

THORATEC CORP  
Form 10-Q  
August 01, 2013  
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**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 June 29, 2013

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**

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(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 x No o

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

Indicate by check mark 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

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if 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 x

As of July 26, 2013, the registrant had 57,528,311 shares of common stock outstanding.

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**THORATEC CORPORATION**

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Table of Contents**PART I. FINANCIAL INFORMATION****ITEM 1. UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**THORATEC CORPORATION**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**

(unaudited)

(in thousands)

|   | June 29, 2013 | December 29, 2012 |
|---|---------------|-------------------|
| <b>ASSETS</b>   |               |                   |
| Current assets:   |               |                   |
| Cash and cash equivalents   | \$ 110,194    | \$ 101,322        |
| Short-term available-for-sale investments   | 150,506       | 148,426           |
| Receivables, net of allowances of \$2,289 and \$2,127, respectively   | 67,950        | 70,471            |
| Inventories   | 64,972        | 47,100            |
| Deferred tax assets   | 10,626        | 10,626            |
| Income tax receivable   | 13,798        | 11,950            |
| Prepaid expenses and other assets   | 7,784         | 7,162             |
| Total current assets  | 425,830       | 397,057           |
| Property, plant and equipment, net  | 47,450        | 45,892            |
| Goodwill  | 192,285       | 194,182           |
| Purchased intangible assets, net  | 28,284        | 33,571            |
| Long-term available-for-sale investments  | 10,155        | 10,607            |
| Other long-term assets  | 28,875        | 17,055            |
| Total Assets  | \$ 732,879    | \$ 698,364        |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>   |               |                   |
| Current liabilities:  |               |                   |
| Accounts payable  | \$ 18,576     | \$ 19,959         |
| Accrued compensation  | 17,490        | 25,409            |
| Contingent liabilities, current portion   | 6,138         | 4,220             |
| Other accrued liabilities   | 15,004        | 19,098            |
| Total current liabilities   | 57,208        | 68,686            |
| Long-term deferred tax liability  | 1,241         | 2,780             |
| Other long-term liabilities   | 12,889        | 12,323            |
| Contingent liabilities, non-current portion   | 11,694        | 17,832            |
| Total Liabilities   | 83,032        | 101,621           |
| Shareholders' equity:   |               |                   |
| Common shares: no par, authorized 100,000; issued and outstanding 57,514 and 57,584 as of June 29, 2013 and December 29, 2012, respectively |               |                   |
| Additional paid-in capital  | 607,370       | 577,448           |
| Retained earnings   | 59,229        | 34,364            |

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|  |    |          |    |          |
|--|----|----------|----|----------|
| Accumulated other comprehensive loss:      |    |          |    |          |
| Unrealized loss on investments             |    | (1,148)  |    | (1,141)  |
| Cumulative translation adjustments         |    | (15,604) |    | (13,928) |
| Total accumulated other comprehensive loss |    | (16,752) |    | (15,069) |
| Total Shareholders' Equity                 |    | 649,847  |    | 596,743  |
| Total Liabilities and Shareholders' Equity | \$ | 732,879  | \$ | 698,364  |

See notes to the unaudited 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 29,<br>2013   | June 30,<br>2012 | June 29,<br>2013 | June 30,<br>2012 |
| Product sales                            | \$ 130,479         | \$ 118,659       | \$ 248,204       | \$ 245,428       |
| Cost of product sales                    | 41,000             | 36,022           | 76,073           | 74,909           |
| Gross profit                             | 89,479             | 82,637           | 172,131          | 170,519          |
| Operating expenses:                      |                    |                  |                  |                  |
| Selling, general and administrative      | 34,924             | 32,013           | 69,669           | 63,214           |
| Research and development                 | 21,506             | 19,808           | 46,019           | 39,504           |
| Total operating expenses                 | 56,430             | 51,821           | 115,688          | 102,718          |
| Income from operations                   | 33,049             | 30,816           | 56,443           | 67,801           |
| Other income and (expense):              |                    |                  |                  |                  |
| Interest expense and other               |                    |                  | (4)              | (3)              |
| Interest income and other                | 213                | 88               | 1,330            | 822              |
| Income before income taxes               | 33,262             | 30,904           | 57,769           | 68,620           |
| Income tax expense                       | (10,073)           | (10,096)         | (16,410)         | (22,326)         |
| Net income                               | \$ 23,189          | \$ 20,808        | \$ 41,359        | \$ 46,294        |
| Net Income per share:                    |                    |                  |                  |                  |
| Basic                                    | \$ 0.40            | \$ 0.35          | \$ 0.72          | \$ 0.79          |
| Diluted                                  | \$ 0.40            | \$ 0.35          | \$ 0.71          | \$ 0.78          |
| Shares used to compute income per share: |                    |                  |                  |                  |
| Basic                                    | 57,429             | 58,737           | 57,457           | 58,587           |
| Diluted                                  | 58,120             | 59,518           | 58,398           | 59,513           |

See notes to the unaudited condensed consolidated financial statements.

Table of Contents**THORATEC CORPORATION****CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME****(unaudited)****(in thousands)**

|  | <b>Three Months Ended</b> |                      | <b>Six Months Ended</b> |                      |
|--|---------------------------|----------------------|-------------------------|----------------------|
|  | <b>June 29, 2013</b>      | <b>June 30, 2012</b> | <b>June 29, 2013</b>    | <b>June 30, 2012</b> |
| Net income   | \$ 23,189                 | \$ 20,808            | \$ 41,359               | \$ 46,294            |
| Unrealized gains (losses) on investments (net of taxes (benefits) of \$(142) and \$405 for the three months ended June 29, 2013 and June 30, 2012, respectively, and \$5 and \$420 for the six months ended June 29, 2013 and June 30, 2012, respectively) | (225)                     | 598                  | (7)                     | 625                  |
| Foreign currency translation adjustments   | 612                       | (1,466)              | (1,676)                 | 165                  |
| Total other comprehensive income (loss)  | 387                       | (868)                | (1,683)                 | 790                  |
| Comprehensive income   | \$ 23,576                 | \$ 19,940            | \$ 39,676               | \$ 47,084            |

See notes to the unaudited condensed consolidated financial statements.

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## THORATEC CORPORATION

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)

(in thousands)

|   | Six Months Ended |                  |
|---|------------------|------------------|
|   | June 29,<br>2013 | June 30,<br>2012 |
| <b>Cash flows from operating activities:</b>                                      |                  |                  |
| Net Income  | \$ 41,359        | \$ 46,294        |
| Adjustments to reconcile net income to net cash provided by operating activities: |                  |                  |
| Depreciation and amortization   | 9,175            | 9,738            |
| Investment premium amortization, net  | 1,750            | 1,049            |
| Allowance for bad debt  | 201              |                  |
| Non-cash interest income (expense) and other                                      | (532)            | 351              |
| Tax benefit related to stock options  | 1,351            | 1,624            |
| Share-based compensation expense  | 13,372           | 10,467           |
| Excess tax benefits from share-based compensation                                 | (1,424)          | (1,679)          |
| Loss on disposal of assets  | 88               | 42               |
| Change in net deferred tax liability  | 120              | (1,672)          |
| Changes in assets and liabilities:  |                  |                  |
| Receivables   | 2,146            | (8,233)          |
| Inventories   | (19,136)         | 7,858            |
| Other current and non-current assets  | 920              | 214              |
| Accounts payable  | (326)            | 3,004            |
| Income taxes, net   | (3,807)          | 3,303            |
| Other current and non-current liabilities   | (9,160)          | 2,206            |
| Net cash provided by operating activities   | 36,097           | 74,566           |
| <b>Cash flows from investing activities:</b>                                      |                  |                  |
| Purchases of available-for-sale investments                                       | (71,506)         | (87,595)         |
| Sales and maturities of available-for-sale investments                            | 67,587           | 110,160          |
| Purchases of property, plant and equipment  | (5,680)          | (3,937)          |
| Long-term restricted cash (Note 12)   | (13,000)         |                  |
| Net cash provided by (used in) investing activities                               | (22,599)         | 18,628           |
| <b>Cash flows from financing activities:</b>                                      |                  |                  |
| Payment of contingent consideration   | (4,220)          | (1,518)          |
| Proceeds from stock option exercises  | 2,893            | 3,671            |
| Proceeds from stock issued under employee stock purchase plan                     | 2,536            | 1,896            |
| Excess tax benefits from share-based compensation                                 | 1,424            | 1,679            |
| Repurchase and retirement of common shares  | (6,889)          | (5,352)          |
| Net cash provided by (used in) financing activities                               | (4,256)          | 376              |
| Effect of exchange rate changes on cash and cash equivalents                      | (370)            | (292)            |
| Net increase in cash and cash equivalents   | 8,872            | 93,278           |
| Net cash and cash equivalents at beginning of period                              | 101,322          | 42,661           |
| Net cash and cash equivalents at end of period                                    | \$ 110,194       | \$ 135,939       |



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**Supplemental disclosure of consolidated cash flow information:**

|                     |    |        |    |        |
|---------------------|----|--------|----|--------|
| Cash paid for taxes | \$ | 18,696 | \$ | 18,947 |
|---------------------|----|--------|----|--------|

**Supplemental disclosure of consolidated non-cash investing and financing activities:**

|                                       |    |       |    |       |
|---------------------------------------|----|-------|----|-------|
| Transfers of equipment from inventory | \$ | 1,152 | \$ | 1,686 |
|---------------------------------------|----|-------|----|-------|

|   |    |     |    |     |
|---|----|-----|----|-----|
| Purchases of property, plant and equipment through accounts payable and accrued liabilities | \$ | 279 | \$ | 916 |
|---|----|-----|----|-----|

See notes to the unaudited condensed consolidated financial statements.

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**THORATEC CORPORATION**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**Note 1. Operations and Significant Accounting Policies**

*Basis of Presentation*

The interim unaudited condensed consolidated financial statements of Thoratec Corporation ( we, our, us, or the Company ) have been prepared and presented in accordance with accounting principles generally accepted in the United States of America ( GAAP ) 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 as of and for the periods presented. Certain information and footnote disclosures normally included in our annual financial statements, prepared in accordance with GAAP, have been condensed or omitted. The accompanying financial statements should be read in conjunction with our fiscal 2012 consolidated financial statements, and the accompanying notes thereto, filed with the SEC in our Annual Report on Form 10-K for the fiscal year ended December 29, 2012 (the 2012 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 unaudited condensed consolidated financial statements necessarily requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities on the unaudited condensed consolidated balance sheet dates and the reported amounts of revenues and expenses for the periods presented. The actual amounts could differ from those estimated amounts.

