

THORATEC CORP  
Form 10-Q  
August 07, 2014  
[Table of Contents](#)

**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 28, 2014

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**

Edgar Filing: THORATEC CORP - Form 10-Q

(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 x

Accelerated filer o

Non-accelerated filer o  
(Do not check if smaller reporting company)

Smaller reporting company o

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 25, 2014, the registrant had 56.3 million shares of common stock outstanding.

Table of Contents

**THORATEC CORPORATION**

**TABLE OF CONTENTS**

<u>Part I. Financial Information</u>	3
<u>Item 1. Unaudited Condensed Consolidated Financial Statements</u>	3
<u>Condensed Consolidated Balance Sheets as of June 28, 2014 and December 28, 2013</u>	3
<u>Condensed Consolidated Statements of Operations for the Three and Six Months Ended June 28, 2014 and June 29, 2013</u>	4
<u>Condensed Consolidated Statements of Comprehensive Income for the Three and Six Months Ended June 28, 2014 and June 29, 2013</u>	5
<u>Condensed Consolidated Statements of Cash Flows for the Six Months Ended June 28, 2014 and June 29, 2013</u>	6
<u>Notes to Unaudited Condensed Consolidated Financial Statements</u>	7
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	20
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	27
<u>Item 4. Controls and Procedures</u>	27
<u>Part II. Other Information</u>	28
<u>Item 1. Legal Proceedings</u>	28
<u>Item 1A. Risk Factors</u>	28
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	29
<u>Item 6. Exhibits</u>	30
<u>Signatures</u>	31
<u>Exhibits</u>	
EX-3.1	
<u>EX-3.2</u>	
EX-31.1	
EX-31.2	
EX-32.1	
EX-32.2	
EX-101 INSTANCE DOCUMENT	
EX-101 SCHEMA DOCUMENT	
EX-101 CALCULATION LINKBASE DOCUMENT	
EX-101 DEFINITION LINKBASE DOCUMENT	
EX-101 LABELS LINKBASE DOCUMENT	
EX-101 PRESENTATION LINKBASE DOCUMENT	

Thoratec, the Thoratec logo, Thoralon, HeartMate, HeartMate II, IVAD, PVAD, and Pocket Controller are registered trademarks or trademarks of Thoratec Corporation, in the United States and/or other jurisdictions.

CentriMag and PediMag are registered trademarks of Thoratec LLC and PediVAS is a registered trademark of Thoratec Switzerland GmbH.

DuraHeart is a registered trademark of Terumo Corporation.

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

	<b>June 28, 2014</b>	<b>December 28, 2013</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 134,729	\$ 139,099
Short-term available-for-sale investments	156,472	166,691
Receivables, net of allowances of \$1,976 in 2014 and \$2,163 in 2013	68,648	71,418
Inventories	67,367	60,293
Deferred tax assets	15,161	15,161
Income tax receivable	12,353	5,733
Prepaid expenses and other assets	7,335	7,272
Total current assets	462,065	465,667
Property, plant and equipment, net	55,970	55,163
Goodwill	205,955	205,764
Purchased intangible assets, net	32,602	36,403
Long-term available-for-sale investments	4,270	4,234
Other long-term assets	25,385	24,476
Total Assets	\$ 786,247	\$ 791,707
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 18,239	\$ 17,599
Accrued compensation	14,338	22,759
Contingent liabilities, current portion	9,750	6,962
Other accrued liabilities	26,912	27,001
Total current liabilities	69,239	74,321
Long-term deferred tax liability	1,793	2,224
Other long-term liabilities	12,779	12,105
Contingent liabilities, non-current portion (Note 2)	25,198	36,384
Total Liabilities	109,009	125,034
Shareholders' equity:		
Common shares: no par, authorized 100,000; issued and outstanding 56,332 in 2014 and 56,904 in 2013		
Additional paid-in-capital	626,501	621,589
Retained earnings	63,969	57,587
Accumulated other comprehensive loss:	(13,232)	(12,503)
Total Shareholders' Equity	677,238	666,673
Total Liabilities and Shareholders' Equity	\$ 786,247	\$ 791,707

Edgar Filing: THORATEC CORP - Form 10-Q

See notes to the unaudited condensed consolidated financial statements.

Table of Contents

**THORATEC CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

(unaudited)

(in thousands, except per share data)

	Three Months Ended		Six Months Ended	
	June 28, 2014	June 29, 2013	June 28, 2014	June 29, 2013
Product sales	\$ 118,063	\$ 130,479	\$ 243,760	\$ 248,204
Cost of product sales	34,307	41,000	74,333	76,073
Gross profit	83,756	89,479	169,427	172,131
Operating expenses:				
Selling, general and administrative	35,477	34,924	70,978	69,669
Research and development	23,048	21,506	46,387	46,019
Total operating expenses	58,525	56,430	117,365	115,688
Income from operations	25,231	33,049	52,062	56,443
Other income and (expense):				
Interest expense and other	(2)		(2)	(4)
Interest income and other	559	213	806	1,330
Income before income taxes	25,788	33,262	52,866	57,769
Income tax expense	(8,375)	(10,073)	(17,214)	(16,410)
Net income	\$ 17,413	\$ 23,189	\$ 35,652	\$ 41,359
Net Income per share:				
Basic	\$ 0.31	\$ 0.40	\$ 0.63	\$ 0.72
Diluted	\$ 0.30	\$ 0.40	\$ 0.62	\$ 0.71
Shares used to compute income per share:				
Basic	56,723	57,429	56,781	57,457
Diluted	57,188	58,120	57,538	58,398

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 28, 2014</b>	<b>June 29, 2013</b>	<b>June 28, 2014</b>	<b>June 29, 2013</b>
Net income	\$ 17,413	\$ 23,189	\$ 35,652	\$ 41,359
Unrealized gains (losses) on investments (net of taxes (benefits) of \$(2) and \$(142) for the three months ended June 28, 2014 and June 29, 2013, respectively, and \$(284) and \$5 for the six months ended June 28, 2014 and June 29, 2013, respectively)	4	(225)	(1,407)	(7)
Foreign currency translation adjustments	(781)	612	678	(1,676)
Total other comprehensive income (loss)	(777)	387	(729)	(1,683)
Comprehensive income	\$ 16,636	\$ 23,576	\$ 34,923	\$ 39,676

See notes to the unaudited condensed consolidated financial statements.

Table of Contents

## THORATEC CORPORATION

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)

(in thousands)

	Six Months Ended	
	June 28, 2014	June 29, 2013
<b>Cash flows from operating activities:</b>		
Net Income	\$ 35,652	\$ 41,359
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	8,207	9,175
Investment premium amortization, net	2,176	1,750
Allowance for (reduction in) bad debt	(995)	201
Non-cash interest income (expense) and other	232	(532)
Tax benefit related to stock options	875	1,351
Change in fair value of contingent consideration	(1,436)	
Share-based compensation expense	14,615	13,372
Excess tax benefits from share-based compensation	(989)	(1,424)
Loss on disposal of assets	613	88
Change in net deferred tax liability	(226)	120
Changes in assets and liabilities:		
Receivables	3,697	2,146
Inventories	(8,104)	(19,136)
Other current and non-current assets	559	920
Accounts payable	1,167	(326)
Income taxes, net	(7,410)	(3,807)
Other current and non-current liabilities	(7,799)	(9,160)
Net cash provided by operating activities	40,834	36,097
<b>Cash flows from investing activities:</b>		
Purchases of available-for-sale investments	(86,877)	(71,506)
Sales and maturities of available-for-sale investments	94,232	67,587
Purchases of property, plant and equipment	(5,330)	(5,680)
Long-term restricted cash		(13,000)
Note receivable from Apica (Note 14)	(2,019)	
Net cash provided by (used in) investing activities	6	(22,599)
<b>Cash flows from financing activities:</b>		
Payment of contingent consideration	(6,107)	(4,220)
Proceeds from stock option exercises	2,867	2,893
Proceeds from stock issued under employee stock purchase plan	2,800	2,536
Excess tax benefits from share-based compensation	989	1,424
Repurchase and retirement of common shares	(46,030)	(6,889)
Net cash used in financing activities	(45,481)	(4,256)
Effect of exchange rate changes on cash and cash equivalents	271	(370)
Net increase (decrease) in cash and cash equivalents	(4,370)	8,872
Net cash and cash equivalents at beginning of period	139,099	101,322



