

THORATEC CORP
Form 10-Q
November 08, 2007

Table of Contents

**U.S. 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 September 29, 2007**

or

**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

**(State or other jurisdiction of incorporation or
organization)**

94-2340464

(I.R.S. Employer Identification No.)

**6035 Stoneridge Drive, Pleasanton, California
(Address of principal executive offices)**

**94588
(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 No

Indicate by check mark whether the registrant is, a large accelerated filer, an accelerated filer or a non-accelerated filer (as defined in Rule 12b-2 of the Exchange Act):

Large-accelerated filer Accelerated filer Non-accelerated filer

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

As of October 27, 2007, the registrant had 54,014,105 shares of common stock outstanding.

**THORATEC CORPORATION
TABLE OF CONTENTS**

<u>Part I. Financial Information</u>	3
<u>Item 1. Condensed Consolidated Financial Statements (unaudited)</u>	3
<u>Condensed Consolidated Balance Sheets as of September 29, 2007 and December 30, 2006</u>	3
<u>Condensed Consolidated Statements of Operations for the Three and Nine Months Ended September 29, 2007 and September 30, 2006</u>	4
<u>Condensed Consolidated Statements of Cash Flows for the Nine Months Ended September 29, 2007 and September 30, 2006</u>	5
<u>Condensed Consolidated Statements of Comprehensive Income (Loss) for the Three and Nine Months Ended September 29, 2007 and September 30, 2006</u>	6
<u>Notes to Condensed Consolidated Financial Statements</u>	7
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	20
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	29
<u>Item 4. Controls and Procedures</u>	30
<u>Part II. Other Information</u>	31
<u>Item 1A. Risk Factors</u>	31
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	32
<u>Item 6. Exhibits</u>	33
<u>Signatures</u>	34
Exhibits	
<u>EXHIBIT 31.1</u>	
<u>EXHIBIT 31.2</u>	
<u>EXHIBIT 32.1</u>	
<u>EXHIBIT 32.2</u>	

Thoratec, the Thoratec logo, Thoralon, TLC-II, HeartMate, and HeartMate II are registered trademarks of Thoratec Corporation, and IVAD is a trademark of Thoratec Corporation.

CentriMag is a registered trademark of Levitronix LLC.

ITC, A-VOX Systems, AVOXimeter, HEMOCHRON, ProTime, Surgicutt, Tenderlett,

Tenderfoot, and
IRMA are registered
trademarks of
International
Technidyne
Corporation (ITC),
our wholly-owned
subsidiary.

Table of Contents**PART I. FINANCIAL INFORMATION****ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)****THORATEC CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS****(unaudited)
(in thousands)**

	September 29, 2007	December 30, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 14,499	\$ 67,453
Short-term available-for-sale investments	196,419	127,025
Restricted short-term investments		1,681
Receivables, net of allowances of \$1,010 and \$491, respectively	39,963	43,718
Inventories	58,857	49,666
Deferred tax assets	5,965	6,623
Prepaid expenses and other assets	13,549	2,986
 Total current assets	 329,252	 299,152
 Property, plant and equipment, net	 46,480	 45,808
Goodwill	98,494	98,494
Purchased intangible assets, net	124,910	134,349
Deferred tax assets		1,006
Other assets	15,417	12,326
 Total Assets	 \$ 614,553	 \$ 591,135
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	\$ 11,106	\$ 13,591
Accrued compensation	13,166	12,043
Accrued income taxes	1,063	3,691
Other accrued liabilities	5,608	4,136
 Total current liabilities	 30,943	 33,461
 Senior subordinated convertible notes	 143,750	 143,750
Long-term deferred tax liability	43,395	46,421
Other	6,966	2,430
 Total Liabilities	 225,054	 226,062
Shareholders equity:		
Common shares: authorized 100,000; issued and outstanding 53,988 and 52,329, respectively	453,326	427,941
Accumulated deficit	(65,165)	(63,675)

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Accumulated other comprehensive income (loss):		
Unrealized gain (loss) on investments	113	(16)
Cumulative translation adjustments	1,225	823
Total accumulated other comprehensive income	1,338	807
Total Shareholders' Equity	389,499	365,073
Total Liabilities and Shareholders' Equity	\$ 614,553	\$ 591,135

See notes to condensed consolidated financial statements.