**Note 2. Fair Value Measurements**

Our financial assets and liabilities carried at fair value are primarily comprised of investments in money market funds, certificates of deposit, municipal and corporate bonds, commercial paper, variable demand notes, auction rate securities, derivative contracts, certain investments held as assets under the deferred compensation plan, marketable equity securities, and the contingent consideration. The fair value accounting guidance requires that assets and liabilities be carried at fair value and classified in one of the following three categories:

Level 1: Quoted prices in active markets for identical assets or liabilities that the Company has the ability to access

Level 2: Observable market based inputs or unobservable inputs that are corroborated by market data such as quoted prices, interest rates and yield curves

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Level 3: Inputs that are unobservable data points that are not corroborated by market data

We review the fair value hierarchy classification on a quarterly basis. Changes in the ability to observe valuation inputs may result in a reclassification of levels of certain securities within the fair value hierarchy. We recognize transfers into and out of levels within the fair value hierarchy in the period in which the actual event or change in circumstances that caused the transfer occurs. There were no transfers between Level 1, Level 2, and Level 3 during either the first six months of 2013 or first six months of 2012.

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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:

|   | Total Fair Value | Quoted Prices in Active Markets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---|------------------|---|---|---|
|   | (in thousands)   |   |   |   |
| <b>As of June 29, 2013:</b>                               |                  |   |   |   |
| Cash equivalents:   |                  |   |   |   |
| Money market funds  | \$ 57,981        | \$ 57,981                                 | \$  | \$  |
| Commercial paper  | 8,600            |   | 8,600   |   |
| Municipal bonds   | 11,735           |   | 11,735  |   |
| Short-term investments:                                   |                  |   |   |   |
| Municipal bonds   | 128,508          |   | 128,508                                       |   |
| Variable demand notes                                     | 7,700            |   | 7,700   |   |
| Corporate bonds   | 4,302            |   | 4,302   |   |
| Commercial paper  | 7,996            |   | 7,996   |   |
| Certificate of deposit                                    | 2,000            |   | 2,000   |   |
| Prepaid expenses and other assets:                        |                  |   |   |   |
| Foreign exchange contracts                                | 1,580            |   | 1,580   |   |
| Long-term investments:                                    |                  |   |   |   |
| Auction rate securities                                   | 10,155           |   |   | 10,155                                    |
| Other long-term assets:                                   |                  |   |   |   |
| Investments included in our deferred compensation plan    |                  |   |   |   |
|   | 2,475            |   | 2,475   |   |
| Marketable equity securities                              | 2,298            | 2,298                                     |   |   |
| Other accrued liabilities                                 |                  |   |   |   |
| Foreign exchange contracts                                | 344              |   | 344   |   |
| Contingent consideration (current and long-term portions) | \$ 17,832        | \$  | \$  | \$ 17,832                                 |

|                                    | Total Fair Value | Quoted Prices in Active Markets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|------------------------------------|------------------|---|---|---|
|                                    | (in thousands)   |   |   |   |
| <b>As of December 29, 2012:</b>    |                  |   |   |   |
| Cash equivalents:                  |                  |   |   |   |
| Money market funds                 | \$ 59,230        | \$ 59,230                                 | \$  | \$  |
| Commercial paper                   | 4,998            |   | 4,998   |   |
| Municipal bonds                    | 3,045            |   | 3,045   |   |
| Corporate bonds                    | 380              |   | 380   |   |
| Short-term investments:            |                  |   |   |   |
| Municipal bonds                    | 107,533          |   | 107,533                                       |   |
| Variable demand notes              | 21,330           |   | 21,330  |   |
| Corporate bonds                    | 12,258           |   | 12,258  |   |
| Commercial paper                   | 5,299            |   | 5,299   |   |
| Certificate of deposit             | 2,006            |   | 2,006   |   |
| Prepaid expenses and other assets: |                  |   |   |   |
| Foreign exchange contracts         | 16               |   | 16  |   |
| Long-term investments:             |                  |   |   |   |
| Auction rate securities            | 10,607           |   |   | 10,607                                    |

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|   |           |       |           |
|---|-----------|-------|-----------|
| Other long-term assets:                                   |           |       |           |
| Investments included in our deferred compensation plan    | 1,731     |       | 1,731     |
| Marketable equity securities                              | 2,602     | 2,602 |           |
| Other accrued liabilities                                 |           |       |           |
| Foreign exchange contracts                                | 380       |       | 380       |
| Contingent consideration (current and long-term portions) | \$ 22,052 | \$    | \$ 22,052 |

Financial assets and liabilities are considered Level 2 when their fair values are determined using inputs that are observable in the market or can be derived principally from or corroborated by observable market data such as pricing for similar securities, recently executed transactions, cash flow models with yield curves, and benchmark securities. Our Level 2 financial assets and liabilities include short-term investments, foreign exchange instruments and certain of our deferred compensation plan securities. In addition, Level 2 financial instruments are valued using comparisons to like-kind financial instruments and models that use readily observable market data as their basis.

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Financial assets and liabilities are considered Level 3 when their fair values are determined using pricing models, discounted cash flow methodologies, or similar techniques, and at least one significant model assumption or input is unobservable. Level 3 financial assets and liabilities include the following:

- Auction rate securities** Due to limited market activity the determination of fair value requires significant judgment or estimation. The auction rate securities were valued using a discounted cash-flow model over a five-year period based on estimated interest rates, the present value of future principal payments, and interest payments discounted at rates considered to reflect the current market conditions and the credit quality of auction rate securities.
- Contingent consideration** The fair value of the contingent consideration in connection with the acquisition of the medical business of Levitronix LLC (Levitronix Medical) in August 2011 requires significant management judgment or estimation and is calculated using the income approach, utilizing various revenue assumptions and applying a probability to each outcome. By applying this method, the estimated undiscounted range of outcomes was from \$9.7 million to \$37.4 million. The fair value of the contingent consideration as of the acquisition date was estimated and recorded at \$23.6 million. The fair value of the contingent consideration is remeasured at the estimated fair value at each reporting period with the change in fair value recorded within operating expense within our consolidated statements of operations. Actual amounts paid may differ from the obligations recorded. The accretion of interest expense was not significant for all periods presented. In the first six months of 2013 and 2012, we paid \$4.2 million and \$1.5 million, respectively, of the contingent consideration. As of June 29, 2013, the estimated fair value of the remaining contingent consideration was \$17.8 million.

Available-for-sale investments are carried at fair value and are included in the tables above under short- and long-term investments. The aggregate fair value, amortized cost basis and gross unrealized gains and losses of available-for-sale investments by major security type were as follows:

|                                 | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value |
|---------------------------------|-------------------|------------------------------|-------------------------------|---------------|
| (in thousands)                  |                   |                              |                               |               |
| <b>As of June 29, 2013:</b>     |                   |                              |                               |               |
| Short-term investments:         |                   |                              |                               |               |
| Municipal bonds                 | \$ 128,424        | \$ 135                       | \$ (51)                       | \$ 128,508    |
| Variable demand notes           | 7,700             |                              |                               | 7,700         |
| Corporate bonds                 | 4,296             | 6                            |                               | 4,302         |
| Commercial paper                | 7,996             |                              |                               | 7,996         |
| Certificate of deposit          | 2,000             |                              |                               | 2,000         |
| Total short-term investments    | \$ 150,416        | \$ 141                       | \$ (51)                       | \$ 150,506    |
| Long-term investments:          |                   |                              |                               |               |
| Auction rate securities         | \$ 11,100         |                              | \$ (945)                      | \$ 10,155     |
| Other long-term assets:         |                   |                              |                               |               |
| Marketable equity securities(A) | 2,996             |                              | (698)                         | 2,298         |
| Total long-term                 | \$ 14,096         | \$                           | \$ (1,643)                    | \$ 12,453     |
| <b>As of December 29, 2012:</b> |                   |                              |                               |               |
| Short-term investments:         |                   |                              |                               |               |
| Municipal bonds                 | \$ 107,416        | \$ 136                       | \$ (19)                       | \$ 107,533    |
| Variable demand notes           | 21,330            |                              |                               | 21,330        |
| Corporate bonds                 | 12,244            | 17                           | (3)                           | 12,258        |
| Commercial paper                | 5,298             | 1                            |                               | 5,299         |

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|                              |    |         |    |     |    |         |    |         |
|------------------------------|----|---------|----|-----|----|---------|----|---------|
| Certificate of deposit       |    | 2,000   |    | 6   |    | 2,006   |    |         |
| Total short-term investments | \$ | 148,288 | \$ | 160 | \$ | (22)    | \$ | 148,426 |
| Long-term investments:       |    |         |    |     |    |         |    |         |
| Auction rate securities      | \$ | 11,900  | \$ |     | \$ | (1,293) | \$ | 10,607  |
| Other long-term assets:      |    |         |    |     |    |         |    |         |
| Marketable equity securities |    | 2,996   |    |     |    | (394)   |    | 2,602   |
| Total long-term              | \$ | 14,896  | \$ |     | \$ | (1,687) | \$ | 13,209  |

---

(A) As of June 29, 2013 and December 29, 2012, our available-for-sale equity securities have been in a continuous loss position for less than 12 months.

As of June 29, 2013, we owned approximately \$11.1 million face amount of auction rate securities classified as long-term. The assets underlying these investments are student loans backed by the U.S. government under the Federal Family Education Loan Program or by private insurers and are rated between AAA and BBB. Historically, these securities have provided liquidity through a Dutch auction process that resets the applicable interest rate periodically every seven to 35 days.

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Beginning in February of 2008, these auctions began to fail. The principal amount of these auction rate securities will not be accessible until future auctions for these securities are successful, a secondary market is established, these securities are called for redemption, or they are paid at maturity.

As of June 29, 2013, we had recorded an estimated cumulative unrealized loss of \$0.9 million (\$0.6 million, net of tax) related to the temporary impairment of the auction rate securities, which was included in accumulated other comprehensive income (loss) within the consolidated shareholders' equity. In addition, our management reviews impairments and credit loss associated with our investments, including auction rate securities, to determine the classification of the impairment as temporary or other-than-temporary and to bifurcate the credit and non-credit component of an other-than-temporary impairment event. We (i) do not intend to sell any of the auction rate securities prior to maturity at an amount below the original purchase value; (ii) intend to hold the investment to recovery and, based on a more-likely-than-not probability assessment, will not be required to sell the security before recovery; and (iii) deem that it is not probable that we will receive less than 100% of the principal and accrued interest from the issuer. Therefore, 100% of the impairment was charged to other comprehensive income (loss). Our auction rate securities are classified as long-term and are valued at \$10.2 million using significant unobservable inputs. Further, we continue to liquidate investments in auction rate securities as opportunities arise. In the first six months of 2013, we liquidated at par value \$0.8 million of our auction rate securities.

If the issuers of the auction rate securities are unable to successfully complete future auctions and their credit ratings deteriorate, then we may in the future be required to record the other-than-temporary impairment charges to the consolidated statement of operations. It could conceivably take until the final maturity of the underlying notes (up to 30 years) to realize the investments' fair value.

Our deferred compensation plan includes our corporate owned life insurance policies and mutual fund investments. The underlying mutual fund investments are deemed trading securities. The mutual fund investments' fair value and the cash surrender value of our corporate-owned life insurance policies are classified in the condensed consolidated balance sheets in Other long-term assets. The aggregate value of our deferred compensation plan assets was as follows:

|                            | June 29, 2013  | December 29, 2012 |
|----------------------------|----------------|-------------------|
|                            | (in thousands) |                   |
| Deferred compensation plan | \$ 5,055       | \$ 4,225          |

The unrealized gain before tax from the change in the value of the deferred compensation plan was \$0.3 million during the first six months of 2013 and 2012.