Edgar Filing: THORATEC CORP - Form 10-Q

Net cash and cash equivalents at end of period	\$	134,729	\$	110,194
<b>Supplemental disclosure of consolidated cash flow information:</b>				
Cash paid for taxes	\$	24,206	\$	18,696
<b>Supplemental disclosure of consolidated non-cash investing and financing activities:</b>				
Transfers of equipment from inventory	\$	1,012	\$	1,152
Repurchases and retirement of common shares through other accrued liabilities	\$	2,266	\$	
Purchases of property, plant and equipment through accounts payable and accrued liabilities	\$	583	\$	279

See notes to the unaudited condensed consolidated financial statements.

Table of Contents

**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 2013 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 28, 2013 (the 2013 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.

***Recent Accounting Pronouncement***

In May 2014, the Financial Accounting Standards Board issued Accounting Standard Update ( ASU ) No. 2014-09, *Revenue from Contracts with Customers* (Topic 606), which provides guidance for revenue recognition. This ASU affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of non-financial assets. The guidance in this ASU supersedes the revenue recognition requirements in Topic 605, *Revenue Recognition*, and most industry-specific guidance. This ASU also supersedes some cost guidance included in Subtopic 605-35, *Revenue Recognition-Construction-Type and Production-Type Contracts*. The standard will be effective for the Company starting in fiscal 2017. We have not yet evaluated the impact of the adoption of this accounting standard update on our condensed consolidated financial statements.

**Note 2. Acquisition**

**Acquisition of DuraHeart II**

On June 30, 2013 ( acquisition date ), we acquired certain assets (the Purchased Assets ) and assumed certain liabilities from Terumo Corporation ( Terumo ) related to the DuraHeart II Left Ventricular Assist System product line ( DuraHeart II ) previously under development by Terumo. Under the terms of the acquisition, we made an upfront cash payment to Terumo of \$13.0 million, and will be obligated to make potential future milestone payments, based on regulatory approvals and product sales, of up to \$43.5 million. Terumo also maintains the right to repurchase the Purchased Assets in the event that we do not fulfill certain conditions at various dates. As part of the agreement, we hired a team of Terumo employees. Additionally, we entered into a distribution partnership with Terumo, in which Terumo will commercialize DuraHeart II in Japan and potentially other parts of Asia, if and when local regulatory approvals are obtained.

We accounted for the DuraHeart II acquisition as a business combination. In connection with the acquisition, we recorded \$2.0 million of acquisition-related costs, which were recognized in our consolidated statement of operations in fiscal 2013 within operating expenses. We also recorded \$9.9 million of goodwill, equal to the amount by which the purchase consideration exceeded the fair value of the Purchased Assets. This goodwill was allocated to our sole operating segment and is deductible for U.S. income tax purposes. We will be obligated to pay potential post-closing cash milestone payments of \$5.5 million and \$10.5 million upon Conformité Européene ( CE ) Mark approval in Europe and U.S. Food and Drug Administration ( FDA ) approval, respectively, for the DuraHeart II device currently under development (collectively referred to as the regulatory milestones ). Additional milestone payments totaling \$27.5 million will become payable by us upon reaching various commercial sale milestones after the regulatory approvals are obtained (referred to as the commercial sales milestones ). The fair value of the combined contingent consideration due upon achievement of the regulatory milestones and the commercial sales milestones was estimated to be \$18.8 million at the acquisition date and has been recorded as a non-current liability, because such contingent consideration is expected to be settled no earlier than 2016.

Table of Contents

Total purchase price consideration was estimated as follows (in thousands):

Cash paid at the acquisition closing date (June 30, 2013)	\$	13,000
Estimated fair value of contingent consideration		18,800
Total estimated purchase price	\$	31,800

We determined the initial fair value of the contingent consideration in connection with the regulatory and commercial sales milestones using various estimates, including probabilities of success, discount rates and the estimated amount of time until the conditions of the milestone payments are met. This fair value measurement was based on significant inputs not observable in the market, representing a Level 3 measurement within the fair value hierarchy (see Note 3 for more information about fair value measurements). The key assumptions used to determine the fair value of the contingent consideration at the acquisition date in connection with the regulatory milestones included a discount rate and probability-adjusted milestone payment date ranges. The key assumptions used to determine the fair value of contingent consideration at the acquisition date in connection with the commercial sales milestones included a discount rate and probability-weighted expected milestone payment date ranges based on the aggregate number of commercial units sold. The fair value of this contingent consideration is remeasured at the end of each reporting period with the change in fair value recorded within operating expense in our condensed consolidated statements of operations. In the six months ended June 28, 2014, the fair value of the contingent consideration decreased by \$3.2 million as a result of changes in the probabilities of possible outcomes, offset by accretion expense associated with the passage of time. The decrease was reported as research and development expense and selling, general and administrative expense totaling \$2.2 million and \$1.0 million, respectively, in the condensed consolidated statement of operations for the six months ended June 28, 2014.

Purchase Price Allocation as of the acquisition date is summarized as follows (in thousands):

Property, plant and equipment	\$	8,900
Identifiable intangible assets:		
Favorable lease contract		600
IPR&D asset		12,400
Goodwill		9,900
Total estimated purchase price consideration		31,800
Less: Contingent consideration		18,800
Cash paid at the acquisition closing	\$	13,000

We recorded an IPR&D asset of \$12.4 million, which represents an estimate of the fair value of the in-process technology related to the DuraHeart II device. The fair value of the IPR&D asset was determined using the multi-period excess earnings method, which is equal to the present value of the incremental after-tax cash flows attributable to that intangible asset, discounted based on our best estimate of a market participant's after-tax weighted average cost of capital.

We recorded equipment totaling \$8.9 million based on the fair value at the acquisition date. Of that amount, \$8.1 million is related to certain equipment that is expected to be primarily used in the production of DuraHeart II units in anticipation of future clinical trials and throughout the commercialization of the product. Depreciation will commence upon production of the DuraHeart II units.

The following pro forma information presents the combined results of operations for the six months ended June 29, 2013 as if we had completed the DuraHeart II acquisition at the beginning of 2012. The pro forma financial information is provided for comparative purposes only and is not

## Edgar Filing: THORATEC CORP - Form 10-Q

necessarily indicative of what actual results would have been had the acquisition occurred on the date indicated, nor does it give effect to synergies, cost savings, fair market value adjustments, immaterial depreciation expense and other changes expected to result from the acquisition. Accordingly, the pro forma financial results do not purport to be indicative of condensed consolidated results of operations as of June 29, 2013, for any period ended on June 29, 2013, or for any other future date or period.

		<b>Six months Ended June 29, 2013</b>
Product sales	\$	248,204
Income before taxes		42,392
Net income		30,350

Table of Contents**Note 3. 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, asset-backed securities, auction rate securities ( ARS ), forward contracts, certain investments held as assets under the deferred compensation plan, marketable equity securities and the contingent consideration in connection with acquisitions. 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 we have 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

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 2014 or first six months of 2013.

