

THORATEC CORP  
Form 10-Q  
November 05, 2008

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

(Mark one)

**Quarterly report pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934  
For the quarterly period ended September 27, 2008**

**Or**

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

**COMMISSION FILE NUMBER: 000-49798**

**THORATEC CORPORATION**

**(Exact name of registrant as specified in its charter)**

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

**94-2340464  
(I.R.S. Employer Identification No.)**

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

**94588  
(Zip Code)**

**(925) 847-8600**

**(Registrant's telephone number, including area code)**

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

*Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):*

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

*(Do not check if a smaller reporting company)*

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

As of October 25, 2008, the registrant had 56,073,382 shares of common stock outstanding.

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CentriMag is a registered trademark of Levitronix LLC.

ITC, A-VOX Systems, AVOXimeter, HEMOCHRON, ProTime, Surgicutt, Tenderlett, Tenderfoot, and IRMA are registered trademarks of International Technidyne Corporation, Thoratec Corporation's wholly-owned subsidiary.

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

|  | <b>September<br/>27,<br/>2008</b> | <b>December<br/>29,<br/>2007</b> |
|--|-----------------------------------|----------------------------------|
| <b>ASSETS</b>  |                                   |                                  |
| Current assets:  |                                   |                                  |
| Cash and cash equivalents  | \$ 65,493                         | \$ 20,689                        |
| Short-term available-for-sale investments  | 159,387                           | 197,661                          |
| Receivables, net of allowances of \$716 and \$861, respectively  | 57,554                            | 45,368                           |
| Inventories  | 59,228                            | 54,935                           |
| Short-term deferred tax assets   | 6,125                             | 6,077                            |
| Prepaid expenses and other assets  | 14,982                            | 6,379                            |
| Total current assets   | 362,769                           | 331,109                          |
| Property, plant and equipment, net   | 48,529                            | 46,477                           |
| Goodwill   | 98,368                            | 98,368                           |
| Purchased intangible assets, net   | 111,880                           | 121,767                          |
| Long-term deferred tax assets  | 3,123                             | 62                               |
| Long-term income tax receivable  | 2,729                             | 2,755                            |
| Long-term available-for-sale investments   | 30,554                            |                                  |
| Other assets   | 12,484                            | 13,181                           |
| Total Assets   | \$ 670,436                        | \$ 613,719                       |
| <b>LIABILITIES AND SHAREHOLDERS EQUITY</b>   |                                   |                                  |
| Current liabilities:   |                                   |                                  |
| Accounts payable   | \$ 10,402                         | \$ 9,770                         |
| Accrued compensation   | 21,045                            | 14,314                           |
| Accrued income taxes   | 3,700                             |                                  |
| Other accrued liabilities  | 12,022                            | 5,289                            |
| Total current liabilities  | 47,169                            | 29,373                           |
| Senior subordinated convertible notes  | 143,750                           | 143,750                          |
| Long-term deferred tax liability   | 31,696                            | 35,953                           |
| Other  | 6,677                             | 6,614                            |
| Total Liabilities  | 229,292                           | 215,690                          |
| Shareholders equity:   |                                   |                                  |
| Common shares: no par, authorized 100,000; issued and outstanding 56,044 and 54,108 as of September 27, 2008 and December 29, 2007, respectively |                                   |                                  |

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|   |            |            |
|---|------------|------------|
| Additional paid-in capital                          | 490,933    | 458,383    |
| Accumulated deficit                                 | (45,950)   | (61,577)   |
| Accumulated other comprehensive (loss) income:      |            |            |
| Unrealized (loss) gain on investments               | (3,908)    | 317        |
| Cumulative translation adjustments                  | 69         | 906        |
| Total accumulated other comprehensive (loss) income | (3,839)    | 1,223      |
| Total Shareholders' Equity                          | 441,144    | 398,029    |
| Total Liabilities and Shareholders' Equity          | \$ 670,436 | \$ 613,719 |

See notes to condensed consolidated financial statements.