The amortized cost and fair value of available-for-sale debt investments, by contractual maturity, were as follows as of June 29, 2013:

|   | Amortized<br>Cost | Fair<br>Value |
|---|-------------------|---------------|
|   | (in thousands)    |               |
| Maturing within 1 year                    | \$ 106,528        | \$ 106,612    |
| Maturing after 1 year through 5 years     | 43,888            | 43,894        |
| Short-term available-for-sale investments | 150,416           | 150,506       |
| Maturing after 5 years                    | 11,100            | 10,155        |



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|    |         |    |         |
|----|---------|----|---------|
| \$ | 161,516 | \$ | 160,661 |
|----|---------|----|---------|

The following table provides a roll forward of the fair value, as determined by Level 3 inputs, of the auction rate securities during the first six months of 2013:

|   | Auction<br>Rate<br>Securities<br>(in thousands) |
|---|---|
| Balance as of December 29, 2012   | \$ 10,607                                       |
| Settlements at par  | (800)   |
| Unrealized gain on auction rate securities, included in other comprehensive income (loss) | 348   |
| Balance as of June 29, 2013   | \$ 10,155                                       |

We continue to monitor the market for auction rate securities and consider its impact (if any) on the fair value of our investments. If the current market conditions deteriorate further, or the anticipated recovery in fair values does not occur, we may be required to record additional unrealized losses in other comprehensive income or other-than-temporary impairment charges to the condensed consolidated statements of operations in future periods.

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The following table provides a roll forward of the fair value, as determined by Level 3 inputs, of contingent consideration during the first six months of 2013:

|                                 | <b>Contingent<br/>Consideration<br/>(in thousands)</b> |
|---------------------------------|--|
| Balance as of December 29, 2012 | \$ 22,052  |
| Payments                        | (4,220)  |
| Change in fair value            |  |
| Balance as of June 29, 2013     | \$ 17,832  |

The following table presents quantitative information about the inputs and valuation methodologies used for our fair value measurements classified in Level 3 of the fair value hierarchy as of June 29, 2013:

|                          | <b>Fair Value at<br/>June 29,<br/>2013<br/>(in thousands)</b> | <b>Valuation Methodology</b>             | <b>Significant Unobservable Input</b> | <b>Weighted Average (range)</b>                      |
|--------------------------|---|--|---------------------------------------|--|
| Auction rate securities  | \$ 10,155   | Discounted cash flow                     | Discount rate                         | 1.41% (1.41%)  |
|                          |   |  | Market credit spread                  | 2.60% (0.70% - 3.14%)                                |
|                          |   |  | Liquidity factor                      | 0.00% (0.00% - 0.00%)                                |
| Contingent consideration | \$ 17,832   | Multiple outcome<br>discounted cash flow | Annual Revenue                        | \$38.9 million (\$25.7 million<br>to \$46.0 million) |
|                          |   |  | Discount rate                         | 1.08% (0.77% - 1.45%)                                |
|                          |   |  | Probability of occurrence             | 20% (5% - 50%)                                       |

*Auction rate securities*

The significant unobservable inputs used in the fair value measurement of the auction rate securities are the weighted average discount rate, market credit spread and liquidity factor. A significant increase (decrease) in the discount rate in isolation could result in a significantly higher (lower) fair value measurement, whereas a significant increase (decrease) in the market credit spread and liquidity factor in isolation could result in a significantly lower (higher) fair value measurement. Although the discount rate as compared to the market credit spread and liquidity factors are not directly related, they will generally move in opposite directions.

The fair value of auction rate securities is calculated on a quarterly basis by senior management based on a collaborative effort of the corporate treasury and accounting groups. To assess the reasonableness of the fair value measurement, management compares its fair value measurement to the values calculated by independent third parties.

*Contingent consideration*

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The estimated fair value of the liability for contingent consideration represents revenue targets related to the Levitronix Medical acquisition. The fair value of the liability is determined using a discounted cash flow methodology with significant inputs that include projected revenue, discount rate and percent probability of occurrence. A significant increase (decrease) in the projected revenue in isolation could result in a significantly higher (lower) fair value measurement; a significant increase (decrease) in the discount rate in isolation could result in a significantly lower (higher) fair value measurement; and the changes in the probability of occurrence between the outcomes in isolation could result in a significantly lower or higher fair value measurement.

The fair value of the contingent consideration is calculated on a quarterly basis by management based on a collaborative effort of our operations, finance and accounting groups. Potential valuation adjustments are made as additional information becomes available, including the progress toward achieving revenue targets as compared to initial projections, the impact of market competition, and changes in actual and projected product mix and average selling price, with the impact of such adjustments being recorded in the condensed consolidated statement of operations. No adjustment was necessary in the first six months of 2013 and 2012.

Table of Contents*Assets and Liabilities That Are Measured at Fair Value on a Nonrecurring Basis*

Non-financial assets such as goodwill, intangible assets, and property, plant, and equipment are evaluated for impairment and adjusted to fair value using Level 3 inputs, only when impairment is recognized. Fair values are considered Level 3 when management makes significant assumptions in developing a discounted cash flow model based upon a number of considerations including projections of revenues, earnings and a discount rate. In addition, in evaluating the fair value of goodwill impairment, further corroboration is obtained using our market capitalization. No impairment was recorded in the first six months of 2013 and 2012.

**Note 3. Foreign Exchange Instruments**

We utilize foreign currency forward exchange contracts and options with recognized financial institutions to manage our exposure to the impact of fluctuations in foreign currency exchange rates on certain intercompany balances and foreign currency denominated sales and purchase transactions. We do not use derivative financial instruments for speculative or trading purposes. These forward contracts are not designated as hedging instruments for accounting purposes. Principal hedged currencies include the Euro, British Pound Sterling and U.S. Dollar. The periods of these forward contracts range up to six months and the notional amounts are intended to be consistent with changes in the underlying exposures. We intend to exchange foreign currencies for U.S. Dollars at maturity.

Total gross notional amounts for outstanding derivatives instruments were as follows:

|                               | June 29,<br>2013 |    | December 29,<br>2012 |
|-------------------------------|------------------|----|----------------------|
| Forward contracts:            |                  |    |                      |
| Euro (sell)                   | 17.6 million     |    | 13.9 million         |
| British Pound Sterling (sell) | £ 1.3 million    | £  | 1.8 million          |
| U.S. Dollar (sell)            | \$ 30.3 million  | \$ | 5.3 million          |
| U.S. Dollar (buy)             | \$ 83.0 million  | \$ | 73.5 million         |

The following table shows the derivative instruments measured at gross fair value reported on the condensed consolidated balance sheets:

|   | June 29, 2013                        |                              |
|---|--------------------------------------|------------------------------|
|   | Prepaid expenses<br>and other assets | Other accrued<br>liabilities |
|   | (in thousands)                       |                              |
| Derivatives not designated as hedging instruments (forward contracts) | \$ 1,580                             | \$ 344                       |

|  | December 29, 2012                    |                              |
|--|--------------------------------------|------------------------------|
|  | Prepaid expenses<br>and other assets | Other accrued<br>liabilities |
|  | (in thousands)                       |                              |

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|   |    |    |    |     |
|---|----|----|----|-----|
| Derivatives not designated as hedging instruments (forward contracts) | \$ | 16 | \$ | 380 |
|---|----|----|----|-----|

The following table shows the effect of derivative instruments not designated as hedging instruments and foreign currency transactions gains and losses which were included in Interest income and other in the condensed consolidated statements of operations:

|  | Three Months Ended |               | Six Months Ended |               |
|--|--------------------|---------------|------------------|---------------|
|  | June 29, 2013      | June 30, 2012 | June 29, 2013    | June 30, 2012 |
|  | (in thousands)     |               |                  |               |
| Foreign currency exchange gain (loss) on foreign contracts | \$ (1,477)         | \$ 5,256      | \$ 1,304         | \$ 2,331      |
| Foreign currency transactions gain (loss)                  | 1,437              | (5,423)       | (1,008)          | (2,309)       |

Table of Contents**Note 4. Balance Sheet Information**

The following tables provide details of selected condensed consolidated balance sheets items as of the end of each period:

Inventories consisted of the following:

|                 | <b>June 29,<br/>2013</b> | <b>December 29,<br/>2012</b> |
|-----------------|--------------------------|------------------------------|
|                 | (in thousands)           |                              |
| Finished goods  | \$ 22,626                | 15,087                       |
| Work in process | 13,142                   | 11,020                       |
| Raw materials   | 29,204                   | 20,993                       |
| Total           | \$ 64,972                | 47,100                       |

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

|                                      | <b>June 29,<br/>2013</b> | <b>December 29,<br/>2012</b> |
|--------------------------------------|--------------------------|------------------------------|
|                                      | (in thousands)           |                              |
| Land, building and improvements      | \$ 20,601                | \$ 20,543                    |
| Equipment and capitalized software   | 49,935                   | 46,290                       |
| Furniture and leasehold improvements | 22,345                   | 20,933                       |
| Total                                | 92,881                   | 87,766                       |
| Less accumulated depreciation        | (45,431)                 | (41,874)                     |
| Total                                | \$ 47,450                | \$ 45,892                    |

Depreciation expense was \$2.2 million and \$4.1 million for the three and six months ended June 29, 2013, respectively, and \$2.1 million and \$4.2 million for the three and six months ended June 30, 2012, respectively.

Warranty provision, included in Other accrued liabilities on the condensed consolidated balance sheets, and the changes in the balances for the six months ended June 29, 2013 and June 30, 2012 were as follows:

|                                  | <b>June 29,<br/>2013</b> | <b>June 30,<br/>2012</b> |
|----------------------------------|--------------------------|--------------------------|
|                                  | (in thousands)           |                          |
| Balance, beginning of the period | \$ 2,212                 | \$ 2,452                 |
| Additions                        | 420                      | 989                      |
| Settlements                      | (945)                    | (769)                    |
| Balance, end of the period       | \$ 1,687                 | \$ 2,672                 |

Changes in Accumulated Other Comprehensive Loss by component during the first six months of 2013:

|  | Foreign currency<br>items (A) | Unrealized<br>gain (loss) on<br>available-for-sale<br>securities (A)<br>(in thousands) | Total       |
|--|-------------------------------|--|-------------|
| Balance as of December 29, 2012                                | \$ (13,928)                   | \$ (1,141)   | \$ (15,069) |
| Other comprehensive loss before reclassification               | (1,676)                       | (7)  | (1,683)     |
| Amounts reclassified from accumulated other comprehensive loss |                               |  |             |
| Net current period other comprehensive loss                    | (1,676)                       | (7)  | (1,683)     |
| Balance as of June 29, 2013                                    | \$ (15,604)                   | \$ (1,148)   | \$ (16,752) |

(A) All amounts are net of tax.