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

	<b>Total Fair Value</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
		(in thousands)		
<b>As of June 28, 2014:</b>				
Cash equivalents:				
Money market funds	\$ 87,209	\$ 87,209	\$	\$
Commercial paper	4,100		4,100	
Municipal bonds	1,531		1,531	
Short-term investments:				
Municipal bonds	132,926		132,926	
Asset-backed securities	3,150		3,150	
Corporate bonds	14,698		14,698	
Commercial paper	3,698		3,698	
Certificate of deposit	2,000		2,000	
Prepaid expenses and other assets:				
Foreign exchange contracts	1,134		1,134	
Long-term investments:				

Edgar Filing: THORATEC CORP - Form 10-Q

Auction rate securities	4,270			4,270
Other long-term assets:				
Investments included in our deferred compensation plan	2,177		2,177	
Marketable equity securities	2,341	2,341		
Other accrued liabilities:				
Foreign exchange contracts	487		487	
Contingent consideration (current and non-current portions)	\$ 34,948	\$	\$	\$ 34,948

	Total Fair Value	Level 1 (in thousands)	Level 2	Level 3
<b>As of December 28, 2013:</b>				
Cash equivalents:				
Money market funds	\$ 97,200	\$ 97,200	\$	\$
Commercial paper	13,899		13,899	
Short-term investments:				
Municipal bonds	142,486		142,486	
Variable demand notes	6,700		6,700	
Corporate bonds	5,507		5,507	
Commercial paper	9,998		9,998	
Certificate of deposit	2,000		2,000	
Prepaid expenses and other assets:				
Foreign exchange contracts	592		592	
Long-term investments:				
Auction rate securities	4,234			4,234
Other long-term assets:				
Investments included in our deferred compensation plan	1,700		1,700	
Marketable equity securities	4,019	4,019		
Other accrued liabilities:				
Foreign exchange contracts	156		156	
Contingent consideration (current and non-current portions)	\$ 43,346	\$	\$	\$ 43,346

Table of Contents

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.

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. These available-for-sale debt 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 ARS.

**Contingent consideration** The fair value of the contingent consideration related to 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, using various revenue assumptions and applying a probability to each outcome. The fair value of the contingent consideration is remeasured at the end of each reporting period with the change in fair value recorded within operating expense in our condensed 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. Refer to Note 2 for a discussion of the fair value of the contingent consideration associated with the DuraHeart II acquisition.

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

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(in thousands)			
<b>As of June 28, 2014:</b>				
Short-term investments:				
Municipal bonds	\$ 132,792	\$ 137	\$ (3)	\$ 132,926
Corporate bonds	14,712	3	(17)	14,698
Commercial paper	3,698			3,698
Asset-backed securities	3,149	1		3,150
Certificate of deposit	2,000			2,000
Total short-term investments	\$ 156,351	\$ 141	\$ (20)	\$ 156,472
Long-term investments:				
Auction rate securities	\$ 4,900		\$ (630)	\$ 4,270
Other long-term assets:				
Marketable equity securities	2,996		(655)	2,341
Total long-term	\$ 7,896		\$ (1,285)	\$ 6,611
<b>As of December 28, 2013:</b>				
Short-term investments:				



Edgar Filing: THORATEC CORP - Form 10-Q

Municipal bonds	\$	142,321	\$	178	\$	(13)	\$	142,486
Variable demand notes		6,700						6,700
Corporate bonds		5,500		7				5,507
Commercial paper		9,998						9,998
Certificate of deposit		2,000						2,000
Total short-term investments	\$	166,519	\$	185	\$	(13)	\$	166,691
Long-term investments:								
Auction rate securities	\$	4,900	\$		\$	(666)	\$	4,234
Other long-term assets:								
Marketable equity securities		2,996		1,023				4,019
Total long-term	\$	7,896	\$	1,023	\$	(666)	\$	8,253

Table of Contents

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 as of June 28, 2014 and December 28, 2013 was \$5.9 million and \$5.2 million, respectively. The unrealized gain before tax from the change in the value of the deferred compensation plan was not significant during the first six months of 2014 or first six months of 2013.

The amortized cost and fair value of available-for-sale debt investments, by contractual maturity, were as follows as of June 28, 2014:

	Amortized Cost		Fair Value
	(in thousands)		
Maturing within 1 year	\$	121,566	\$ 121,646
Maturing after 1 year through 5 years		34,785	34,826
Short-term available-for-sale investments		156,351	156,472
Maturing after 5 years		4,900	4,270
	\$	161,251	\$ 160,742

The following table provides a roll forward of the fair value, as determined by Level 3 inputs, of the ARS during the first six months of 2014:

	Auction Rate Securities (in thousands)
Balance as of December 28, 2013	\$ 4,234
Unrealized holding gain on auction rate securities, included in other comprehensive income (loss)	36
Balance as of June 28, 2014	\$ 4,270

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 2014:

	Contingent Consideration (in thousands)
Balance as of December 28, 2013	\$ 43,346
Payments	(6,962)
Change in fair value	(1,436)
Balance as of June 28, 2014	\$ 34,948

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 28, 2014:

Edgar Filing: THORATEC CORP - Form 10-Q

	Fair Value at June 28, 2014 (in thousands)	Valuation Methodology	Significant Unobservable Input	Weighted Average (range, if applicable)
Auction rate securities	\$ 4,270	Discounted cash flow	Discount rate	1.64%
			Market credit spread	2.34%
			Liquidity factor	0.36%
Levitronix Medical Contingent consideration	\$ 17,040	Multiple outcome discounted cash flow	Annual Revenue	\$34.5 million to \$51.4 million
			Discount rate	0.98%
			Probability of occurrence	10% to 75%
DuraHeart II Contingent consideration	\$ 17,908	Multiple outcome discounted cash flow	Milestone dates	2016 to 2030
			Discount rate	5.3% to 17.0%
			Probability of occurrence	5% to 80%

Table of Contents

*Auction Rate Securities*

The significant unobservable inputs used in the fair value measurement of ARS 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 ARS 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*

The estimated fair value of the liability for contingent consideration represents revenue and milestone targets related to our Levitronix Medical and DuraHeart II acquisitions, respectively. The fair value of the liability is determined using a discounted cash flow methodology with significant inputs that include projected revenue, discount rate and percentage probability of occurrence for the Levitronix Medical contingent consideration; and regulatory milestone targets, commercial milestones targets, discount rate and percent probability of occurrence of these milestones for the DuraHeart II contingent consideration. A significant increase (decrease) in the projected revenue in isolation could result in a significantly higher (lower) fair value measurement; a significant delay (acceleration) in the projected regulatory milestone achievement date in isolation could result in a significantly lower (higher) 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 significant change in 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 regulatory, research and development, operations, finance and accounting groups. Potential valuation adjustments are made as additional information becomes available, including the progress toward achieving revenue and milestone 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 statements of operations. During the first six months of 2014, we recorded remeasurement adjustments to decrease the DuraHeart II contingent consideration by \$3.2 million (reductions of research and development expense of \$1.0 million and selling, general and administrative expense of \$2.2 million) as a result of changes to certain underlying assumptions, the probabilities of possible outcomes and accretion expense associated with the passage of time. During the first six months of 2014, we recorded remeasurement adjustments to increase the Levitronix contingent consideration by \$1.7 million (reported in selling, general and administrative expense) as a result of changes in the probabilities of possible outcome.

*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 an 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 either the six months ended June 28, 2014 or June 29, 2013.