3

Table of Contents

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

	Three Months Ended		Nine Months Ended	
	September	September	September	September
	29,	30,	29,	30,
	2007	2006	2007	2006
Product sales	\$ 56,055	\$ 51,747	\$ 170,698	\$ 155,285
Cost of product sales	23,707	22,078	70,152	64,840
Gross profit	32,348	29,669	100,546	90,445
Operating expenses:				
Selling, general and administrative	20,873	17,977	61,952	55,228
Research and development	10,712	8,766	32,372	28,108
Amortization of purchased intangible assets	3,143	2,974	9,439	8,921
Litigation				447
Total operating expenses	34,728	29,717	103,763	92,704
Loss from operations	(2,380)	(48)	(3,217)	(2,259)
Other income and (expense):				
Interest expense	(1,016)	(1,051)	(3,158)	(3,159)
Interest income and other	2,261	2,186	6,214	5,678
Income (loss) before income taxes	(1,135)	1,087	(161)	260
Income tax benefit (expense)	(273)	403	(269)	637
Net income (loss)	\$ (1,408)	\$ 1,490	\$ (430)	\$ 897
Net income (loss) per share, basic and diluted	\$ (0.03)	\$ 0.03	\$ (0.01)	\$ 0.02
Shares used to compute net income (loss) per share:				
Basic	53,808	51,955	53,303	52,154
Diluted	53,808	52,755	53,303	53,510

See notes to condensed consolidated financial statements.

Table of Contents

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

	Nine Months Ended	
	September	September
	29,	30,
	2007	2006
Cash flows from operating activities:		
Net income (loss)	\$ (430)	\$ 897
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	16,183	15,016
Investment discount amortization	664	88
Write-down of investment	215	
Non-cash interest and other expenses	1,523	1,483
Tax benefit related to stock options	3,131	2,418
Share-based compensation expense	8,132	7,644
Excess tax benefits from share-based compensation	(1,861)	(2,283)
Loss on disposal of assets	74	9
Change in net deferred tax liability	(1,890)	(5,234)
Changes in assets and liabilities:		
Receivables	2,201	(2,466)
Inventories	(11,846)	(2,734)
Prepaid expenses and other assets	(1,774)	(464)
Accounts payable and other liabilities	(688)	1,038
Accrued income taxes	(8,646)	(637)
Other	(405)	(258)
Net cash provided by operating activities	4,583	14,517
Cash flows from investing activities:		
Purchases of investments	(247,363)	(255,300)
Sales of investments	177,475	245,359
Maturities of investments and restricted investments	1,712	53,795
Investment in convertible debenture		(5,027)
Purchases of property, plant and equipment, net	(4,867)	(22,547)
Other		(214)
Net cash provided by (used in) investing activities	(73,043)	16,066
Cash flows from financing activities:		
Proceeds from stock option exercises	13,311	10,447
Proceeds from stock issued under employee stock purchase plan	1,084	860
Excess tax benefits from share-based compensation	1,861	2,283
Repurchase and retirement of common shares	(878)	(16,201)
Net cash provided by (used in) financing activities	15,378	(2,611)

Effect of exchange rate changes on cash and cash equivalents	128	250
Net increase (decrease) in cash and cash equivalents	(52,954)	28,222
Cash and cash equivalents at beginning of period	67,453	35,109
Cash and cash equivalents at end of period	\$ 14,499	\$ 63,331
Supplemental disclosure of cash flow information:		
Cash paid for taxes	\$ 8,642	\$ 1,496
Cash paid for interest	\$ 1,707	\$ 1,707
Supplemental disclosure of non-cash investing and financing activities:		
Transfers of equipment from inventory	\$ 2,820	\$ 1,260

See notes to condensed consolidated financial statements.

Table of Contents

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

	Three Months Ended		Nine Months Ended	
	September	September	September	September
	29,	30,	29,	30,
	2007	2006	2007	2006
Net income (loss)	\$ (1,408)	\$ 1,490	\$ (430)	\$ 897
Other net comprehensive income (loss):				
Unrealized gain on investments (net of taxes of \$141 and \$59 for the three months ended and \$86 and \$146 for the nine months ended September 29, 2007 and September 30, 2006, respectively)	211	89	129	220
Foreign currency translation adjustments (net of taxes of none and \$43 for the three months ended and none and \$167 for the nine months ended September 29, 2007 and September 30, 2006, respectively)	162	(64)	402	251
Comprehensive income (loss)	\$ (1,035)	\$ 1,515	\$ 101	\$ 1,368

See notes to condensed consolidated financial statements.