**Note 5. Goodwill and Intangible Assets, net**

The carrying amount of goodwill and the changes in the balances during the first six months of 2013 were as follows:

|                                     |            |
|-------------------------------------|------------|
| Balance as of December 29, 2012     | \$ 194,182 |
| Foreign currency translation impact | (1,897)    |
| Balance as of June 29, 2013         | \$ 192,285 |

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Intangibles (net of accumulated amortization and impairment) were as follows:

|   | Gross<br>Amount | As of June 29, 2013         |                           | Net<br>Amount |
|---|-----------------|-----------------------------|---------------------------|---------------|
|   |                 | Accumulated<br>Amortization | Accumulated<br>Impairment |               |
| (in thousands)                            |                 |                             |                           |               |
| Patents and trademarks                    | \$ 43,506       | \$ (34,155)                 | \$                        | \$ 9,351      |
| Core technology                           | 37,180          | (22,187)                    | (12,642)                  | 2,351         |
| Developed technology                      | 128,013         | (79,113)                    | (37,600)                  | 11,300        |
| Pre-existing license agreement            | 2,300           | (630)                       |                           | 1,670         |
| Customer based relationships<br>and other | 6,622           | (3,119)                     |                           | 3,503         |
|   | 217,621         | (139,204)                   | (50,242)                  | 28,175        |
| Foreign currency translation<br>impact    | 109             |                             |                           | 109           |
| Total purchased intangible<br>assets      | \$ 217,730      | \$ (139,204)                | \$ (50,242)               | \$ 28,284     |

|   | Gross<br>Amount | As of December 29, 2012     |                           | Net<br>Amount |
|---|-----------------|-----------------------------|---------------------------|---------------|
|   |                 | Accumulated<br>Amortization | Accumulated<br>Impairment |               |
| (in thousands)                            |                 |                             |                           |               |
| Patents and trademarks                    | \$ 43,475       | \$ (33,463)                 | \$                        | \$ 10,012     |
| Core technology                           | 37,180          | (21,388)                    | (12,642)                  | 3,150         |
| Developed technology                      | 127,940         | (76,379)                    | (37,600)                  | 13,961        |
| Pre-existing license agreement            | 2,300           | (465)                       |                           | 1,835         |
| Customer based relationships<br>and other | 6,578           | (2,220)                     |                           | 4,358         |
|   | 217,473         | (133,915)                   | (50,242)                  | 33,316        |
| Foreign currency translation<br>impact    | 255             |                             |                           | 255           |
| Total purchased intangible<br>assets      | \$ 217,728      | \$ (133,915)                | \$ (50,242)               | \$ 33,571     |

Purchased identifiable intangible assets are amortized on either a straight-line or accelerated method based on the expected pattern of future benefits related to those respective intangible assets. Subsequent to the impairment of the core and developed technology associated with our PVAD and IVAD intangible assets which was recorded in the fourth quarter of 2012, we changed our method of amortization for this intangible asset from the straight-line method to an accelerated method to more closely reflect the expected pattern of benefits associated with the remaining carrying amount of this intangible asset.

Amortization expense related to identifiable intangible assets was \$2.6 million and \$5.1 million for the three and six months ended June 29, 2013, respectively, and \$2.7 million and \$5.5 million for the three and six months ended June 30, 2012, respectively.

Estimated amortization expenses for the next five fiscal years and all years thereafter are as follows:



(in thousands)

| <b>Fiscal year:</b> |    |        |
|---------------------|----|--------|
| Remainder of 2013   | \$ | 5,418  |
| 2014                |    | 6,695  |
| 2015                |    | 4,562  |
| 2016                |    | 3,335  |
| 2017                |    | 2,537  |
| Thereafter          |    | 5,737  |
| Total               | \$ | 28,284 |

**Note 6. Credit Facility**

On December 19, 2011, we signed an unsecured revolving credit facility agreement that provides for up to \$50 million in revolving credit that will expire on December 19, 2016. The interest rate charged on the amounts borrowed is LIBOR plus a margin (ranging from 0.75% to 1.25%). The credit agreement contains financial covenants. We were in compliance with all such covenants as of June 29, 2013. The credit agreement permits us to use the facility for working capital and general corporate purposes. As of June 29, 2013, there were no borrowings under this credit facility.

Table of Contents**Note 7. Share-Based Compensation**

Our Board of Directors approved the 2006 Incentive Stock Plan (the 2006 Plan ). The 2006 Plan was last amended in May 2012. Participation in the 2006 Plan is limited to employees, directors, and consultants. Shares reserved for future issuance under the 2006 Plan may be used for grants of stock options ( options ), restricted stock units ( RSUs ), and other types of awards. Options granted under the 2006 Plan are either incentive or nonqualified stock options and generally become exercisable in annual installments over a period of four years from the date of grant and expire generally ten years from the grant date. RSUs generally vest in annual installments over a four-year period.

The Board of Directors authorizes the granting of options, RSUs and other type of awards to employees and consultants. The exercise prices of the options shall not be less than the fair market value of common stock on the date of grant. The fair value of RSUs granted is determined based on the number of RSUs granted and the quoted price of our common stock on the date of grant. As of June 29, 2013, approximately 3.45 million shares remained available for issuance under the 2006 Plan.

Additionally, we sponsor an Employee Stock Purchase Plan (the ESPP ) in which eligible employees may contribute up to 15% of their base compensation to purchase shares of common stock at a price equal to 85% of the lower of the market value of the stock at the beginning or end of each six-month offer period. As of June 29, 2013, approximately 340,000 shares remained available for issuance under the ESPP.

Share-based compensation consists of the following:

|   | Three Months Ended |               | Six Months Ended |               |
|---|--------------------|---------------|------------------|---------------|
|   | June 29, 2013      | June 30, 2012 | June 29, 2013    | June 30, 2012 |
|   | (in thousands)     |               |                  |               |
| Cost of product sales                               | \$ 616             | \$ 550        | \$ 1,187         | \$ 1,115      |
| Selling, general and administrative expenses        | 4,625              | 3,409         | 8,308            | 6,388         |
| Research and development                            | 1,964              | 1,586         | 3,877            | 3,102         |
| Total share-based compensation expense before taxes | 7,205              | 5,545         | 13,372           | 10,605        |
| Tax benefit for share-based compensation expense    | 2,790              | 2,069         | 5,070            | 3,959         |
| Total share-based compensation (net of taxes)       | \$ 4,415           | \$ 3,476      | \$ 8,302         | \$ 6,646      |

Share-based compensation costs of \$0.5 million and \$0.2 million were capitalized to inventory as of June 29, 2013 and December 29, 2012, respectively.

**Stock Options**

The fair value of each option is estimated at the date of grant using the Black-Scholes option pricing model with the following assumptions:

|  | Three Months Ended |               | Six Months Ended |               |
|--|--------------------|---------------|------------------|---------------|
|  | June 29, 2013      | June 30, 2012 | June 29, 2013    | June 30, 2012 |
| Risk free interest rate (weighted average) | 1.57%              | 1.22%         | 1.36%            | 1.42%         |
| Expected volatility                        | 37%                | 43%           | 37%              | 43%           |
| Expected option term (years)               | 4.93               | 4.83 to 5.86  | 4.92 to 5.89     | 4.81 to 5.83  |
| Dividends                                  | None               | None          | None             | None          |

*Determining Fair Value for Options*

- Valuation and amortization method* We estimate the fair value of stock options granted using the Black-Scholes option pricing model. This fair value is then amortized over the requisite service periods of the awards.
- Expected Term* The expected term of options represents the period of time that options are expected to be outstanding. We use separate assumptions for groups of employees (for example, officers) that have similar historical exercise behavior, giving consideration to the contractual terms of the share-based awards, vesting schedules and expectations of future employee behavior as influenced by changes to the terms of our share-based awards. The range above reflects the expected option impact of these separate groups.

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- *Expected Volatility* Our expected volatility was based on a combination of historical volatility trends and market-based implied volatility because we determined that this combination of historical volatility trends and market-based implied trends is reflective of market conditions. In determining the extent of use of implied volatility, we considered: (i) the volume of market activity of traded options; (ii) the ability to reasonably match the input variables of traded options to those of stock options granted by us, including the date of grant; (iii) the similarity of the exercise prices; and (iv) the length of term of traded options.
- *Risk-Free Interest Rate* The risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of grant.
- *Expected Dividend* The expected dividend assumption is based on our current expectations about our anticipated dividend policy.

Stock option activity is summarized as follows:

|   | Number of<br>Options<br>(in thousands) | Weighted<br>Average Exercise<br>Price Per Share | Weighted Average<br>Remaining Contract<br>Life (years) |
|---|--|---|--|
| Outstanding options as of December 29, 2012                         | 2,498                                  | \$ 25.98  | 6.27   |
| Granted   | 559                                    | 35.70   |  |
| Exercised   | (156)                                  | 18.52   |  |
| Forfeited or expired  | (50)                                   | 32.05   |  |
| Outstanding options as of June 29, 2013                             | 2,851                                  | \$ 28.19  | 6.60   |
| Outstanding options exercisable as of June 29, 2013                 | 1,515                                  | \$ 23.83  | 4.65   |
| Outstanding options vested as of June 29, 2013 and expected to vest | 2,766                                  | \$ 28.01  | 6.52   |

As of June 29, 2013, there was \$10.2 million of unrecognized compensation expense, net of estimated forfeitures, related to stock options, which expense we expect to recognize over a weighted average period of 1.73 years.

*Restricted Stock Units*

Restricted stock unit activity is summarized as follows:

|   | Number of<br>Units<br>(in thousands) | Weighted Average<br>Grant Date Fair<br>Value | Weighted Average<br>Remaining Contract<br>Life (in years) |
|---|--------------------------------------|--|---|
| Outstanding units as of December 29, 2012 | 1,462                                | \$ 31.52                                     | 1.37  |
| Granted                                   | 545                                  | 35.28  |   |
| Released                                  | (490)                                | 30.09  |   |
| Forfeited or expired                      | (53)                                 | 32.89  |   |

|                                       |       |    |       |      |
|---------------------------------------|-------|----|-------|------|
| Outstanding units as of June 29, 2013 | 1,464 | \$ | 33.35 | 1.66 |
|---------------------------------------|-------|----|-------|------|

As of June 29, 2013, there was \$40.0 million of unrecognized compensation expense, net of estimated forfeitures, related to restricted stock units, which amount we expect to recognize over 2.63 years.

#### *Employee Stock Purchase Plan*

The estimated subscription date fair value of the offering under the ESPP for each of the six months ended June 29, 2013 and June 30, 2012 was approximately \$0.5 million, using the Black-Scholes option pricing model and the following assumptions:

|                         | Six Months Ended |               |
|-------------------------|------------------|---------------|
|                         | June 29, 2013    | June 30, 2012 |
| Risk-free-interest rate | 0.08%            | 0.15%         |
| Expected volatility     | 30%              | 40%           |
| Expected option life    | 0.50 years       | 0.50 years    |
| Dividends               | None             | None          |

As of June 29, 2013, there was approximately \$0.4 million of unrecognized compensation expense related to ESPP subscriptions that began on May 1, 2013, which amount we expect to recognize through October 31, 2013.