**Note 4. 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.

Table of Contents

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

	June 28, 2014		December 28, 2013	
Forward contracts:				
Euro (sell)		22.7 million		20.2 million
British Pound Sterling (sell)	£	1.3 million	£	1.3 million
U.S. Dollar (sell)	\$	8.5 million	\$	23.5 million
U.S. Dollar (buy)	\$	58.5 million	\$	60.0 million

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

	As of June 28, 2014		As of December 28, 2013	
	Prepaid expenses and other assets	Other accrued liabilities	Prepaid expenses and other assets	Other accrued liabilities
	(in thousands)			
Derivatives not designated as hedging instruments (forward contracts)	\$ 1,134	\$ 487	\$ 592	\$ 156

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 28, 2014	June 29, 2013	June 28, 2014	June 29, 2013
	(in thousands)			
Foreign currency exchange gain (loss) on foreign contracts	\$ (420)	\$ (1,477)	\$ (67)	\$ 1,304
Foreign currency transactions gain (loss)	291	1,437	(119)	(1,008)

**Note 5. 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:

	June 28, 2014	December 28, 2013
	(in thousands)	
Finished goods	\$ 28,655	\$ 22,885
Work in process	14,686	13,739

Edgar Filing: THORATEC CORP - Form 10-Q

Raw materials		24,026		23,669
Total	\$	67,367	\$	60,293

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

		June 28, 2014		December 28, 2013
		(in thousands)		
Land, building and improvements	\$	20,594	\$	20,594
Equipment and capitalized software		63,256		61,383
Furniture and leasehold improvements		25,048		22,458
Total		108,898		104,435
Less accumulated depreciation		(52,928)		(49,272)
Total	\$	55,970	\$	55,163

As of June 28, 2014, we have \$7.6 million of equipment that have not yet been placed in service (included in the Equipment and capitalized software line in the table above) from the DuraHeart II acquisition.

Depreciation expense was \$2.3 million and \$4.4 million for the three and six months ended June 28, 2014, respectively, and \$2.2 million and \$4.1 million for the three and six months ended June 29, 2013, respectively.

Table of Contents

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 28, 2014 and June 29, 2013 were as follows:

	June 28, 2014		June 29, 2013	
	(in thousands)			
Balance, beginning of the period	\$	9,899	\$	2,212
Additions		1,710		420
Settlements		(2,258)		(945)
Balance, end of the period	\$	9,351	\$	1,687

The increased level of warranty activity in the first six months of 2014 as compared to the prior period was due to new warranty additions and settlements related to sales of our HeartMate II Pocket Controller, which was introduced in 2013.

Changes in Accumulated other comprehensive loss by component during the six months ended June 28, 2014:

	Foreign currency items (A)		Unrealized gain (loss) on available-for-sale securities (A)		Total	
	(in thousands)					
Balance as of December 28, 2013	\$	(13,039)	\$	536	\$	(12,503)
Other comprehensive loss before reclassification		678		(1,407)		(729)
Net current period other comprehensive loss		678		(1,407)		(729)
Balance as of June 28, 2014	\$	(12,361)	\$	(871)	\$	(13,232)

(A) All amounts are net of tax.

**Note 6. Goodwill and Purchased Intangible Assets, net**

The carrying amount of goodwill and the changes in the balance for the six months ended June 28, 2014 were as follows (in thousands):

Balance as of December 28, 2013	\$	205,764
Foreign currency translation impact		191
Balance as of June 28, 2014	\$	205,955

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



Edgar Filing: THORATEC CORP - Form 10-Q

	Gross Amount	As of June 28, 2014		Net Amount
		Accumulated Amortization	Accumulated Impairment	
(in thousands)				
<u>Intangible assets subject to amortization:</u>				
Patents and trademarks	\$ 43,532	\$ (35,347)	\$	\$ 8,185
Core technology	37,180	(23,420)	(12,642)	1,118
Developed technology	128,073	(83,094)	(37,600)	7,379
Pre-existing license agreement	2,300	(958)		1,342
Customer based relationships and other	7,246	(4,988)		2,258
Foreign currency translation impact	(80)			(80)
	218,251	(147,807)	(50,242)	20,202
<u>Intangible assets not yet subject to amortization:</u>				
IPR&D (see Note 2)	12,400			12,400
Total purchased intangible assets	\$ 230,651	\$ (147,807)	\$ (50,242)	\$ 32,602

	Gross Amount	As of December 28, 2013		Net Amount
		Accumulated Amortization	Accumulated Impairment	
(in thousands)				
<u>Intangible assets subject to amortization:</u>				
Patents and trademarks	\$ 43,532	\$ (34,755)	\$	\$ 8,777
Core technology	37,180	(22,986)	(12,642)	1,552
Developed technology	128,073	(81,635)	(37,600)	8,838
Pre-existing license agreement	2,300	(794)		1,506
Customer based relationships and other	7,246	(4,043)		3,203
Foreign currency translation impact	127			127
	218,458	(144,213)	(50,242)	24,003
<u>Intangible assets not yet subject to amortization:</u>				
IPR&D (see Note 2)	12,400			12,400
Total purchased intangible assets	\$ 230,858	\$ (144,213)	\$ (50,242)	\$ 36,403

Table of Contents

Amortization expense related to identifiable intangible assets was \$1.9 million and \$3.8 million for the three and six months ended June 28, 2014, respectively, and \$2.6 million and \$5.1 million for the three and six months ended June 29, 2013, respectively.

Estimated amortization expenses for the next five fiscal years and all years thereafter, excluding intangible assets not yet subject to amortization are as follows:

	(in thousands)	
<b>Fiscal year:</b>		
Remainder of 2014	\$	3,392
2015		4,745
2016		3,445
2017		2,569
2018		2,153
Thereafter		3,898
Total	\$	20,202

**Note 7. Credit Facility**

On December 19, 2011, we signed an unsecured revolving credit facility agreement that provides for up to \$50.0 million 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 with which we were in compliance as of June 28, 2014. The credit agreement permits us to use the facility for working capital and general corporate purposes. We did not have any borrowings under this credit facility during the six months ended June 28, 2014 or June 29, 2013.

**Note 8. Legal Proceeding**

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.

On January 24, 2014, we and three of our present and former officers were named as defendants in a complaint filed in the United States District Court for the Northern District of California. The action, entitled Cooper v. Thoratec Corp., Case No. 4:14-cv-00360, is a putative class action brought on behalf of purchasers of our securities between April 29, 2010, and November 27, 2013, inclusive (the Class Period), and alleges violations of Section 10(b) of the Securities Exchange Act of 1934 (the Exchange Act), and Rule 10b-5 promulgated thereunder, as well as Section 20(a) of the Exchange Act. On April 21, 2014, the Court appointed Bradley Cooper as Lead Plaintiff (Plaintiff). On June 20, 2014, Plaintiff filed a consolidated amended class action complaint (Complaint), adding a former officer of the Company as a defendant. The Complaint alleges that during the Class Period, Defendants made false or misleading statements in various SEC filings, press releases, earnings calls, and healthcare conferences regarding the Company's business and outlook, focusing primarily on Defendants' alleged failure to disclose that the HeartMate II Left Ventricular Assist Device had a purported increased rate of pump thrombosis during the Class Period. Plaintiff seeks unspecified damages, among other relief. Defendants will file a motion to dismiss the Complaint by August 19, 2014. Although the results of litigation are inherently uncertain, based on the information currently available, we do not believe the ultimate resolution of this action will have

a material effect on our financial position, liquidity or results of operations.

### Note 9. Share-Based Compensation

Our 2006 Incentive Stock Plan, as amended in May 2014 ( 2006 Plan ) permits the issuance of stock options ( options ), restricted stock units ( RSUs ), performance share units ( PSUs ) and other types of awards to employees, directors, and consultants. As of June 28, 2014, approximately 3.7 million shares remained available for issuance under the 2006 Plan.

