of disclosure in Note 9)	5,000			5,000
	$ 232,987	$ 61,106	$ 135,018	$ 36,863
Liabilities				
Mark to market on financial instruments (fair value for purposes of disclosure in Note 6)	$ 58	$	$ 58	$
Make-whole provision (fair value for purposes of disclosure in Note 11)	153			153
Senior subordinated convertible notes (fair value for purposes of disclosure in note 11)	156,201	156,201		
	$ 156,412	$ 156,201	$ 58	$ 153

Assets measured at fair value, on a recurring basis using significant unobservable Level 3 inputs consist of securities with an auction reset feature (auction rate securities) whose underlying assets are student loans issued by various tax-exempt state agencies, most of which are supported by federal government guarantees. In addition, we are using significant unobservable Level 3 inputs for our disclosure of the fair value of our convertible debenture.

The following table provides a reconciliation of the beginning and ending balances for the assets and liabilities measured at fair value using significant unobservable inputs (level 3):

	Fair Value Measurement Using Significant Unobservable Inputs (Level 3)		
	Auction Rate Securities	Other Long Term Assets	Other Long Term Liabilities
	(in thousands)		
Balance at December 29, 2007	$	$ 5,000	$ 96
Transfer to Level 3	46,050		
Settlements at par	(8,850)		
Realized holding loss, included in interest income and other			116

Unrealized holding loss, included in other comprehensive loss	(5,049)		
Balance at March 29, 2008	$ 32,151	$ 5,000	$ 212
Realized holding gain, included in interest income and other			(59)
Unrealized holding loss, included in other comprehensive loss	(288)		
Balance at June 29, 2008	$ 31,863	$ 5,000	$ 153

Given the complexity of our investments in auction rate securities, we estimated the fair value of these auction rate securities based on the following: (i) the underlying structure of each security; (ii) the present value of future principal and interest payments discounted at rates considered to reflect current market conditions; (iii) consideration of the probabilities of default, auction failure, or repurchase at par for each period; and (iv) estimates of the recovery rates in the event of default for each security. These estimated fair values could change significantly based on future market conditions.

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3. Investments in Available-for-Sale Securities

Our investment portfolio is comprised of short-term and long-term investments. Investments classified as short-term available-for-sale consist primarily of corporate and municipal bonds, and United States government obligations with callable bond features. Investments classified as long-term available-for-sale consist primarily of auction rate securities, whose underlying assets are student loans.

Our investments in available-for-sale securities are recorded at estimated fair value on our financial statements, and the temporary differences between cost and estimated fair value are presented as a separate component of accumulated other comprehensive income.

	As of	
	June 28, 2008	December 29, 2007
	(in thousands)	
Short-term investments		
Unrealized gains on corporate and municipal bonds (before taxes)	$ 782	$ 517
Unrealized loss on corporate and municipal bonds (before taxes)	(189)	
Long-term investments		
Unrealized loss on auction rate securities (before taxes)	(5,337)	
Net unrealized gain (loss) (before taxes)	$ (4,744)	$ 517

The specific identification method is used to determine realized gains and losses on investments.

As of June 28, 2008, we owned approximately $37.2 million of auction rate securities that are marketed by financial institutions and structured to periodically reset through auctions ranging from 7 to 35 days. The underlying collateral of the auction rate securities consists of student loans. Beginning in February of 2008, these auctions began to fail. As a result, we will not be able to access these funds until future auctions for these securities are successful, until a secondary market is established, or until these securities are called for redemption. As such, our auction rate securities are classified as long-term and are valued at $31.9 million.

We intend and have the ability to hold these auction rate securities until the market recovers or until maturity. We do not anticipate having to sell these securities in order to operate our business. We believe that, based on our current unrestricted cash, cash equivalents and short- term available for-sale securities with an aggregate value of $196.1 million at June 28, 2008, the current lack of liquidity in the credit and capital markets will not have an impact on our liquidity, our cash flow or our ability to fund our operations. If the issuers of the auction rate securities are unable to successfully complete future auctions and their credit ratings deteriorate, we may in the future be required to record an impairment charge on these investments. It could conceivably take until the final maturity of the underlying notes (up to 30 years) to realize our investments recorded value.

4. Recently Issued Accounting Pronouncements

In June 2008, the Financial Accounting Standards Board (FASB) Issued Financial Statement Position (FSP) Emerging Issues Task Force (EITF) 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities*. FSP EITF 03-6-1 clarified that all outstanding unvested share-based payment awards that contain rights to non-forfeitable dividends participate in undistributed earnings with common shareholders. Awards of this nature are considered participating securities and the two-class method of computing basic and diluted earnings per share must be applied. FSP EITF 03-6-1 is effective for financial statements issued for fiscal years and interim periods beginning after December 15, 2008. We are currently evaluating the accounting impact and disclosure requirements that this guidance will have on our consolidated results of operations or financial condition when we adopt FSP EITF 03-6-1 at the beginning of our fiscal year 2009.