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**Note 8. Common and Preferred Stock**

On November 26, 2012, our Board of Directors authorized the repurchase of up to \$150 million of shares of the Company's common stock (November 2012 program). As part of the authorization, the Company entered into an Accelerated Share Repurchase (ASR) agreement with an investment bank, under which we agreed to repurchase an aggregate of \$75.0 million of our common stock. Under the ASR program, we paid \$75.0 million and received an initial delivery of approximately 1.5 million shares, which represented 75% of the ASR program's estimated value at inception. At the maturity of the program in the first quarter of 2013, an additional 0.6 million shares were delivered to the Company. The total value of the shares repurchased by the Company under the ASR program was based on a per share price of \$36.00, representing the volume-weighted average price of our common stock during the repurchase period, less an agreed upon discount. As of June 29, 2013, \$75.0 million was available for repurchases of shares of our common stock under the November 2012 program.

At the inception of the ASR program, we recorded \$18.8 million as an equity forward contract, which was included in Additional-Paid-in Capital. We are incorporated in California, and as California law does not recognize treasury stock, the shares repurchased decreased the common shares outstanding. Accordingly, at the settlement date, when we received the 0.6 million shares, we reduced the equity forward contract value by \$18.8 million and allocated \$6.9 million to APIC (based on the average-issuance price per share of all shares outstanding prior to the settlement) and \$11.8 million to retained earnings (based on the excess amount over the average-issuance price per share of all shares outstanding).

Shares of our common stock purchased that were not part of our publicly announced repurchase programs represent the surrender value of shares of restricted stock units withheld in order to satisfy tax withholding obligations upon vesting. The shares purchased do not reduce the dollar value that may yet be purchased under our publicly announced repurchase programs. The aggregate value of shares purchased during the three and six months ended June 29, 2013 was approximately \$1.1 million and \$6.9 million, respectively. The aggregate value of shares purchased during the three and six months ended June 30, 2012 was approximately \$0.1 million and \$4.9 million, respectively.

**Note 9. Income Taxes**

On January 2, 2013, the U.S. President signed into law The American Taxpayer Relief Act of 2012. This Act extends the research tax credit for two years to December 31, 2013. The extension of the research tax credit is retroactive and includes amounts paid or incurred after December 29, 2011. As a result of the enactment after the Company's 2012 year end, we recognized, in the first quarter of 2013, a benefit of approximately \$1.3 million for qualifying amounts incurred in 2012.

Our effective income tax rates for the three months ended June 29, 2013 and June 30, 2012 were 30.3% and 32.7%, respectively. Our effective income tax rates for the six months ended June 29, 2013 and June 30, 2012 were 28.4% and 32.5%, respectively. The decrease is primarily attributable to the 2012 federal research tax credits, which we recognized in the first quarter of 2013 (in the period of enactment), as well as the 2013 federal research tax credits.

During the next 12 months, it is reasonably possible that audit resolutions and the expiration of statutes of limitations could potentially reduce our unrecognized tax benefits by up to \$4.1 million. However, this amount may change because we continue to have ongoing negotiations with various taxing authorities throughout the year.

**Note 10. Segment and Geographic Information**

The accounting standard for segment reporting establishes standards for reporting information about operating segments in annual financial statements and requires selected information for those segments to be presented in interim financial reports of public business enterprises. It also establishes standards for related disclosures about products and services, geographic areas and major customers. Based on an evaluation of our business, including the operations acquired in the Levitronix Medical transaction, we determined that we have one operating segment, Cardiovascular group. This segment is organized and operates to develop and manufacture mechanical circulatory products to support the cardiovascular systems of humans.

Product sales attributed to a country or region include product sales to hospitals, physicians and distributors and are based on final destinations where the products are sold. No individual customer or individual country outside of the U.S. accounted for more than 10% of product sales during the three and six months ended June 29, 2013 or during the three and six months ended June 30, 2012.

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|                                       | Three Months Ended |               | Six Months Ended |               |
|---------------------------------------|--------------------|---------------|------------------|---------------|
|                                       | June 29, 2013      | June 30, 2012 | June 29, 2013    | June 30, 2012 |
| (in thousands)                        |                    |               |                  |               |
| Product sales by geographic location: |                    |               |                  |               |
| Domestic                              | \$ 98,766          | \$ 97,131     | \$ 191,035       | \$ 200,992    |
| International                         | 31,713             | 21,528        | 57,169           | 44,436        |
| Total                                 | \$ 130,479         | \$ 118,659    | \$ 248,204       | \$ 245,428    |

|                                | Three Months Ended |               | Six Months Ended |               |
|--------------------------------|--------------------|---------------|------------------|---------------|
|                                | June 29, 2013      | June 30, 2012 | June 29, 2013    | June 30, 2012 |
| (in thousands)                 |                    |               |                  |               |
| Product sales by product line: |                    |               |                  |               |
| HeartMate                      | \$ 115,646         | \$ 106,243    | \$ 218,567       | \$ 217,933    |
| Thoratec                       | 2,684              | 3,776         | 6,516            | 9,564         |
| CentriMag                      | 11,515             | 8,049         | 21,879           | 16,703        |
| Other                          | 634                | 591           | 1,242            | 1,228         |
| Total                          | \$ 130,479         | \$ 118,659    | \$ 248,204       | \$ 245,428    |

|                            | Three Months Ended |               | Six Months Ended |               |
|----------------------------|--------------------|---------------|------------------|---------------|
|                            | June 29, 2013      | June 30, 2012 | June 29, 2013    | June 30, 2012 |
| (in thousands)             |                    |               |                  |               |
| Product sales by category: |                    |               |                  |               |
| Pump                       | \$ 93,428          | \$ 85,774     | \$ 177,759       | \$ 178,293    |
| Non-Pump                   | 36,417             | 32,294        | 69,203           | 65,907        |
| Other                      | 634                | 591           | 1,242            | 1,228         |
| Total                      | \$ 130,479         | \$ 118,659    | \$ 248,204       | \$ 245,428    |

**11. Net Income Per Share**

Restricted stock awards ( RSA ) previously granted under the 2006 Plan are subject to repurchase and have non-forfeitable rights to receive dividends as common stock and therefore are considered participating securities. All outstanding RSAs were fully vested at the end of 2012. Under the two-class method, basic and diluted net income per common share are determined by calculating net income per share for common stock and participating securities based on participation rights in undistributed earnings. Dilutive net income per common share also considers the dilutive effect of in-the-money stock options and restricted stock units, calculated using the treasury stock method. Under the treasury stock method, the amount of assumed proceeds from unexercised stock options and restricted stock units includes the amount of unrecognized compensation cost attributable to future services, assumed proceeds from the exercise of the options, and the incremental income tax benefit or liability that would be recorded in additional-paid-in capital when the award becomes deductible.

Basic and diluted net income per common share attributable to common shareholders under the two-class method was calculated as follows:

|  | Three Months Ended |               | Six Months Ended |               |
|--|--------------------|---------------|------------------|---------------|
|  | June 29, 2013      | June 30, 2012 | June 29, 2013    | June 30, 2012 |
| (in thousands, except per share data)                |                    |               |                  |               |
| <i>Basic net income per common share calculation</i> |                    |               |                  |               |
| Net Income   | \$ 23,189          | \$ 20,808     | \$ 41,359        | \$ 46,294     |
| Net Income allocated to participating securities     |                    |               |                  | (19)          |
| Net Income attributable to common shareholders       | \$ 23,189          | \$ 20,808     | \$ 41,359        | \$ 46,275     |



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|  |         |         |         |         |
|--|---------|---------|---------|---------|
| Weighted average number of common shares used to compute basic net income per common share | 57,429  | 58,737  | 57,457  | 58,587  |
| Basic net income per common share  | \$ 0.40 | \$ 0.35 | \$ 0.72 | \$ 0.79 |

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|  | Three Months Ended |               | Six Months Ended |               |
|--|--------------------|---------------|------------------|---------------|
|  | June 29, 2013      | June 30, 2012 | June 29, 2013    | June 30, 2012 |
| (in thousands, except per share data)  |                    |               |                  |               |
| <i>Diluted net income per common share calculation</i>                                       |                    |               |                  |               |
| Net income   | \$ 23,189          | \$ 20,808     | \$ 41,359        | \$ 46,294     |
| Net income allocated to participating securities   |                    |               |                  | (19)          |
| Net income attributable to common shareholders   | \$ 23,189          | \$ 20,808     | \$ 41,359        | \$ 46,275     |
| Weighted average number of common shares used to compute basic net income per common share   | 57,429             | 58,737        | 57,457           | 58,587        |
| Dilutive effect of stock-based compensation plans  | 691                | 781           | 941              | 926           |
| Weighted average number of common shares used to compute diluted net income per common share | 58,120             | 59,518        | 58,398           | 59,513        |
| Diluted net income per common share  | \$ 0.40            | \$ 0.35       | \$ 0.71          | \$ 0.78       |

Potential common share equivalents excluded where the inclusion would be anti-dilutive are as follows:

|   | Three Months Ended |               | Six Months Ended |               |
|---|--------------------|---------------|------------------|---------------|
|   | June 29, 2013      | June 30, 2012 | June 29, 2013    | June 30, 2012 |
| (in thousands)  |                    |               |                  |               |
| Options to purchase shares not included in the computation of diluted net income per share because their inclusion would be anti-dilutive | 1,149              | 627           | 963              | 443           |

**12. Subsequent Event**

On June 30, 2013 (the first day of our third quarter of fiscal 2013), we entered into an Asset Purchase Agreement with Terumo Corporation ( Terumo ) and completed the acquisition of certain assets and assumed certain liabilities related to the DuraHeart II Left Ventricular Assist System product line previously under development by Terumo. We paid \$13.0 million at the closing on June 30, 2013 in cash (which was held in escrow, and included within Other long-term assets in the accompanying condensed consolidated balance sheet as of June 29, 2013), and agreed to pay future milestone payments of up to \$43.5 million, based on regulatory approvals and product sales. No amounts were held in escrow at the closing of the acquisition on June 30, 2013. This acquisition will be accounted for as a business combination, and the assets and liabilities will be recorded as of the acquisition date at their respective fair values. The impact of the acquisition is not reflected in our unaudited condensed consolidated financial statements as of and for the period ended June 29, 2013, or in these corresponding notes. Through June 29, 2013, acquisition-related expenses associated with this transaction were \$1.3 million. We are in the process of completing the purchase price allocation and pro-forma results of operations for this acquisition.