Share-based compensation consists of the following:

	Three Months Ended		Six Months Ended	
	June 28, 2014	June 29, 2013	June 28, 2014	June 29, 2013
	(in thousands)			
Cost of product sales	\$ 756	\$ 616	\$ 1,377	\$ 1,187
Selling, general and administrative expenses	4,794	4,625	8,819	8,308
Research and development	2,283	1,964	4,419	3,877
Total share-based compensation expense before taxes	7,833	7,205	14,615	13,372
Tax benefit for share-based compensation expense	2,731	2,790	5,003	5,070
Total share-based compensation (net of taxes)	\$ 5,102	\$ 4,415	\$ 9,612	\$ 8,302

Table of Contents**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 28, 2014	June 29, 2013	June 28, 2014	June 29, 2013
Risk free interest rate (weighted average)	2.21%	1.57%	2.19%	1.36%
Expected volatility	35%	37%	37%	37%
Expected option term (years)	5.88	4.93	4.54 to 5.04	4.92 to 5.89
Dividends	None	None	None	None

Stock option activity is summarized as follows:

	Number of Options (in thousands)	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contract Life (years)
Outstanding options as of December 28, 2013	2,261	\$ 29.68	6.95
Granted	586	34.86	
Exercised	(144)	19.89	
Forfeited or expired	(41)	35.87	
Outstanding options as of June 28, 2014	2,662	\$ 31.25	7.42
Outstanding options vested as of June 28, 2014 and expected to vest	2,566	\$ 31.12	7.36
Outstanding options exercisable as of June 28, 2014	1,244	\$ 27.89	5.90

As of June 28, 2014, there was \$10.3 million of unrecognized compensation expense, net of estimated forfeitures, related to options, which expense we expect to recognize over a weighted average period of 1.7 years. The weighted average grant-date fair value of options granted in the first six months of 2014 was \$12.39 per share.

**Restricted Stock Units**

Restricted stock unit activity is summarized as follows:

	Number of Units (in thousands)	Weighted Average Grant-Date Fair Value	Weighted Average Remaining Contract Life (in years)
Outstanding units as of December 28, 2013	1,461	\$ 33.40	1.27
Granted	589	34.64	
Released	(493)	32.21	

## Edgar Filing: THORATEC CORP - Form 10-Q

Forfeited or expired	(48)	34.97	
Outstanding units as of June 28, 2014	1,509 \$	34.22	1.60

As of June 28, 2014, there was \$41.1 million of unrecognized compensation expense, net of estimated forfeitures, related to RSUs, which amount we expect to recognize over 2.6 years.

### *Performance Share Units*

Starting in 2014, the Company issued performance share units ( PSUs ) to certain employees. The number of shares ultimately received will depend on achievement of specified company performance target over the performance period. Fifty percent of the shares awarded vest at the end of the performance period and remaining shares vest twenty-five percent on each of the following two anniversaries after the performance period assuming continued service by the employee. Delivery of the shares is conditioned upon achievement of the target and, if the target is achieved, occurs as of the applicable vesting date. We estimate the fair value of the PSUs based on the number of PSUs that are expected to be earned multiplied by the market price of our common stock on the date of grant. As the performance target is considered a performance condition, the expense for these awards, net of estimated forfeitures, is recorded over the four year vesting period based on a graded accelerated vesting method. Any changes to the expected company performance target would impact the number of PSUs and be accounted for as a cumulative adjustment to the compensation expense in the period in which the change occur.

Table of Contents

Performance share unit activity is summarized as follows:

	Number of Units (in thousands)	Weighted Average Grant Date Fair Value
Outstanding units as of December 28, 2013		\$
Granted	69	35.00
Released		
Changes in PSUs due to performance conditions	(27)	35.00
Forfeited	(2)	35.00
Outstanding units as of June 28, 2014	40	\$ 35.00

As of June 28, 2014, there was \$1.2 million of unrecognized compensation expense, net of estimated forfeitures, related to PSUs, which we expect to recognize over a weighted average period of 2.47 years.

**Note 10. Common and Preferred Stock**

On December 5, 2013, the Board of Directors authorized a new program to repurchase up to \$200.0 million of our shares of common stock ( December 2013 program ), which will expire on December 31, 2015. In the three and six months ended June 28, 2014, we repurchased \$25.2 million and \$37.5 million, respectively, worth of shares of our common stock under the December 2013 program, of which \$2.3 million was accrued on the condensed consolidated balance sheet as of June 28, 2014. In addition, we repurchased \$1.2 million worth of shares of our common stock in the first quarter of 2014 under our previous November 2012 program which expired in the first quarter of fiscal 2014. As of June 28, 2014, \$162.5 million was available for repurchases of shares of our common stock under the December 2013 program. The December 2013 program may be accelerated, suspended, delayed or discontinued at any time.

We are incorporated in California, and as California law does not recognize treasury stock, the shares repurchased decreased the common shares outstanding. We recorded the \$38.7 million of shares repurchased in the six months ended June 28, 2014 by reducing the additional paid-in-capital ( APIC ) balance by the average value per share reflected in the account prior to the repurchase and allocating the excess as a reduction of retained earnings. Based on this allocation, APIC decreased by \$13.9 million and retained earnings decreased by \$24.8 million in the consolidated statement of shareholders' equity.

We also purchased shares of our common stock that were not part of our publicly announced repurchase program, which 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 in the six months ended June 28, 2014 was \$6.9 million, which decreased APIC and retained earnings by \$2.3 million and \$4.6 million, respectively, based on the same allocation methodology discussed above. The aggregate value of shares purchased in the six months ended June 29, 2013 was \$6.9 million, which decreased APIC and retained earnings by \$2.2 million and \$4.7 million, respectively.

**Note 11. Income Taxes**

Our effective income tax rates for the three months ended June 28, 2014 and June 29, 2013 were 32.5% and 30.3%, respectively. Our effective income tax rates for the six months ended June 28, 2014 and June 29, 2013 were 32.6% and 28.4%, respectively. The increase is primarily due to the lack of federal R&D credits in the absence of enacted legislation in 2014. For the three months ended June 29, 2013, we recognized a benefit of approximately \$0.4 million related to these credits. In the first six months of 2013, we recognized a benefit of approximately \$2.0 million for these credits, of which \$1.3 million relates to the 2012 credits recognized as a result of the timing of legislation.

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 \$1.5 million. However, this amount may change because we continue to have ongoing negotiations with various taxing authorities throughout the year.

**Note 12. Segment and Geographic Information**

We have one operating segment and, and therefore, one reportable segment which develops, manufactures and markets proprietary medical devices used for mechanical circulatory support for the treatment of heart failure patients. Our chief operating decision-maker reviews financial information presented on a consolidated basis for purposes of making operating decisions and assessing financial performance, accompanied by disaggregated revenue information by product line. We do not assess the performance of our individual product lines on measures of profit or loss, or asset-based metrics. Therefore, the information below is presented only for revenues by product line, geography, and certain revenue category.

Edgar Filing: THORATEC CORP - Form 10-Q

Table of Contents

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 28, 2014 or during the three and six months ended June 29, 2013.

	Three Months Ended		Six Months Ended	
	June 28, 2014	June 29, 2013	June 28, 2014	June 29, 2013
(in thousands)				
Product sales by geographic location:				
Domestic	\$ 94,172	\$ 98,766	\$ 189,777	\$ 191,035
International	23,891	31,713	53,983	57,169
Total	\$ 118,063	\$ 130,479	\$ 243,760	\$ 248,204

	Three Months Ended		Six Months Ended	
	June 28, 2014	June 29, 2013	June 28, 2014	June 29, 2013
(in thousands)				
Product sales by product line:				
HeartMate	\$ 101,975	\$ 115,646	\$ 211,986	\$ 218,567
CentriMag	13,111	11,515	26,105	21,879
PVAD and IVAD	2,497	2,684	4,749	6,516
Other	480	634	920	1,242
Total	\$ 118,063	\$ 130,479	\$ 243,760	\$ 248,204

	Three Months Ended		Six Months Ended	
	June 28, 2014	June 29, 2013	June 28, 2014	June 29, 2013
(in thousands)				
Product sales by category:				
Pump	\$ 81,583	\$ 93,428	\$ 170,883	\$ 177,759
Non-Pump	36,000	36,417	71,957	69,203
Other	480	634	920	1,242
Total	\$ 118,063	\$ 130,479	\$ 243,760	\$ 248,204

**Note 13. Net Income Per Share**

We calculate basic earnings per share ( EPS ) using net earnings and the weighted-average number of shares outstanding during the reporting period. Diluted EPS includes any dilutive effect of outstanding options and RSUs. PSUs are excluded from the shares used to compute diluted EPS until the company performance target is met.