Table of Contents

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 2006 consolidated financial statements, and the accompanying notes thereto, filed with the SEC in our Annual Report on Form 10-K (the 2006 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. Income Taxes

We adopted the provisions of Financial Accounting Standards Board (FASB) Interpretation No. (FIN) 48 Accounting for Uncertainty in Income Taxes, an interpretation of SFAS No. 109, on December 31, 2006. Under FIN 48, tax positions are evaluated for recognition using a more-likely-than-not recognition threshold, and those tax positions eligible for recognition are measured as the largest amount of tax benefit that is greater than fifty percent likely of being realized upon the effective settlement with a taxing authority that has full knowledge of all relevant information. As a result, of adopting FIN 48, we reported a cumulative-effect adjustment of \$0.5 million, which increased our accumulated deficit as of December 31, 2006.

On December 31, 2006, we had \$9.3 million of unrecognized tax benefits, of which \$3.9 million would impact our effective tax rate if recognized. An unrecognized tax benefit under FIN 48 is the difference between a tax position taken (or expected to be taken) in a tax return and the benefit measured and recognized in a company s financial statements in accordance with the guidelines set forth in FIN 48. The Company s liability for unrecognized tax benefits decreased by approximately the \$0.5 million in the first nine months of 2007 to reflect the impact of a payment to the State of New Jersey in settlement of a tax audit with respect to years 1997 through 2000. On September 29, 2007, we had \$7.3 million of unrecognized tax benefits, of which \$2.5 million would impact our effective tax rate, if recognized. In addition, during the third quarter of 2007 we filed tax returns in certain jurisdictions further decreasing our liability for unrecognized tax benefits by approximately \$1.5 million. It is reasonably possible that we will file or amend our tax returns in other jurisdictions within twelve months after the date of adoption of FIN 48 which will further decrease our liability for unrecognized tax benefits by approximately \$0.8 million.

Our policy for classifying interest and penalties associated with unrecognized income tax benefits is to include such items in income tax expense. On December 31, 2006, gross interest accrued associated with unrecognized income tax benefits was approximately \$0.8 million and the corresponding benefit for the interest deduction was approximately \$0.3 million resulting in a net balance of approximately \$0.5 million. On September 29, 2007, gross interest accrued associated with unrecognized income tax benefits was approximately \$0.6 million and the benefit of the interest deduction was approximately \$0.3 million resulting in a net balance of approximately \$0.3 million because interest payments were made during the nine month period ending September 29, 2007. The amount of penalties accrued on unrecognized income tax benefits included in our condensed consolidated balance sheet was \$0.1 million at September 29, 2007.

We are currently under income tax audit in the State of California for 2003 and 2004, Massachusetts for 2003 and 2004, and Pennsylvania for an unspecified number of years. In February 2007, we concluded our audit with the State of New Jersey for the years 1997 through 2000. A payment of approximately \$1.0 million, including penalties and

interest, made to the State of New Jersey in respect of those years, resulted in a decrease to our reserves for unrecognized tax benefits. In addition, to the extent we are deemed to have sufficient connection to a particular jurisdiction to enable that jurisdiction to tax us, but we have not filed an income tax return in that jurisdiction for the year(s) at issue, the jurisdiction would be able to assert a tax liability for such years without limitation on the number of years it may examine.