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**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**Forward-Looking Statements**

*This Quarterly Report on Form 10-Q includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These statements can be identified by the words expects, projects, hopes, believes, intends, should, estimate, will, would, may, anticipates, plans, could and other similar words. Actual results, events or performance could differ materially from these forward-looking statements based on a variety of factors, many of which are beyond our control. Therefore, readers are cautioned not to put undue reliance on these statements. Factors that could cause actual results or conditions to differ from those anticipated by these and other forward-looking statements include those more fully described in the Risk Factors section of our 2012 Annual Report on Form 10-K (the 2012 Annual Report) and in other documents we file with the Securities and Exchange Commission (SEC). These forward-looking statements speak only as of the date hereof. We are not under any obligation, and we expressly disclaim any obligation, to publicly release any revisions or updates to these forward-looking statements that may be made to reflect events or circumstances after the date hereof, or to reflect the occurrence of unanticipated events.*

*The following presentation of management's discussion and analysis of our financial condition and results of operations should be read together with our unaudited condensed consolidated financial statements included in this Quarterly Report on Form 10-Q.*

**OVERVIEW**

**Continuing Operations Cardiovascular Business**

Thoratec Corporation (we, our, us, or the Company) is the world leader in mechanical circulatory support with a product portfolio to treat the full range of clinical needs for advanced heart failure patients. We develop, manufacture and market proprietary medical devices used for mechanical circulatory support (MCS) for the treatment of heart failure (HF) patients. For chronic circulatory support for HF patients, our primary product lines are our ventricular assist devices (VADs): HeartMate II Left Ventricular Assist System (HeartMate II), Thoratec Paracorporeal Ventricular Assist Device (PVAD), and Thoratec Implantable Ventricular Assist Device (IVAD). We refer to HeartMate II as the HeartMate product line and PVAD and IVAD collectively as the Thoratec product line. For acute circulatory support, our product lines are CentriMag Acute Circulatory System (CentriMag) and for pediatric patients PediMag/PediVAS Acute Circulatory System (PediMag/PediVAS). HeartMate II, PVAD, IVAD, CentriMag and PediMag/PediVAS are approved by the U.S. Food and Drug Administration (FDA), and have received Conformité Européene (CE) Mark approval in Europe.

MCS devices supplement the pumping function of the heart in patients with HF. In most cases, a cannula connects the left ventricle of the heart to a blood pump. Blood flows from the left ventricle to the pump chamber via the cannula, powered by an electric or air driven mechanism that drives the blood through another cannula into the aorta. From the aorta, the blood then circulates throughout the body. Mechanical or tissue valves enable unidirectional flow in some devices. Currently, the power source remains outside the body for all FDA-approved MCS devices. Some of our devices can also provide support for the right side of the heart.

On June 30, 2013 (the first day of our third quarter of fiscal 2013), we entered into an Asset Purchase Agreement with Terumo Corporation ( Terumo ) and completed the acquisition of certain assets and assumed certain liabilities related to the DuraHeart II Left Ventricular Assist System ( DuraHeart II ) product line previously under development by Terumo. We paid at the closing \$13.0 million in cash, and agreed to pay future milestone payments of up to \$43.5 million, based on regulatory approvals and product sales.

### *HeartMate II*

HeartMate II is an implantable, electrically powered, continuous flow, left ventricular assist device ( LVAD ) consisting of a rotary blood pump designed to provide intermediate and long-term MCS. HeartMate II is designed to improve survival and quality of life for a broad range of advanced HF patients. Significantly smaller than previous ventricular assist devices and with only one moving part, the HeartMate II is simpler and designed to operate more quietly than pulsatile devices.

HeartMate II received FDA approval in April 2008 for bridge-to-transplantation ( BTT ) and received FDA approval for use in HF patients who are not eligible for heart transplantation ( Destination Therapy or DT ) in January 2010. In November 2005, HeartMate II received CE Mark approval. The HeartMate II is the most widely used LVAD.

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***CentriMag***

CentriMag is an extracorporeal full-flow acute surgical support platform incorporating a polycarbonate pump, based on magnetically levitated bearingless motor technology. CentriMag is cleared by the FDA for use up to six hours in patients requiring short-term extracorporeal circulatory support during cardiac surgery. Additionally, CentriMag is approved under an FDA humanitarian device exemption ( HDE ) to be used as a right ventricular assist device for periods of support up to 30 days in patients in cardiogenic shock due to acute right ventricular failure. We have an ongoing study to evaluate the effectiveness of the CentriMag for periods of support for up to 30 days. CentriMag has CE Mark approval to provide support for up to 30 days for both cardiac and respiratory failure.

***PediMag/PediVAS***

PediMag and PediVAS are identical, extracorporeal full-flow acute surgical support platforms incorporating a polycarbonate pump, based on magnetically levitated bearingless motor technology, designed to provide acute surgical support to pediatric patients. The brand names differ according to indication for use, duration of support, and regulatory approval. PediMag is cleared by the FDA for use in conjunction with the CentriMag console and motor, for support periods of up to six hours. Outside the U.S., the device is branded as PediVAS. This device has CE Mark approval to provide support for up to 30 days for both cardiac and respiratory failure.

***PVAD***

PVAD is an external, pulsatile VAD, FDA approved for BTT, including home discharge, and post-cardiotomy myocardial recovery and provides left, right, and biventricular MCS. PVAD is a paracorporeal device that is less invasive than implantable VADs since only the cannula is implanted. The paracorporeal nature of PVAD provides several benefits including shorter implantation times (approximately two hours) and the ability to use the device in smaller patients.

A pneumatic power source drives PVAD. It is designed for short-to-intermediate duration for post-cardiotomy myocardial recovery following cardiac surgery and BTT. PVAD and IVAD, described below, offer left, right or biventricular support for use for BTT. This characteristic is significant because the vast majority of BTT patients treated with PVAD and IVAD require right as well as left-side ventricular assistance. PVAD and IVAD are also the only devices approved for both BTT and recovery following cardiac surgery. PVAD incorporates our proprietary biomaterial, Thoralon, which has excellent tissue and blood compatibility and is resistant to blood clots.

PVAD received FDA approval for BTT in December 1995 and for recovery (post-cardiotomy) in May 1998. In June 1998, PVAD received CE Mark approval, allowing for its commercial sale in Europe.

***IVAD***

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IVAD is an implantable, pulsatile VAD, FDA approved for BTT, including home discharge, and post-cardiotomy myocardial recovery and provides left, right or biventricular MCS. IVAD maintains the same blood flow path, valves and blood pumping mechanism as PVAD, but has an outer housing made of a titanium alloy that makes it suitable for implantation.

IVAD received FDA approval for BTT and recovery (post-cardiotomy) in August 2004. In June 2003, the IVAD received CE Mark approval, allowing for its commercial sale in Europe.

### **Critical Accounting Policies and Estimates**

Our unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America. Preparation of these statements requires management to make judgments and estimates. Some accounting policies have a significant impact on amounts reported in these financial statements. A summary of significant accounting policies and a description of accounting policies that are considered critical may be found in our Annual Report on Form 10-K for the fiscal year ended December 29, 2012, in the Notes to the Consolidated Financial Statements (Note 1) and the Critical Accounting Policies and Estimates section in Management's Discussion and Analysis of Financial Condition and Results of Operations. There have been no changes in these significant accounting policies during the six months ended June 29, 2013.

Table of Contents**Results of Operations**

The following table sets forth selected unaudited condensed consolidated statements of operations data for the periods indicated and as a percentage of total product sales:

|                                     | Three Months Ended                         |        |               |        | Six Months Ended |        |               |        |
|-------------------------------------|--|--------|---------------|--------|------------------|--------|---------------|--------|
|                                     | June 29, 2013                              |        | June 30, 2012 |        | June 29, 2013    |        | June 30, 2012 |        |
|                                     | (in thousands, except for percentage data) |        |               |        |                  |        |               |        |
| Product sales                       | \$ 130,479                                 | 100.0% | \$ 118,659    | 100.0% | \$ 248,204       | 100.0% | \$ 245,428    | 100.0% |
| Cost of product sales               | 41,000                                     | 31.4   | 36,022        | 30.4   | 76,073           | 30.6   | 74,909        | 30.5   |
| Gross profit                        | 89,479                                     | 68.6   | 82,637        | 69.6   | 172,131          | 69.4   | 170,519       | 69.5   |
| Operating expenses:                 |  |        |               |        |                  |        |               |        |
| Selling, general and administrative | 34,924                                     | 26.8   | 32,013        | 27.0   | 69,669           | 28.1   | 63,214        | 25.8   |
| Research and development            | 21,506                                     | 16.5   | 19,808        | 16.6   | 46,019           | 18.5   | 39,504        | 16.0   |
| Total operating expenses            | 56,430                                     | 43.3   | 51,821        | 43.6   | 115,688          | 46.6   | 102,718       | 41.8   |
| Income from operations              | 33,049                                     | 25.3   | 30,816        | 26.0   | 56,443           | 22.8   | 67,801        | 27.7   |
| Other income and (expense):         |  |        |               |        |                  |        |               |        |
| Interest expense and other          |  |        |               |        | (4)              |        | (3)           |        |
| Interest income and other           | 213  | 0.2    | 88            | 0.1    | 1,330            | 0.5    | 822           | 0.3    |
| Income before income taxes          | 33,262                                     | 25.5   | 30,904        | 26.1   | 57,769           | 23.3   | 68,620        | 28.0   |
| Income tax expense                  | (10,073)                                   | (7.7)  | (10,096)      | (8.5)  | (16,410)         | (6.6)  | (22,326)      | (9.1)  |
| Net income                          | \$ 23,189                                  | 17.8   | \$ 20,808     | 17.6   | \$ 41,359        | 16.7   | \$ 46,294     | 18.9   |

**Three and six months ended June 29, 2013 and June 30, 2012****Product Sales**

Product sales consisted of the following:

|                     | Three Months Ended |               |          | Six Months Ended |               |          |
|---------------------|--------------------|---------------|----------|------------------|---------------|----------|
|                     | June 29, 2013      | June 30, 2012 | % Change | June 29, 2013    | June 30, 2012 | % Change |
|                     | (in thousands)     |               |          | (in thousands)   |               |          |
| Total product sales | \$ 130,479         | \$ 118,659    | 10.0%    | \$ 248,204       | \$ 245,428    | 1.1%     |

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In the second quarter of 2013 as compared to the second quarter of 2012, product sales increased by \$11.8 million or 10%, driven by strong sales volume of our HeartMate II and CentriMag products. HeartMate II contributed approximately \$9.4 million to the increase, driven by unit growth of 9% due primarily to the expansion of our international business, which included the commercial launch in Japan. The CentriMag and PediMag product line contributed approximately \$3.5 million to the increase. The increase was partially offset by a decline of approximately \$1.1 million in sales of the Thoratec product line. From a regional perspective, the U.S. sales contributed approximately \$1.6 million to the increase, while international sales contributed approximately \$10.2 million.

In the first six months of 2013 as compared to the first six months of 2012, product sales increased by \$2.8 million or 1.1%, driven by strong sales volume of our CentriMag products. HeartMate II contributed approximately \$0.6 million to the increase, while the CentriMag and PediMag product line contributed approximately \$5.2 million to the increase. The increase was partially offset by a decline of approximately \$3.0 million in sales of the Thoratec product line. From a regional perspective, U.S. sales declined by approximately \$9.9 million, while international sales increased by approximately \$12.7 million. HeartMate II growth in the United States through the first six months of 2013 remained pressured by the recent launch of a competitive device, a dynamic which we anticipate will continue to affect our results.