The reconciliations of the numerators and denominators of each of the basic and diluted EPS calculations were as follows:

	Three Months Ended		Six Months Ended	
	June 28, 2014	June 29, 2013	June 28, 2014	June 29, 2013
(in thousands, except per share data)				
Numerator:				



Edgar Filing: THORATEC CORP - Form 10-Q

Net Income	\$	17,413	\$	23,189	\$	35,652	\$	41,359
Denominator:								
Weighted average shares used to compute basic EPS		56,723		57,429		56,781		57,457
Dilutive effect of share-based compensation plans		465		691		757		941
Weighted average shares used to compute diluted EPS		57,188		58,120		57,538		58,398
Net income per share:								
Basic	\$	0.31	\$	0.40	\$	0.63	\$	0.72
Diluted	\$	0.30	\$	0.40	\$	0.62	\$	0.71

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

	Three Months Ended		Six Months Ended	
	June 28, 2014	June 29, 2013	June 28, 2014	June 29, 2013
Options to purchase shares not included in the computation of diluted net income per share because their inclusion would be anti-dilutive	461	1,149	749	963

(in thousands)

Table of Contents

**Note 14. Subsequent Events**

On July 2, 2014, our wholly owned subsidiary, Thoratec Switzerland GmbH, acquired all of the outstanding equity interests of Apica Cardiovascular Limited ( Apica ) and certain related subsidiaries from the former stockholders of Apica (the Acquisition ). In the second quarter of 2014 (prior to the Acquisition), we provided Apica with a loan in the amount of \$2.0 million. The upfront purchase price for the Acquisition was \$35.0 million (prior to certain adjustments, including the repayment of the loan to Thoratec). In addition, milestone payments up to an aggregate maximum amount of \$40.0 million will be payable in the future, contingent upon the achievement of (i) First-in-Man implant, (ii) certain regulatory approvals in Europe and the U. S., and (iii) a certain minimum number of sales of related products. 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 28, 2014, or in these corresponding notes. Through June 28, 2014, acquisition-related expenses associated with this transaction and recorded as general and administrative expenses were \$1.3 million. We are in the process of completing the purchase price allocation and pro-forma results of operations for this Acquisition.

On August 6, 2014, we signed an Accelerated Share Repurchase ( 2014 ASR ) agreement with an investment bank, under which we agreed to repurchase an aggregate of \$30.0 million of our common stock. Under the 2014 ASR program, we will pay \$30.0 million and will receive an initial delivery of shares, which would represent 80% of the 2014 ASR program s value based on the stock price at inception. The total number of shares to be repurchased is based on the volume-weighted average price of our common stock during the repurchase period, less an agreed upon discount. At settlement, we could either receive additional shares from the bank or be required to deliver additional shares or cash, at our option. The total number of shares ultimately repurchased will not be known until the repurchase period ends and a final settlement occurs.

Table of Contents

**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, 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 Annual Report on Form 10-K (the 2013 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**

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 PVAD and IVAD 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, we acquired certain assets and assumed certain liabilities from Terumo Corporation (Terumo) related to the DuraHeart II Left Ventricular Assist product line (DuraHeart II) previously under development by Terumo. Under the terms of the acquisition, we made an up-front cash payment of \$13.0 million, and we will be obligated to make potential future milestone payments, based on regulatory approvals

and product sales, of up to \$43.5 million. No milestone payments have been made to Terumo since the date of the acquisition.

On July 2, 2014, our wholly owned subsidiary, Thoratec Switzerland GmbH, acquired all of the outstanding equity interests of Apica Cardiovascular Limited ( Apica ) and certain related subsidiaries from the former stockholders of Apica. In the second quarter of 2014 (prior to the acquisition of Apica on July 2, 2014), we provided Apica with a loan in the amount of \$2.0 million. The upfront purchase price for the Acquisition was \$35.0 million (prior to certain adjustments, including the repayment of the loan to Thoratec). In addition, milestone payments up to an aggregate maximum amount of \$40.0 million will be payable in the future, contingent upon the achievement of certain clinical and regulatory events in both Europe and the U.S. and a certain minimum number of sales of related products.

### ***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 our predecessor long-term LVAD and with only one moving part, HeartMate II is simpler and designed to operate more quietly than pulsatile devices.

Table of Contents

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, we completed the required conformity assessment procedure and design dossier reviews to be given authority from our Notified Body to affix the CE Mark to the HeartMate II for marketing in Europe. We believe HeartMate II is the most widely used LVAD.

***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 thirty 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 up to thirty days. We completed the required conformity assessment procedure to affix the CE Mark to the CentriMag for marketing in Europe, and the device is marketed in Europe to provide support for up to thirty 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 been CE Marked for marketing in Europe 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, we completed the required conformity assessment procedure and design dossier reviews to be given authority from our Notified Body to affix the CE Mark to the PVAD, allowing for its commercial sale in Europe.

#### ***IVAD***

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, we completed the required conformity assessment procedure and design dossier reviews to be given authority from our Notified Body to affix the CE Mark to the IVAD, 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 2013 Annual Report, 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 28, 2014.

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 28, 2014		June 29, 2013		June 28, 2014		June 29, 2013	
	(in thousands, except for percentage data)							
Product sales	\$ 118,063	100.0%	\$ 130,479	100.0%	\$ 243,760	100.0%	\$ 248,204	100.0%
Cost of product sales	34,307	29.1	41,000	31.4	74,333	30.5	76,073	30.6
Gross profit	83,756	70.9	89,479	68.6	169,427	69.5	172,131	69.4
Operating expenses:								
Selling, general and administrative	35,477	30.1	34,924	26.8	70,978	29.1	69,669	28.1
Research and development	23,048	19.5	21,506	16.5	46,387	19.0	46,019	18.5
Total operating expenses	58,525	49.6	56,430	43.3	117,365	48.1	115,688	46.6
Income from operations	25,231	21.3	33,049	25.3	52,062	21.4	56,443	22.8
Other income and (expense):								
Interest expense and other	(2)				(2)		(4)	
Interest income and other	559	0.5	213	0.2	806	0.3	1,330	0.5
Income before income taxes	25,788	21.8	33,262	25.5	52,866	21.7	57,769	23.3
Income tax expense	(8,375)	(7.1)	(10,073)	(7.7)	(17,214)	(7.1)	(16,410)	(6.6)
Net income	\$ 17,413	14.7	\$ 23,189	17.8	\$ 35,652	14.6	\$ 41,359	16.7

**Three and six months ended June 28, 2014 and June 29, 2013****Product Sales**

Product sales consisted of the following:

	Three Months Ended			Six Months Ended		
	June 28, 2014	June 29, 2013	% Change	June 28, 2014	June 29, 2013	% Change
	(in thousands)			(in thousands)		
Total product sales	\$ 118,063	\$ 130,479	(9.5)%	\$ 243,760	\$ 248,204	(1.8)%

## Edgar Filing: THORATEC CORP - Form 10-Q

In the second quarter of 2014 as compared to the second quarter of 2013, product sales decreased by \$12.4 million or 9.5%, driven by decreased sales volume of our HeartMate II, which was partially offset by an increase in sales volume of our CentriMag products. HeartMate II contributed \$13.7 million to the decrease due primarily to reduced market growth relative to prior periods in conjunction with market share loss to a competitive device, dynamics that may continue to affect our results. The decrease was partially offset by an increase in the CentriMag and PediMag product line of \$1.6 million. Additionally, the decrease was driven by a decline of \$0.3 million in sales of other products. From a regional perspective, the U.S. sales decreased by \$4.6 million, while international sales decreased by \$7.8 million due to declines in both Europe and Japan.