Table of Contents

The provision for income taxes in the accompanying condensed consolidated statements of operations differs from the provision calculated by applying the U.S. federal statutory income tax rate of 35% to income (loss) before taxes due to the following:

	Three Months Ended				Nine Months Ended			
	September 29, 2007		September 30, 2006		September 29, 2007		September 30, 2006	
	(in thousands, except percentages)							
U.S. federal statutory income tax benefit (expense)	\$ 398	35.0%	\$ (381)	35.0%	\$ 56	35.0%	\$ (91)	35.0%
State income tax benefit, net of federal tax expense	15	1.3	(66)	6.0	2	1.8	(16)	6.0
Non-deductible expenses	441	38.8	(349)	32.1	305	189.9	(84)	32.1
Foreign earnings permanently reinvested	(7)	(0.6)	5	(0.5)	(1)	(0.9)	1	(0.5)
Tax advantaged investment income	(594)	(52.3)	338	(31.0)	(100)	(62.6)	81	(31.0)
Return to provision true-up and other	(526)	(46.2)	856	(78.6)	(531)	(330.3)	746	(286.2)
Income tax benefit (expense)	\$ (273)	(24.0)%	\$ 403	(37.0)%	\$ (269)	(167.1)%	\$ 637	(244.6)%

At September 29, 2007 and December 30, 2006, we reported a net deferred tax liability of approximately \$37.4 million and \$38.8 million, respectively, comprised principally of temporary differences between the financial statement and income tax basis of intangible assets.

3. Recently Issued Accounting Pronouncements

In June 2007, the Emerging Issues Task Force (EITF) reached a final consensus on Issue No. 07-3 (EITF 07-3), *Accounting for Nonrefundable Advance Payments for Goods or Services to Be Used in Future Research and Development Activities*, which requires that non-refundable advance payments for future research and development activities be capitalized until the goods have been delivered or related services have been performed. Adoption is on a prospective basis and could impact the timing of expense recognition for agreements entered into after December 31, 2007. We have not determined whether the adoption of EITF 07-3 will have a significant impact on our consolidated financial position or operating results.

In May 2007, the FASB issued FASB Staff Position No. FIN 48-1, *Definition of Settlement in FASB Interpretation No. 48*, (FSP FIN 48-1) which amends FIN 48 to provide guidance on how we should determine whether a tax position is effectively settled for the purpose of recognizing previously unrecognized tax benefits. FSP FIN 48-1, a tax position is considered to be effectively settled if the taxing authority completed its examination, we do not plan to appeal, and it is remote that the taxing authority would re-examine the tax position in the future. FSP FIN 48-1 did not have a material impact on our application of FIN 48, which we adopted as of December 31, 2006. See further discussion regarding our implementation of FIN 48 in Note 2.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*. SFAS No. 159 permits us to choose, at specified election dates, eligible instruments to measure at fair value (Fair Value Option). Unrealized gains and losses on instruments for which the Fair Value Option has been elected are reported in earnings. The Fair Value Option is applied instrument-by-instrument (with certain exceptions), is irrevocable (unless a new election date occurs) and is applied only to an entire instrument. If we elect to adopt the

Fair Value Option, we would be required to recognize changes in fair value in earnings and to expense upfront cost and fees associated with the instrument for which the Fair Value Option is elected from and after January 1, 2008. We have not yet determined whether we will elect to apply the Fair Value Option or the impact that such election may have on our consolidated financial position, operating results or cash flows.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*, which defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. SFAS No. 157 does not require any new fair value measurements, but rather eliminates inconsistencies in guidance found in various prior accounting pronouncements. We are currently evaluating the accounting and disclosure requirements that this guidance will have on our results of operations or financial condition when we adopt SFAS No. 157 at the beginning of our 2008 fiscal year.

Table of Contents

4. Cash and cash equivalents

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

5. Investments

Investments classified as short-term available-for-sale are reported at fair value based upon quoted market prices and consist primarily of auction rate securities, corporate and municipal bonds, and United States government obligations. All investments mature within two years or less from the date of purchase. Investments with maturities beyond one year may be classified as short term, if they are available and intended for use in current operations, based on their highly liquid nature or due to the frequency with which the interest rate is reset, such as with auction rate securities.

For all investments, temporary differences between cost and fair value are presented as a separate component of accumulated other comprehensive income (loss). Unrealized gain on investments was \$0.1 million and none as of September 29, 2007 and December 30, 2006, respectively. We have determined that our investments had no impairments that were other than temporary. The specific identification method is used to determine realized gains and losses on investments.