There were 167 HeartMate II centers in the U.S. throughout the second quarter of 2013. Outside of the U.S., we added 11 centers during the second quarter of 2013, bringing the international total to 175 centers.



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Sales originating outside of the U.S. and U.S. export sales collectively accounted for approximately 24% and 18% of our total product sales for each of the second quarter of 2013 and the second quarter of 2012, respectively, and approximately 23% and 18% of our total product sales for each of the first six months of 2013 and the first six months of 2012, respectively.

**Gross Profit**

Gross profit and gross margin were as follows:

|                    | Three Months Ended                 |                  | Six Months Ended |                  |
|--------------------|------------------------------------|------------------|------------------|------------------|
|                    | June 29,<br>2013                   | June 30,<br>2012 | June 29,<br>2013 | June 30,<br>2012 |
|                    | (in thousands, except percentages) |                  |                  |                  |
| Total gross profit | \$ 89,479                          | \$ 82,637        | \$ 172,131       | \$ 170,519       |
| Total gross margin | 68.6%                              | 69.6%            | 69.4%            | 69.5%            |

In the second quarter of 2013 as compared to the second quarter of 2012, gross margin decreased by one percentage point, while during the first six months of 2013 as compared to the first six months of 2012, gross margin decreased by one tenth percentage point. This decrease was primarily due to manufacturing variances and the impact of the U.S. medical device excise tax, which we recorded for the first time in 2013, offset in part by lower intangible amortization expenses and the absence of the Levitronix Medical fair market value inventory adjustments in 2013.

**Selling, General and Administrative Expenses**

Selling, general and administrative expenses were as follows:

|  | Three Months Ended |                  |          | Six Months Ended |                  |          |
|--|--------------------|------------------|----------|------------------|------------------|----------|
|  | June 29,<br>2013   | June 30,<br>2012 | % Change | June 29,<br>2013 | June 30,<br>2012 | % Change |
|  | (in thousands)     |                  |          | (in thousands)   |                  |          |
| Total selling, general and administrative expenses | \$ 34,924          | \$ 32,013        | 9.1%     | \$ 69,669        | \$ 63,214        | 10.2%    |

In the second quarter of 2013 as compared to the second quarter of 2012, selling, general and administrative expenses increased by \$2.9 million, while in the first six months of 2013 as compared to the first six months of 2012, selling, general and administrative expenses increased by \$6.5 million. The increases were primarily due to incremental personnel supporting our market development initiatives and the acquisition related expenses for DuraHeart II, offset by reduced consulting expense and the absence of a charge related to the termination of a distributor in 2012.

*Research and Development Expenses*

Research and development expenses were as follows:

|                                | Three Months Ended                 |                                    |          | Six Months Ended                   |                                    |          |
|--------------------------------|------------------------------------|------------------------------------|----------|------------------------------------|------------------------------------|----------|
|                                | June 29,<br>2013<br>(in thousands) | June 30,<br>2012<br>(in thousands) | % Change | June 29,<br>2013<br>(in thousands) | June 30,<br>2012<br>(in thousands) | % Change |
| Total research and development | \$ 21,506                          | \$ 19,808                          | 8.6%     | \$ 46,019                          | \$ 39,504                          | 16.5%    |

Research and development (R&D) expenses are largely project driven, and fluctuate based on the level of project activity planned and subsequently approved and conducted.

In the second quarter of 2013 as compared to the second quarter of 2012, R&D expenses increased by \$1.7 million, while in the first six months of 2013 as compared to the first six months of 2012, R&D expenses increased by \$6.5 million. The increases were due to incremental personnel supporting our next generation product development programs, primarily related to HeartMate III, PHP, and the fully implantable system.

Table of Contents***Interest Income and Other***

Interest income and other consisted of the following:

|                                 | Three Months Ended |                  |          | Six Months Ended |                  |          |
|---------------------------------|--------------------|------------------|----------|------------------|------------------|----------|
|                                 | June 29,<br>2013   | June 30,<br>2012 | % Change | June 29,<br>2013 | June 30,<br>2012 | % Change |
|                                 | (in thousands)     |                  |          | (in thousands)   |                  |          |
| Interest income                 | \$ 222             | \$ 331           | (32.9)%  | \$ 468           | \$ 622           | (24.8)%  |
| Foreign currency, net           | (40)               | (167)            | 76.0%    | 296              | 22               | 1,245.5% |
| Other                           | 31                 | (76)             | 140.8%   | 566              | 178              | 218.0%   |
| Total interest income and other | \$ 213             | \$ 88            |          | \$ 1,330         | \$ 822           |          |

The changes in interest income and foreign currency (net) were not significant. The change in other items was due to the mark-to-market value of our deferred compensation plan assets during the current period.

***Income Taxes***

On January 2, 2013, the U.S. President signed into law The American Taxpayer Relief Act of 2012. This Act extends the research tax credit for two years to December 31, 2013. The extension of the research tax credit is retroactive and includes amounts paid or incurred after December 29, 2011. As a result of the enactment after the Company's 2012 year end, we recognized, in the first quarter of 2013, a benefit of approximately \$1.3 million for qualifying amounts incurred in 2012.

Our effective income tax rates for the three months ended June 29, 2013 and June 30, 2012 were 30.3% and 32.7%, respectively. Our effective income tax rates for the six months ended June 29, 2013 and June 30, 2012 were 28.4% and 32.5%, respectively. The decrease is primarily attributable to the 2012 federal research tax credits, which we recognized in the first quarter of 2013 (in the period of enactment), as well as the 2013 federal research tax credits.

Our effective tax rate is calculated based on the statutory tax rates imposed on projected annual pre-tax income or loss in various jurisdictions. Because changes in our forecasted earnings for 2013 can significantly affect our projected annual effective tax rate, our quarterly tax rate could fluctuate significantly depending on our profitability.

**Liquidity and Capital Resources*****Cash, Cash Equivalents and Investments***

Cash and cash equivalents include highly liquid financial instruments that are readily convertible to cash and have maturities of 90 days or less from the date of purchase.

Investments classified as short-term consist of various financial instruments such as municipal bonds, corporate bonds, variable demand notes, commercial paper and certificate of deposit. Bonds with high credit quality with maturities of greater than 90 days when purchased are classified as short-term available-for-sale investments. Investments classified as long-term consist of our investments in auction rate securities.

Following is a summary of our cash, cash equivalents and investments:

|  | June 29, 2013  | December 29, 2012 |
|--|----------------|-------------------|
|  | (in thousands) |                   |
| Cash and cash equivalents                    | \$ 110,194     | \$ 101,322        |
| Short-term investments                       | 150,506        | 148,426           |
| Long-term investments                        | 10,155         | 10,607            |
| Total cash, cash equivalents and investments | \$ 270,855     | \$ 260,355        |

We believe that cash and cash equivalents, short-term available-for-sale investments on hand and expected cash flows from operations will be sufficient to fund our operations, capital requirements, and share repurchase programs for at least the next 12 months.

Table of Contents**Cash Flow Activities**

|  | June 29, 2013  | June 30, 2012 |
|--|----------------|---------------|
|  | (in thousands) |               |
| Net cash provided by operating activities                    | \$ 36,097      | \$ 74,566     |
| Net cash (used in) provided by investing activities          | (22,599)       | 18,628        |
| Net cash (used in) provided by financing activities          | (4,256)        | 376           |
| Effect of exchange rate changes on cash and cash equivalents | (370)          | (292)         |
| Net increase in cash and cash equivalents                    | 8,872          | 93,278        |

**Cash Provided by Operating Activities**

Cash provided by operating activities in the first six months of 2013 was \$36.1 million and consisted of net income of \$41.4 million, adjustments for non-cash items of \$24.1 million, and cash used in working capital of \$29.4 million. Adjustments for non-cash items primarily consisted of \$13.4 million of stock-based compensation expense and \$9.2 million of depreciation and amortization expense, offset in part by \$1.4 million for excess tax benefits from stock-based compensation. The decrease in cash from the changes in working capital activities primarily consisted of an increase in inventory of \$19.1 million (in part due to the launch of our Pocket Controller this year), offset in part by a decrease in accounts receivable of \$2.1 million from higher collections in the first six months of 2013. Decreases to accounts payable and other liabilities totaling \$13.3 million also contributed to cash used in operating activities.

Cash provided by operating activities in the first six months of 2012 was \$74.6 million and consisted of net income of \$46.3 million, adjustments for non-cash items of \$19.9 million, and cash provided by working capital of \$8.4 million. Adjustments for non-cash items primarily consisted of \$10.5 million of stock-based compensation expense and \$9.7 million of depreciation and amortization expense, offset by \$1.7 million related to deferred income taxes and \$1.7 million for excess tax benefits from stock-based compensation. The increase in cash from changes in working capital activities primarily consisted of a decrease in inventory of \$7.9 million resulting from lower inventory levels, offset by an increase in accounts receivable of \$8.2 million from higher sales in the first six months of 2012. Increases to accounts payable and other liabilities totaling \$8.5 million also contributed to cash in operating activities.

**Cash Provided by (Used in) Investing Activities**

Cash used in investing activities in the first six months of 2013 of \$22.6 million was primarily attributable to purchases of available for sale investments of \$71.5 million, restricted cash of \$13.0 million held in escrow for the anticipated acquisition of the DuraHeart II, as well as capital expenditures of \$5.7 million to support our manufacturing facilities and administration growth, which was offset by the maturities and sales of available for sale investments of \$67.6 million.

Cash provided by investing activities in the first six months of 2012 of \$18.6 million was primarily attributable to the maturities and sales of available for sale investments of \$110.1 million, offset in part by purchases of available for sale investments of \$87.6 million and capital expenditures of \$3.9 million to support our manufacturing facilities and administration growth.

*Cash Provided by (Used in) Financing Activities*

Cash used in financing activities in the first six months of 2013 of \$4.3 million was primarily comprised of \$6.9 million to repurchase vested restricted stock units for settlement of income tax withholding liabilities and \$4.2 million paid in contingent consideration. This amount was offset in part by \$2.9 million of proceeds related to stock option exercises, \$2.5 million of proceeds from stock issued under the employee stock purchase plan, and \$1.4 million from excess tax benefits for share-based compensation.

Cash provided by financing activities in the first six months of 2012 of \$0.4 million was primarily comprised of \$3.7 million of proceeds related to stock option exercises, \$1.9 million of proceeds from stock issued under the employee stock purchase plan, and \$1.7 million from excess tax benefits for share-based compensation. This amount was offset in part by \$0.5 million used to repurchase shares of our common stock under the stock repurchase program, \$4.9 million used to repurchase vested restricted stock units and awards for settlement of income tax withholding liabilities, and \$1.5 million paid in contingent consideration.