In the first six months of 2014 as compared to the first six months of 2013, product sales decreased by \$4.4 million or 1.8%, driven by decrease in sales volume of our HeartMate II products due primarily to the same reasons discussed above. HeartMate II contributed \$6.6 million to the decrease which was partially offset by an increase in the CentriMag and PediMag product line of \$4.2 million. Additionally, the decrease was driven by a decline of \$2.0 million in sales of the other products. From a regional perspective, U.S. sales decreased by \$1.3 million and international sales decreased by \$3.2 million.

Sales originating outside of the U.S. and U.S. export sales collectively accounted for approximately 20% and 24% of our total product sales for each of the second quarter of 2014 and the second quarter of 2013, respectively, and approximately 22% and 23% of our total product sales for each of the first six months of 2014 and the first six months of 2013, respectively.



Table of Contents**Gross Profit**

Gross profit and gross margin were as follows:

	Three Months Ended		Six Months Ended	
	June 28, 2014	June 29, 2013	June 28, 2014	June 29, 2013
	(in thousands, except percentages)			
Total gross profit	\$ 83,756	\$ 89,479	\$ 169,427	\$ 172,131
Total gross margin	70.9%	68.6%	69.5%	69.4%

In the second quarter of 2014 as compared to the second quarter of 2013, gross margin increased by approximately two percentage points, while during the first six months of 2014 as compared to the first six months of 2013, gross margin percentage did not significantly change. The increase in the second quarter of 2014 as compared to the second quarter of 2013 was primarily due to favorable manufacturing absorption variances and underlying efficiencies and lower intangible amortization expense related to PVAD and IVAD intangible assets, offset in part by unfavorable warranty expense and inventory reserves.

**Selling, General and Administrative Expenses**

Selling, general and administrative expenses were as follows:

	Three Months Ended			Six Months Ended		
	June 28, 2014	June 29, 2013	% Change	June 28, 2014	June 29, 2013	% Change
	(in thousands)			(in thousands)		
Total selling, general and administrative expenses	\$ 35,477	\$ 34,924	1.6%	\$ 70,978	\$ 69,669	1.9%

In the second quarter of 2014 as compared to the second quarter of 2013, selling, general and administrative expenses increased by \$0.5 million, while in the first six months of 2014 as compared to the first six months of 2013, selling, general and administrative expenses increased by \$1.3 million. The increases were primarily due to market development initiatives, offset by lower incentive compensation in 2014 and the remeasurement of the estimated contingent consideration associated with our acquisitions.

**Research and Development Expenses**

Research and development expenses were as follows:

Edgar Filing: THORATEC CORP - Form 10-Q

	Three Months Ended			Six Months Ended		
	June 28, 2014	June 29, 2013	% Change	June 28, 2014	June 29, 2013	% Change
	(in thousands)			(in thousands)		
Total research and development expenses	\$ 23,048	\$ 21,506	7.2%	\$ 46,387	\$ 46,019	0.8%

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 2014 as compared to the second quarter of 2013, R&D expenses increased by \$1.5 million, while in the first six months of 2014 as compared to the first six months of 2013, R&D expenses increased by \$0.4 million. The increase in the second quarter of 2014 as compared to the second quarter of 2013 was primarily due to expenses associated with the DuraHeart II program, which we acquired in 2013, a continued investment in the PHP program, in part offset by the remeasurement of the estimated contingent consideration associated with the DuraHeart II acquisition.

***Interest Income and Other***

Interest income and other consisted of the following:

	Three Months Ended			Six Months Ended		
	June 28, 2014	June 29, 2013	% Change	June 28, 2014	June 29, 2013	% Change
	(in thousands)			(in thousands)		
Interest income	\$ 201	\$ 222	(9.5)%	\$ 425	\$ 468	(9.2)%
Foreign currency, net	(130)	(40)	225.0%	(187)	296	(163.2)%
Other	488	31	1,474.2%	568	566	0.4%
Total interest income and other	\$ 559	\$ 213		\$ 806	\$ 1,330	

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.

Table of Contents***Income Taxes***

Our effective income tax rates for the three months ended June 28, 2014 and June 29, 2013 were 32.5% and 30.3%, respectively. Our effective income tax rates for the six months ended June 28, 2014 and June 29, 2013 were 32.6% and 28.4%, respectively. The increase is primarily due to the lack of federal R&D credits in the absence of enacted legislation in 2014. For the three months ended June 29, 2013, we recognized a tax benefit of approximately \$0.4 million related to these credits. In the first six months of 2013, we recognized a benefit of approximately \$2.0 million for these credits, of which \$1.3 million relates to the 2012 credits recognized as a result of the timing of legislation.

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 2014 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, certificates of deposit, and asset-backed securities. 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:

	<b>June 28, 2014</b>		<b>December 28, 2013</b>
	(in thousands)		
Cash and cash equivalents	\$ 134,729	\$	139,099
Short-term investments	156,472		166,691
Long-term investments	4,270		4,234
Total cash, cash equivalents and investments	\$ 295,471	\$	310,024

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.

*Cash Flow Activities*

	June 28, 2014	(in thousands)	June 29, 2013
Net cash provided by operating activities	\$ 40,834		\$ 36,097
Net cash (used in) provided by investing activities	6		(22,599)
Net cash used in financing activities	(45,481)		(4,256)
Effect of exchange rate changes on cash and cash equivalents	271		(370)
Net increase (decrease) in cash and cash equivalents	(4,370)		8,872

*Cash Provided by Operating Activities*

Cash provided by operating activities in the first six months of 2014 was \$40.8 million and consisted of net income of \$35.7 million, adjustments for non-cash items of \$23.1 million, and cash used in working capital of \$17.9 million. Adjustments for non-cash items primarily consisted of \$14.6 million of stock-based compensation expense and \$8.2 million of depreciation and amortization expense, offset in part by \$1.0 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 \$8.1 million primarily from higher HeartMate product line inventory, offset in part by a decrease in accounts receivable of \$3.7 million from higher collections in the first six months of 2014. Decreases to accounts payable and other liabilities totaling \$14.0 million also contributed to cash provided by operating activities.

Table of Contents

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 in 2013, 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 (Used in) Investing Activities***

Cash provided by investing activities in the first six months of 2014 was primarily attributable to sales and maturities of available for sale investments of \$94.2 million, which was offset by purchases of available for sale investments of \$86.9 million, capital expenditures of \$5.3 million to support our manufacturing facilities and administration growth, and a note receivable from Apica of \$2.0 million.

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 Used in Financing Activities***

Cash used in financing activities in the first six months of 2014 of \$45.5 million was primarily comprised of \$39.1 million used for repurchases of 1.1 million shares of our common stock under the stock repurchase programs authorized, \$6.9 million used to repurchase vested restricted stock units for settlement of income tax withholding liabilities and \$6.1 million paid in contingent consideration. This amount was offset in part by \$2.9 million of proceeds related to stock option exercises, \$2.8 million of proceeds from stock issued under the employee stock purchase plan, and \$1.0 million from excess tax benefits for share-based compensation.

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.

***Stock Repurchase Program***

On December 5, 2013, the Board of Directors authorized a new program to repurchase up to \$200.0 million of our shares of common stock ( December 2013 program ), which will expire on December 31, 2015. In the three and six months ended June 28, 2014, we repurchased \$25.2 million and \$37.5 million, respectively, worth of shares of our common stock under the December 2013 program, of which \$2.3 million was

## Edgar Filing: THORATEC CORP - Form 10-Q

accrued on the condensed consolidated balance sheet as of June 28, 2014. In addition, we repurchased \$1.2 million worth of shares of our common stock in the first quarter of 2014 under our previous November 2012 program which expired in the first quarter of fiscal 2014. As of June 28, 2014, \$162.5 million was available for repurchases of shares of our common stock under the December 2013 program. The December 2013 program may be accelerated, suspended, delayed or discontinued at any time.