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

|   | <b>Three Months Ended</b> |                  | <b>Nine Months Ended</b> |                  |
|---|---------------------------|------------------|--------------------------|------------------|
|   | <b>September</b>          | <b>September</b> | <b>September</b>         | <b>September</b> |
|   | <b>27,</b>                | <b>29,</b>       | <b>27,</b>               | <b>29,</b>       |
|   | <b>2008</b>               | <b>2007</b>      | <b>2008</b>              | <b>2007</b>      |
| Product sales                                       | \$ 80,815                 | \$ 56,055        | \$ 227,890               | \$ 170,698       |
| Cost of product sales                               | 32,045                    | 23,707           | 92,460                   | 70,152           |
| Gross profit  | 48,770                    | 32,348           | 135,430                  | 100,546          |
| Operating expenses:                                 |                           |                  |                          |                  |
| Selling, general and administrative                 | 23,845                    | 20,873           | 68,338                   | 61,952           |
| Research and development                            | 13,443                    | 10,712           | 38,801                   | 32,372           |
| Amortization of purchased intangible assets         | 3,295                     | 3,143            | 9,887                    | 9,439            |
| Total operating expenses                            | 40,583                    | 34,728           | 117,026                  | 103,763          |
| Income (loss) from operations                       | 8,187                     | (2,380)          | 18,404                   | (3,217)          |
| Other income and (expense):                         |                           |                  |                          |                  |
| Interest expense                                    | (1,009)                   | (1,016)          | (3,030)                  | (3,158)          |
| Interest income and other                           | 2,183                     | 2,261            | 6,642                    | 6,214            |
| Income (loss) before income taxes                   | 9,361                     | (1,135)          | 22,016                   | (161)            |
| Income tax expense                                  | (2,179)                   | (273)            | (5,834)                  | (269)            |
| Net income (loss)                                   | \$ 7,182                  | \$ (1,408)       | \$ 16,182                | \$ (430)         |
| Net income (loss) per share:                        |                           |                  |                          |                  |
| Basic   | \$ 0.13                   | \$ (0.03)        | \$ 0.30                  | \$ (0.01)        |
| Diluted   | \$ 0.12                   | \$ (0.03)        | \$ 0.28                  | \$ (0.01)        |
| Shares used to compute net income (loss) per share: |                           |                  |                          |                  |
| Basic   | 55,328                    | 53,808           | 54,702                   | 53,303           |
| Diluted   | 63,993                    | 53,808           | 62,979                   | 53,303           |

See notes to condensed consolidated financial statements.

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

|   | <b>Nine Months Ended</b> |                  |
|---|--------------------------|------------------|
|   | <b>September</b>         | <b>September</b> |
|   | <b>27,</b>               | <b>29,</b>       |
|   | <b>2008</b>              | <b>2007</b>      |
| <b>Cash flows from operating activities:</b>                                      |                          |                  |
| Net income (loss)   | \$ 16,182                | \$ (430)         |
| Adjustments to reconcile net income to net cash provided by operating activities: |                          |                  |
| Depreciation and amortization   | 17,675                   | 16,183           |
| Investment premium amortization (net)   | 1,313                    | 664              |
| Write-down of investment  | 490                      | 215              |
| Non-cash interest and other expenses  | 355                      | 1,523            |
| Tax benefit related to stock options  | 5,386                    | 3,131            |
| Share-based compensation expense  | 7,967                    | 8,132            |
| Excess tax benefits from share-based compensation                                 | (3,598)                  | (1,861)          |
| Loss on disposal of assets  | 448                      | 74               |
| Change in net deferred tax liability  | (4,549)                  | (1,890)          |
| Changes in assets and liabilities:  |                          |                  |
| Receivables   | (13,811)                 | 2,201            |
| Inventories   | (7,019)                  | (11,846)         |
| Prepaid expenses and other assets   | 322                      | (1,774)          |
| Accounts payable and other liabilities  | 12,114                   | (1,093)          |
| Accrued income taxes, net   | (3,368)                  | (8,646)          |
| Net cash provided by operating activities   | 29,907                   | 4,583            |
| <b>Cash flows from investing activities:</b>                                      |                          |                  |
| Purchases of available-for-sale investments                                       | (143,797)                | (247,363)        |
| Sales of available-for-sale investments   | 90,419                   | 177,475          |
| Maturities of available-for-sale investments and restricted investments           | 52,742                   | 1,712            |
| Purchases of property, plant and equipment  | (6,876)                  | (4,867)          |
| Net cash used in investing activities   | (7,512)                  | (73,043)         |
| <b>Cash flows from financing activities:</b>                                      |                          |                  |
| Proceeds from stock option exercises  | 18,959                   | 13,311           |
| Proceeds from stock issued under employee stock purchase plan                     | 1,050                    | 1,084            |
| Excess tax benefits from share-based compensation                                 | 3,598                    | 1,861            |
| Repurchase and retirement of common shares  | (1,192)                  | (878)            |
| Net cash provided by financing activities   | 22,415                   | 15,378           |
| Effect of exchange rate changes on cash and cash equivalents                      | (6)                      | 128              |