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In May 2008, the FASB issued FSP Accounting Principles Board (APB) 14-1, *Accounting For Convertible Debt Instruments That May Be Settled in Cash Upon Conversion (Including Partial Cash Settlement)* that alters the accounting treatment for convertible debt instruments that allow for either mandatory or optional cash settlements. FSP APB 14-1, will impact the accounting associated with our senior subordinated convertible notes recorded at a book value of $143.5 million. FSP APB 14-1 will require us to recognize additional (non-cash) interest expense based on the market rate for similar debt instruments without the conversion feature. Furthermore, it will require recognizing interest expense in prior periods pursuant to the required retrospective accounting treatment upon adoption. The FSP will be effective for fiscal years beginning after December 15, 2008. We are currently evaluating the accounting impact and disclosure requirements that this guidance will have on our consolidated results of operations or financial conditions when we adopt FSP APB 14-1 at the beginning of our fiscal year 2009.

In May 2008, the FASB issued SFAS No. 162, *Hierarchy of Generally Accepted Accounting Principles*. SFAS No. 162 identifies the source of accounting principles and the framework for selecting the principles used in the preparation of financial statements. SFAS No. 162 is effective 60 days following the SEC s approval of the Public Company Accounting Oversight Board amendments to AU Section 411, *The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles.* The implementation of this standard will not have a material impact to our consolidated financial position and results of operations.

In April 2008, the FASB issued FSP No. 142-3, *Determination of the Useful Life of Intangible Assets*. FSP No. 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, *Goodwill and Other Intangible Assets*. FSP No. 142-3 is effective for financial statements issued for fiscal years and interim periods beginning after December 15, 2008. We are currently evaluating the accounting impact and disclosure requirements that this guidance will have on our consolidated results of operations or financial conditions when we adopt FSP No. 142-3 at the beginning of our fiscal year 2009.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities*, which is intended to help investors better understand how derivative instruments and hedging activities affect an entity s financial position, financial performance and cash flows through enhanced disclosure requirements. The main requirement is to disclose the objectives and strategies for using derivative instruments by their underlying risk as well as a tabular format of the fair values of the derivative instruments and their gains and losses. SFAS No. 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. We are currently evaluating the impact this pronouncement will have on our disclosure requirement for our derivatives at the beginning of our fiscal year 2009.

In February 2008, the FASB issued SFAS No. 157-2, *Effective Date of FASB Statement No. 157*. With the issuance of SFAS No. 157-2, the FASB agreed to: (a) defer the effective date of SFAS No. 157 for one year for certain nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually), and (b) remove certain leasing transactions from the scope of SFAS No. 157. The deferral is intended to provide the FASB time to consider the effect of certain implementation issues that have arisen from the application of SFAS No. 157 for nonfinancial assets and nonfinancial liabilities. We are currently evaluating the additional accounting and disclosure requirements that we will be required to provide following the expiration of the deferral period.

In December 2007, the FASB issued SFAS No. 141R, *Business Combinations*, which requires the acquiring entity in a business combination to record all assets acquired and liabilities assumed at their respective acquisition-date fair values, changes the recognition of assets acquired and liabilities assumed arising from contingencies, changes the recognition and measurement of contingent consideration, and requires the expensing of acquisition-related costs as incurred. SFAS No. 141R also requires additional disclosure of information surrounding a business combination, such that users of the entity s financial statements can fully understand the nature and financial impact of the business combination. The provisions of SFAS No. 141R will only impact us if we are a party to a business combination after our fiscal year 2008.

5. Cash and cash equivalents

Cash and cash equivalents are defined as short-term, highly liquid investments with original maturities of 90 days or less at the purchase date.

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6. Financial Instruments

We conduct business in foreign countries. Our international operations consist primarily of sales and service personnel for our ventricular assist products who report to our U.S. sales and marketing group and are internally reported as part of that group. All assets and liabilities of our non-U.S. operations are translated into U.S. dollars at the period-end exchange rates and the resulting translation adjustments are included in other comprehensive income. The period-end translation of the non-functional currency assets and liabilities (primarily assets and liabilities on our UK subsidiary s condensed consolidated balance sheet that are not denominated in UK pounds) at the period-end exchange rates result in foreign currency gains and losses, which are included in our condensed consolidated statements of operations in Interest income and other.

We use forward foreign currency contracts to hedge the gains and losses generated by the re-measurement of non-functional currency assets and liabilities (primarily assets and liabilities on our UK subsidiary s condensed consolidated balance sheet that are not denominated in UK pounds). Our contracts typically have maturities of three months or less.

Our financial instrument contracts qualify as derivatives under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and we valued these contracts at the estimated fair value at June 28, 2008. The change in fair value of the forward currency contracts is included in Interest income and other, and offsets the foreign currency exchange gains and losses in the condensed consolidated statement of operations. The impact of these foreign currency contracts are:

	Three Months Ended		Six Months Ended	
	June 28, 2008	June 30, 2007	June 28, 2008	June 30, 2007
	(in thousands)			
Foreign currency exchange gain (loss) on foreign currency contracts	$ (107)	$ 41	$ (1,147)	$ (42)
Foreign currency exchange gain (loss) on foreign translation adjustments	122	(54)	1,230	2

As of June 28, 2008, we had forward contracts to sell euros with a notional value of 7.1 million and to purchase UK pounds with a notional value of £5.0 million, and as of June 30, 2007 we had forward contracts to sell euros with a notional value of 5.4 million and to purchase UK pounds with a notional value of £3.0 million. As of June 28, 2008, our forward contracts had an average exchange rate of one U.S. dollar to 0.6455 euros and one U.S. dollar to 0.5036 UK pounds. The forward contracts are valued based on exchange rates derived from an independent source of market participant assumptions and compiled from the best information available. As of June 28, 2008, the estimated fair of value