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***Stock Repurchase Program***

On November 26, 2012, our Board of Directors authorized the repurchase of up to \$150 million shares of the Company's common stock (November 2012 program). As part of the authorization, the Company entered into an Accelerated Share Repurchase (ASR) agreement with an investment bank, under which we agreed to repurchase an aggregate of \$75.0 million of our common stock. Under the ASR program, we paid \$75.0 million and received an initial delivery of approximately 1.5 million shares, which represented 75% of the ASR program's estimated value at inception. At the maturity of the program in the first quarter of 2013, an additional 0.6 million shares were delivered to the Company. The total value of the shares repurchased by the Company under the ASR program was based on a per share price of \$36.00, representing the volume-weighted average price of our common stock during the repurchase period, less an agreed upon discount. As of June 29, 2013, \$75.0 million is available for repurchases of shares of our common stock under the November 2012 program.

Shares of our common stock purchased that were not part of our publicly announced repurchase programs represent the surrender value of shares of restricted stock awards and units withheld in order to satisfy tax withholding obligations upon vesting. The shares purchased do not reduce the dollar value that may yet be purchased under our publicly announced repurchase programs. The aggregate value of shares purchased during the three and six months ended June 29, 2013 was approximately \$1.1 million and \$6.9 million, respectively. The aggregate value of shares purchased during the three and six months ended June 30, 2012 was approximately \$0.1 million and \$4.9 million, respectively.

**Off Balance Sheet Arrangements**

We maintain an Irrevocable Standby Letter of Credit as part of our workers' compensation insurance program. The Letter of Credit is not collateralized and automatically renews on June 30 of each year, unless terminated by one of the parties. As of June 29, 2013, our Letter of Credit balance was approximately \$0.8 million.

**Credit Facility**

On December 19, 2011, we obtained an unsecured revolving credit facility that provides for up to \$50.0 million in revolving credit that will expire on December 19, 2016. The interest rate charged on the amounts borrowed is LIBOR plus a margin (ranging from 0.75% to 1.25%). The agreement contains financial covenants. We were in compliance with all such covenants as of June 29, 2013. The credit agreement permits us to use the facility for working capital and general corporate purposes. As of June 29, 2013, there were no borrowings under this credit facility.

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**Contractual Obligations**

As of June 29, 2013, the liability for uncertain tax positions was \$10.4 million, including interest and penalties. Due to the high degree of uncertainty regarding the timing of potential future cash flows associated with these liabilities, we are unable to make a reasonably reliable estimate of the amount and period in which these liabilities might be paid.

During the six months ended June 29, 2013, there were no material changes to our contractual obligations reported in our 2012 Annual Report on Form 10-K outside our normal course of business.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

**Interest Rate Risk**

A 50 basis point reduction in interest rates on our investment portfolio and cash equivalents that bear variable interest would have an immaterial impact to interest income on the consolidated statements of operations. In addition, if interest rates were to rise, the market value of our investment portfolio would decline, which could result in a loss if we were to choose or be forced to sell an investment before its scheduled maturity. If interest rates were to rise or fall from current levels by 100 basis points, the change in our net unrealized loss on our short and long-term investments would be \$1.0 million. We do not utilize derivative financial instruments to manage interest rate risks.

**Foreign Currency Rate Fluctuations**

The fair value of our forward currency-exchange contracts is sensitive to changes in currency exchange rates and is estimated based on the amount that we would pay or receive upon termination of the contracts, taking into account the change in currency exchange rates. A 10% directional change in the non-functional currency exchange rates as of June 29, 2013 related to our contracts would result in an increase in the unrealized gain or loss on forward currency-exchange contracts of \$7.8 million. The unrealized gains or losses on forward currency-exchange contracts resulting from changes in currency exchange rates are expected to approximately offset losses or gains on the currency exposures resulting from our operations.

**ITEM 4. CONTROLS AND PROCEDURES**

Attached as exhibits to this Form 10-Q are certifications of our Chief Executive Officer and Chief Financial Officer, which are required in accordance with Rule 13a-14 of the Securities Exchange Act of 1934, as amended (the Exchange Act ). This Controls and Procedures section includes information concerning the controls and controls evaluation referred to in the certifications.



*Disclosure Controls and Procedures*

An evaluation was performed under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rule 13a-15(e) under the Exchange Act, as of June 29, 2013. The evaluation of our disclosure controls and procedures included a review of our processes and implementation and the effect on the information generated for use in this Quarterly Report on Form 10-Q. In the course of this evaluation, we sought to identify any significant deficiencies or material weaknesses in our disclosure controls and procedures, to determine whether we had identified any acts of fraud involving personnel who have a significant role in our disclosure controls and procedures, and to confirm that necessary corrective action, including process improvements, was taken. This type of evaluation is done quarterly so that our conclusions concerning the effectiveness of these controls can be reported in our periodic reports filed with the SEC. The overall goals of these evaluation activities are to monitor our disclosure controls and procedures and to make modifications as necessary. We intend to maintain these disclosure controls and procedures, modifying them as circumstances warrant.

Based on that evaluation, our management, including the Chief Executive Officer and Chief Financial Officer, concluded that as of June 29, 2013 the Company's disclosure controls and procedures, as defined in Rule 13a-15(e) under the Exchange Act, were effective to provide reasonable assurance that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms, and to provide reasonable assurance that such information is accumulated and communicated to our management, including our principal executive officer, as appropriate to allow timely decisions regarding required disclosures.

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***Changes in Internal Control over Financial Reporting***

There have been no changes in our internal controls over financial reporting during the three months ended June 29, 2013 that have materially affected or are reasonably likely to materially affect our internal control over financial reporting.

***Inherent Limitations on Controls and Procedures***

Our management, including the Chief Executive Officer and the Chief Financial Officer, does not expect that our disclosure controls and procedures and our internal controls will prevent all error and all fraud. A control system, no matter how well designed and operated, can only provide reasonable assurances that the objectives of the control system are met. The design of a control system reflects resource constraints; the benefits of controls must be considered relative to their costs. Because there are inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been or will be detected. As these inherent limitations are known features of the financial reporting process, it is possible to design into the process safeguards to reduce, though not eliminate, these risks. These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns occur because of simple error or mistake. Controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of any system of controls is based in part upon certain assumptions about the likelihood of future events. While our disclosure controls and procedures are designed to provide reasonable assurance of achieving their objectives, there can be no assurance that any design will succeed in achieving its stated goals under all future conditions. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with the policies or procedures. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

We intend to review and evaluate the design and effectiveness of our disclosure controls and procedures on an ongoing basis and to improve our controls and procedures over time and to correct any deficiencies that we may discover in the future. While our Chief Executive Officer and Chief Financial Officer have concluded that, as of June 29, 2013, the design of our disclosure controls and procedures, as defined in Rule 13a-15(e) under the Exchange Act, was effective, future events affecting our business may cause us to significantly modify our disclosure controls and procedures.

**PART II. OTHER INFORMATION**

**ITEM 1: LEGAL PROCEEDINGS**

From time to time we are involved in litigation arising out of claims in the normal course of business. Based on the information presently available, management believes that there are no claims or actions pending or threatened against us, the ultimate resolution of which will have a material effect on our financial position, liquidity or results of operations, although the results of litigation are inherently uncertain.

**ITEM 1A. RISK FACTORS**

You should carefully consider the factors discussed in Part I, Item 1A. Risk Factors in our 2012 Annual Report on Form 10-K, which could materially affect our business, financial condition or future operating results. The risks described in our 2012 Annual Report on Form 10-K are not the only risks facing us. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

Table of Contents**ITEM 2. UNREGISTERED SALE OF EQUITY SECURITIES AND USE OF PROCEEDS**

There were no unregistered sales of our equity securities during the three months ended June 29, 2013.

The following table sets forth certain information about our common stock repurchased during the three months ended June 29, 2013:

|                                  | <b>Total number<br/>of shares<br/>purchased(1)</b> | <b>Average price<br/>paid per share</b> | <b>Total number<br/>of shares<br/>purchased<br/>as part of<br/>publicly<br/>announced plans or<br/>programs(2)</b> | <b>Approximate dollar<br/>value (in \$000) of<br/>shares<br/>that may yet be<br/>purchased under<br/>the plans or<br/>programs(2)</b> |
|----------------------------------|--|---|--|---|
| March 31, 2013 to April 30, 2013 | 7,691  | \$ 36.95                                |  | \$ 75,000   |
| May 1, 2013 to May 31, 2013      | 21,184   | \$ 33.60                                |  | \$ 75,000   |
| June 1, 2013 to June 29, 2013    | 2,818  | \$ 32.06                                |  | \$ 75,000   |
| Total                            | 31,693   | \$ 34.28                                |  | \$ 75,000   |

On November 26, 2012, we announced that the Board of Directors had authorized the repurchase of up to \$150 million of the Company's shares of common stock ( November 2012 program ). As part of the authorization, the Company entered into a \$75.0 million Accelerated Share Repurchase ( ASR ) agreement with an investment bank, which began immediately. Under the ASR agreement, we received an initial delivery of 1,479,095 shares, which represented 75% of the ASR program's estimated value at inception. At the maturity of the ASR program in the first quarter of 2013, we received an additional 603,995 shares. The total number of the shares repurchased by the Company under the ASR program was based on a per share price of \$36.00, representing the volume-weighted average price of our common stock during the repurchase period, less an agreed upon discount. The balance of the authorization allows us to acquire shares in the open market or in privately negotiated transactions prior to the program's expiration date.

(1) Shares purchased that were not part of our publicly announced repurchase programs represent the surrender value of shares of restricted stock awards and restricted stock units used to pay income taxes due upon vesting, and do not reduce the dollar value that may yet be purchased under our publicly announced repurchase programs.

(2) Cumulative amounts through each respective month ending in 2013.

**ITEM 6. EXHIBITS**

31.1 Section 302 Certification of Chief Executive Officer.

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31.2 Section 302 Certification of Chief Financial Officer.

32.1 Section 906 Certification of Chief Executive Officer.

32.2 Section 906 Certification of Chief Financial Officer.

101 The following materials from Registrant's Quarterly Report on Form 10-Q for the six months ended June 29, 2013, formatted in Extensible Business Reporting Language (XBRL) includes: (i) Unaudited Condensed Consolidated Balance Sheets as of June 29, 2013 and December 29, 2012, (ii) Unaudited Condensed Consolidated Statements of Operations for the Three and Six Months Ended June 29, 2013 and June 30, 2012, (iii) Unaudited Condensed Consolidated Statements of Comprehensive Income for the Three and Six Months Ended June 29, 2013 and June 30, 2012, (iv) Unaudited Condensed Consolidated Statements of Cash Flows for the Six Months Ended June 29, 2013 and June 30, 2012, and (v) Notes to Unaudited Condensed Consolidated Financial Statements.

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

THORATEC CORPORATION

Date: August 1, 2013

/s/ Gerhard F. Burbach  
Gerhard F. Burbach  
Chief Executive Officer

Date: August 1, 2013

/s/ Taylor C. Harris  
Taylor C. Harris  
Chief Financial Officer and Principal Accounting Officer