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|  |           |           |
|--|-----------|-----------|
| Net increase (decrease) in cash and cash equivalents                           | 44,804    | (52,954)  |
| Cash and cash equivalents at beginning of period                               | 20,689    | 67,453    |
| Cash and cash equivalents at end of period                                     | \$ 65,493 | \$ 14,499 |
| <b>Supplemental disclosure of cash flow information:</b>                       |           |           |
| Cash paid for taxes  | \$ 8,701  | \$ 8,642  |
| Cash paid for interest   | \$ 1,707  | \$ 1,707  |
| <b>Supplemental disclosure of non-cash investing and financing activities:</b> |           |           |
| Transfers of equipment from inventory to property, plant and equipment         | \$ 2,369  | \$ 2,820  |

See notes to condensed consolidated financial statements.



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

|  | <b>Three Months Ended</b> |                  | <b>Nine Months Ended</b> |                  |
|--|---------------------------|------------------|--------------------------|------------------|
|  | <b>September</b>          | <b>September</b> | <b>September</b>         | <b>September</b> |
|  | <b>27,</b>                | <b>29,</b>       | <b>27,</b>               | <b>29,</b>       |
|  | <b>2008</b>               | <b>2007</b>      | <b>2008</b>              | <b>2007</b>      |
| Net income (loss)  | \$ 7,182                  | \$ (1,408)       | \$ 16,182                | \$ (430)         |
| Other comprehensive income (loss):   |                           |                  |                          |                  |
| Unrealized loss on investments (net of taxes of \$713 and \$141 for the three months ended and \$2,817 and \$86 for the nine months ended September 27, 2008 and September 29, 2007, respectively) | (1,070)                   | 211              | (4,225)                  | 129              |
| Foreign currency translation adjustments   | (811)                     | 162              | (837)                    | 402              |
| Comprehensive income (loss)  | \$ 5,301                  | \$ (1,035)       | \$ 11,120                | \$ 101           |

See notes to condensed consolidated financial statements.

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**THORATEC CORPORATION**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(unaudited)**

**1. Basis of Presentation**

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

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

**2. Fair Value Measurement**

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

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

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

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

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

|   | Total      | As of September 27, 2008  |   |  |
|---|------------|---|---|--|
|   |            | Quoted prices<br>in<br>active markets<br>for<br>identical assets<br>(Level 1)<br>(in thousands) | Significant<br>other<br>observable<br>inputs<br>(Level 2) | Significant<br>unobservable<br>inputs<br>(Level 3) |
| <b>Assets</b>   |            |   |   |  |
| Short term investments - municipal bonds  | \$ 159,387 | \$  | \$ 159,387  | \$   |
| Long term investments - auction rate securities   | 30,554     |   |   | 30,554   |
| Convertible debenture with Levitronix LLC<br>(fair value for purposes of disclosure in Note<br>9) | 5,000      |   |   | 5,000  |
|   | \$ 194,941 | \$  | \$ 159,387  | \$ 35,554  |
| <b>Liabilities</b>  |            |   |   |  |
| Mark to market on financial instruments (Note<br>6)   | \$ 41      | \$  | \$ 41   | \$   |
| Make-whole provision (Note 11)  | 66         |   |   | 66   |
| Senior subordinated convertible notes (fair<br>value for purposes of disclosure in Note 11)       | 205,983    | 205,983   |   |  |
|   | \$ 206,090 | \$ 205,983  | \$ 41   | \$ 66  |