We are incorporated in California, and as California law does not recognize treasury stock, the shares repurchased decreased the common shares outstanding. We recorded the \$38.7 million of shares repurchased in the six months ended June 28, 2014 by reducing the additional paid-in-capital ( APIC ) balance by the average value per share reflected in the account prior to the repurchase and allocating the excess as a reduction of retained earnings. Based on this allocation, APIC decreased by \$13.9 million and retained earnings decreased by \$24.8 million in the consolidated statement of shareholders' equity.

We also purchased shares of our common stock that were not part of our publicly announced repurchase program, which 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 in the six months ended June 28, 2014 was \$6.9 million, which decreased APIC and retained earnings by \$2.3 million and \$4.6 million, respectively, based on the same allocation methodology discussed above. The aggregate value of shares purchased in the six months ended June 29, 2013 was \$6.9 million, which decreased APIC and retained earnings by \$2.2 million and \$4.7 million, respectively.

Table of Contents

**Credit Facility**

On December 19, 2011, we signed an unsecured revolving credit facility agreement that provides for up to \$50.0 million 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 with which we were in compliance as of June 28, 2014. The credit agreement permits us to use the facility for working capital and general corporate purposes. We did not have any borrowings under this credit facility during the six months ended June 28, 2014 or June 29, 2013.

**Contractual Obligations**

As of June 28, 2014, the liability for uncertain tax positions was \$8.7 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 28, 2014, there were no material changes to our contractual obligations reported in our 2013 Annual Report.

Table of Contents

**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 28, 2014 related to our contracts would result in an increase in the unrealized gain or loss on forward currency-exchange contracts of \$9.9 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 28, 2014. 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 28, 2014, 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.

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

There have been no changes in our internal controls over financial reporting during the six months ended June 28, 2014 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

Table of Contents

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 28, 2014, 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.

On January 24, 2014, we and three of our present and former officers were named as defendants in a complaint filed in the United States District Court for the Northern District of California. The action, entitled *Cooper v. Thoratec Corp.*, Case No. 4:14-cv-00360, is a putative class action brought on behalf of purchasers of our securities between April 29, 2010, and November 27, 2013, inclusive (the Class Period), and alleges violations of Section 10(b) of the Securities Exchange Act of 1934 (the Exchange Act), and Rule 10b-5 promulgated thereunder, as well as Section 20(a) of the Exchange Act. On April 21, 2014, the Court appointed Bradley Cooper as Lead Plaintiff (Plaintiff). On June 20, 2014, Plaintiff filed a consolidated amended class action complaint (Complaint), adding a former officer of the Company as a defendant. The Complaint alleges that during the Class Period, Defendants made false or misleading statements in various SEC filings, press releases, earnings calls, and healthcare conferences regarding the Company's business and outlook, focusing primarily on Defendants' alleged failure to disclose that the HeartMate II Left Ventricular Assist Device had a purported increased rate of pump thrombosis during the Class Period. Plaintiff seeks unspecified damages, among other relief. Defendants will file a motion to dismiss the Complaint by August 19, 2014. Although the results of litigation are inherently uncertain, based on the information currently available, we do not believe the ultimate resolution of this action will have a material effect on our financial position, liquidity or results of operations.

**ITEM 1A. RISK FACTORS**

You should carefully consider the factors discussed in Part I, Item 1A. Risk Factors in our 2013 Annual Report, which could materially affect our business, financial condition or future operating results. The risks described in our 2013 Annual Report 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 six months ended June 28, 2014.

The following table sets forth certain information about our common stock repurchased during the six months ended June 28, 2014:

	<b>Total number of shares purchased(1)</b>	<b>Average price paid per share</b>	<b>Total number of shares purchased as part of publicly announced plans or programs(2)</b>	<b>Approximate dollar value of shares that may yet be purchased under the plans or programs(2)</b>
March 30, 2014 to April 30, 2014	130,625	\$ 33.87	128,595	\$ 183.4 million
May 1, 2014 to May31, 2014	180,351	\$ 32.39	179,100	\$ 177.6 million
June 1, 2014 to June 28, 2014	446,058	\$ 33.90	443,675	\$ 162.5 million
Total	757,034	\$ 33.53	751,370	\$ 162.5 million

(1) Includes 5,664 shares purchased at an average price of \$33.09 that were not part of our publicly announced repurchase programs for the three months ending June 28, 2014. These shares represent the surrender value of 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 of the quarter ended June 28, 2014.

On December 5, 2013, the Board of Directors authorized a new program to repurchase up to \$200.0 million of our shares of common stock ( December 2013 program ), which will expire on December 31, 2015. In the three months ended June 28, 2014, we repurchased \$25.2 million worth of shares of our common stock under the December 2013 program, of which \$2.3 million was accrued on the condensed consolidated balance sheet as of June 28, 2014. As of June 28, 2014, \$162.5 million was available for repurchases of shares of our common stock under the December 2013 program. The December 2013 program may be accelerated, suspended, delayed or discontinued at any time.

Table of Contents

**ITEM 6. EXHIBITS**

- 3.1 Thoratec's Articles of Incorporation, as amended.(1)
- 3.2 Amendment to Thoratec's Article of Incorporation.
- 10.20 Separation Benefits Agreement by and between Thoratec and Vasant Padmanabhan, dated May 22, 2014.
- 31.1 Section 302 Certification of Chief Executive Officer.
- 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 28, 2014, formatted in Extensible Business Reporting Language (XBRL) includes: (i) Unaudited Condensed Consolidated Balance Sheets as of June 28, 2014 and December 28, 2013, (ii) Unaudited Condensed Consolidated Statements of Operations for the Three and Six Months Ended June 28, 2014 and June 29, 2013, (iii) Unaudited Condensed Consolidated Statements of Comprehensive Income for the Three and Six Months Ended June 28, 2014 and June 29, 2013, (iv) Unaudited Condensed Consolidated Statements of Cash Flows for the Three and Six Months Ended June 28, 2014 and June 29, 2013, and (v) Notes to Unaudited Condensed Consolidated Financial Statements.

---

\*Furnished herewith.

(1) Filed as an Exhibit to Thoratec's Annual Report on Form 10-K for the fiscal year ended December 28, 2002, filed with the SEC on March 20, 2003, and incorporated herein by reference.

Table of Contents

**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 7, 2014

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

Date: August 7, 2014

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

Table of Contents

**EXHIBIT INDEX**

3.1	Thoratec's Articles of Incorporation, as amended.(1)
3.2	Amendment to Thoratec's Article of Incorporation.
10.20	Separation Benefits Agreement by and between Thoratec and Vasant Padmanabhan, dated May 22, 2014.
31.1	Section 302 Certification of Chief Executive Officer.
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 28, 2014, formatted in Extensible Business Reporting Language (XBRL) includes: (i) Unaudited Condensed Consolidated Balance Sheets as of June 28, 2014 and December 28, 2013, (ii) Unaudited Condensed Consolidated Statements of Operations for the Three and Six Months Ended June 28, 2014 and June 29, 2013, (iii) Unaudited Condensed Consolidated Statements of Comprehensive Income for the Three and Six Months Ended June 28, 2014 and June 29, 2013, (iv) Unaudited Condensed Consolidated Statements of Cash Flows for the Six Months Ended June 28, 2014 and June 29, 2013, and (v) Notes to Unaudited Condensed Consolidated Financial Statements.

---

\*Furnished herewith.

(1) Filed as an Exhibit to Thoratec's Annual Report on Form 10-K for the fiscal year ended December 28, 2002, filed with the SEC on March 20, 2003, and incorporated herein by reference.