Table of Contents**6. Financial Instruments**

We conduct business in foreign countries. Our international operations consist primarily of sales and service personnel for our mechanical circulatory support products who report to our U.S. sales and marketing group and are internally reported as part of our Cardiovascular division. All assets and liabilities of our non-U.S. operations stated in UK pounds are translated into U.S. dollars at the period-end exchange rates and the resulting translation adjustments are included in comprehensive income (loss). The period-end translation of the non-functional currency assets and liabilities (primarily assets and liabilities on our UK subsidiary's 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 consolidated balance sheet that are not denominated in UK pounds). These contracts typically have maturities of three months or less.

Our financial instrument contracts qualify as derivatives under SFAS No. 133 Accounting for Derivative Instrument and Hedging Activities and we valued these contracts at the estimated fair value at September 29, 2007. 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 impacts of these foreign currency contracts are:

	Three Months Ended		Nine Months Ended	
	September	September 30,	September	September 30,
	29, 2007	2006	29, 2007	2006
	(in thousands)			
Foreign currency exchange gains				
(losses) on foreign currency contracts	\$(346)	\$ 59	\$(388)	\$ (214)
Foreign currency exchange gains				
(losses) on foreign translation adjustments	431	(43)	433	278

As of September 29, 2007, we had forward contracts to sell euros with a notional value of 6.8 million and purchase UK pounds with a notional value of £4.0 million, and as of September 30, 2006 we had forward contracts to sell euros with a notional value of 3.3 million and purchase UK pounds with a notional value of £1.5 million. As of September 29, 2007, our forward contracts had an average exchange rate of one U.S. dollar to 0.7094 euros and one U.S. dollar to 0.4962 UK pounds. It is highly uncertain how currency exchange rates will fluctuate in the future.

7. Inventories

Inventories consisted of the following:

	As of	
	September	December
	29,	30,
	2007	2006
	(in thousands)	
Finished goods	\$ 24,164	\$ 22,527
Work in process	10,294	7,008
Raw materials	24,399	20,131
Total	\$ 58,857	\$ 49,666

Inventories include an increase of HeartMate II of approximately \$4 million in preparation for the U.S. launch upon possible Food and Drug Administration ("FDA") approval for commercial distribution.

Table of Contents**8. Property, Plant and Equipment, net**

Property, plant and equipment, net, consisted of the following:

	September 29, 2007	As of December 30, 2006
	(in thousands)	
Land	\$ 4,096	\$ 4,096
Building	12,038	12,038
Building lease	2,285	2,285
Equipment	52,205	47,904
Rental equipment	10,926	8,612
Building and leasehold improvements	17,104	16,258
Total	98,654	91,193
Accumulated depreciation and amortization	(52,174)	(45,385)
Property, plant and equipment, net	\$ 46,480	\$ 45,808

Depreciation expense was \$2.3 million and \$2.1 million for the three months ended September 29, 2007 and September 30, 2006, respectively, and \$6.8 million and \$6.1 million for the nine months ended September 29, 2007 and September 30, 2006, respectively.

9. Goodwill and Purchased Intangible Assets

The carrying amount of goodwill was \$98.5 million as of September 29, 2007 and December 30, 2006, \$94.1 million of which amount is attributable to our Cardiovascular division and \$4.4 million of which amount is attributable to International Technidyne Corporation's (ITC) acquisition of the outstanding common shares of privately held A-VOX Systems, Inc. (Avox).

In February 2001, we merged with Thermo Cardiosystems, Inc. (TCA). Prior to the merger with TCA (the Merger), TCA was a subsidiary of Thermo Electron Corporation (TEC). The components of identifiable intangible assets related to the Merger include: patents and trademarks, core technology (Thoralon, our patent protected bio-material), and developed technology (patent technology, other than core technology, acquired in the Merger). The components of intangible assets related to the Avox acquisition include: patents and trademarks, developed technology, and customer and distributor relationships and other. The combined components included in purchased intangibles on the condensed consolidated balance sheets are as follows:

	As of September 29, 2007		
	Gross Carrying Amount	Accumulated Amortization (in thousands)	Net Carrying Amount
Patents and trademarks	\$ 38,515	\$ (24,156)	\$ 14,359
Core technology	37,485	(11,414)	26,071
Developed technology	125,742	(41,950)	83,792
Customer and distributor relationships and other	897	(209)	688
Total purchased intangible assets	\$ 202,639	\$ (77,729)	\$ 124,910