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

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

|                              | Fair Value Measurement Using Significant<br>Unobservable Inputs (Level 3) |   |                                   |
|------------------------------|---|---|-----------------------------------|
|                              | Auction<br>Rate<br>Securities   | Other<br>Long<br>Term<br>Assets<br>(in thousands) | Other Long<br>Term<br>Liabilities |
| Balance at December 29, 2007 | \$  | \$ 5,000  | \$ 96                             |
| Transfer to Level 3          | 46,050  |   |                                   |
| Settlements at par           | (8,850)   |   |                                   |
|                              |   |   | 116                               |

|  |           |          |    |      |
|--|-----------|----------|----|------|
| Unrealized holding loss, included in interest income and other |           |          |    |      |
| Unrealized holding loss, included in other comprehensive loss  | (5,049)   |          |    |      |
| Balance at March 29, 2008                                      | \$ 32,151 | \$ 5,000 | \$ | 212  |
| Unrealized holding gain, included in interest income and other |           |          |    | (59) |
| Unrealized holding loss, included in other comprehensive loss  | (288)     |          |    |      |
| Balance at June 28, 2008                                       | \$ 31,863 | \$ 5,000 | \$ | 153  |
| Unrealized holding gain, included in interest income and other |           |          |    | (87) |
| Unrealized holding loss, included in other comprehensive loss  | (1,309)   |          |    |      |
| Balance at September 27, 2008                                  | \$ 30,554 | \$ 5,000 | \$ | 66   |

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

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

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

|   | September<br>27,<br>2008 | As of<br>December<br>29,<br>2007 |
|---|--------------------------|----------------------------------|
|   | (in thousands)           |                                  |
| <b>Short-term investments</b>                             |                          |                                  |
| Unrealized gains on municipal bonds (before taxes)        | \$ 429                   | \$ 517                           |
| Unrealized loss on municipal bonds (before taxes)         | (296)                    |                                  |
| <b>Long-term investments</b>                              |                          |                                  |
| Unrealized loss on auction rate securities (before taxes) | (6,646)                  |                                  |
| Net unrealized (loss) gain (before taxes)                 | \$ (6,513)               | \$ 517                           |

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

As of September 27, 2008, we owned approximately \$37.2 million face value of auction rate securities that are marketed by financial institutions and structured to periodically reset through auctions ranging from 7 to 35 days. The underlying collateral of the auction rate securities consists of student loans. Beginning in February of 2008, these auctions began to fail. As a result, we will not be able to access these funds until future auctions for these securities are successful, until a secondary market is established, or until these securities are called for redemption. As such, our auction rate securities are classified as long-term and are valued at \$30.6 million.

We intend and have the ability to hold these auction rate securities until the market recovers or until maturity. We do not anticipate having to sell these securities in order to operate our business. We believe that, based on our current unrestricted cash, cash equivalents and short-term available-for-sale securities with an aggregate value of \$224.9 million at September 27, 2008, the current lack of liquidity in the credit and capital markets will not have an impact on our liquidity, our cash flow or our ability to fund our operations. If the issuers of the auction rate securities are unable to successfully complete future auctions and their credit ratings deteriorate, we may in the future be required to record an additional impairment charge on these investments. It could conceivably take until the final maturity of the underlying notes (up to 30 years) to realize our investments recorded value.

**4. Recently Issued Accounting Pronouncements**

In October 2008, the Financial Accounting Standards Board ( FASB ) issued Financial Statement Position ( FSP ) No. 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active*, that clarifies the application of SFAS No. 157 in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial assets is not active. FSP No. 157-3 is applicable to the valuation of auction rate securities held by us for which there was no active market as of September 27, 2008. FSP No. 157-3 is effective upon issuance, including prior periods for which the financial statements have not been issued. The adoption of FSP No. 157-3 during the three month period ending September 27, 2008 did not have a material impact on our condensed consolidated results of operations or financial condition.

In June 2008, the FASB Issued FSP Emerging Issues Task Force ( EITF ) 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities*. FSP EITF 03-6-1 clarified that all outstanding unvested share-based payment awards that contain rights to non-forfeitable dividends participate in

undistributed earnings with common shareholders. Awards of this nature are considered participating securities and the two-class method of computing basic and diluted earnings per share must be applied. FSP EITF 03-6-1 is effective for financial statements issued for fiscal years and interim periods beginning after December 15, 2008. We are currently evaluating the accounting impact and disclosure requirements that this guidance will have on our condensed consolidated results of operations or financial condition when we adopt FSP EITF 03-6-1 at the beginning of our fiscal year 2009.

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In May 2008, the FASB issued FSP Accounting Principles Board ( APB ) 14-1, *Accounting For Convertible Debt Instruments That May Be Settled in Cash Upon Conversion (Including Partial Cash Settlement)* alters the accounting treatment for convertible debt instruments that allow for either mandatory or optional cash settlements. FSP APB 14-1, will impact the accounting associated with our senior subordinated convertible notes recorded at a book value of \$143.8 million. FSP APB 14-1 will require us to recognize additional (non-cash) interest expense based on the market rate for similar debt instruments without the conversion feature. Furthermore, it will require recognizing interest expense in prior periods pursuant to the required retrospective accounting treatment upon adoption. The FSP will be effective for fiscal years beginning after December 15, 2008. We are currently evaluating the accounting impact and disclosure requirements that this guidance will have to our condensed consolidated results of operations or financial conditions when we adopt FSP APB 14-1 at the beginning of our fiscal year 2009.

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

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

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

In February 2008, the FASB issued SFAS No. 157-2, *Effective Date of FASB Statement No. 157*. With the issuance of SFAS No. 157-2, the FASB agreed to: (a) defer the effective date of SFAS No. 157 for one year for certain nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually), and (b) remove certain leasing transactions from the scope of SFAS No. 157. The deferral is intended to provide the FASB time to consider the effect of certain implementation issues that have arisen from the application of SFAS No. 157 for nonfinancial assets and nonfinancial liabilities. We are currently evaluating the additional accounting and disclosure requirements that we will be required to provide at the beginning of our fiscal year 2009, following the expiration of the deferral period.

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

**5. Cash and cash equivalents**

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



**Table of Contents****6. Financial Instruments**

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

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

Our financial instrument contracts qualify as derivatives under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and we valued these contracts at the estimated fair value at September 27, 2008. The change in fair value of the forward currency contracts is included in Interest income and other, and offsets the foreign currency exchange gains and losses in the condensed consolidated statements of operations. The impacts of these foreign currency contracts were:

|  | <b>Three Months Ended</b> |                  | <b>Nine Months Ended</b> |                  |
|--|---------------------------|------------------|--------------------------|------------------|
|  | <b>September</b>          | <b>September</b> | <b>September</b>         | <b>September</b> |
|  | <b>27,</b>                | <b>29,</b>       | <b>27,</b>               | <b>29,</b>       |
|  | <b>2008</b>               | <b>2007</b>      | <b>2008</b>              | <b>2007</b>      |
|  | <b>( in thousands)</b>    |                  |                          |                  |
| Foreign currency exchange gain (loss) on foreign currency contracts      | \$ 325                    | \$ (346)         | \$(822)                  | \$ (388)         |
| Foreign currency exchange (loss) gain on foreign translation adjustments | (302)                     | 431              | 928                      | 433              |

As of September 27, 2008, we had forward contracts to sell euros with a notional value of 6.4 million and to purchase UK pounds with a notional value of £4.6 million, and as of September 29, 2007, we had forward contracts to sell euros with a notional value of 6.8 million and to purchase UK pounds with a notional value of £4.0 million. As of September 27, 2008, our forward contracts had an average exchange rate of one U.S. dollar to 0.6799 euros and one U.S. dollar to 0.5351 UK pounds. The forward contracts are valued based on exchange rates derived from an independent source of market participant assumptions and compiled from the best information available. As of September 27, 2008, the estimated fair value of these foreign currency contracts was \$0.1 million.

**Table of Contents****7. Inventories**

Inventories consisted of the following:

|                 | September<br>27,<br>2008 | As of<br>December<br>29,<br>2007 |
|-----------------|--------------------------|----------------------------------|
|                 | (in thousands)           |                                  |
| Finished goods  | \$ 21,929                | \$ 20,732                        |
| Work in process | 14,030                   | 10,053                           |
| Raw materials   | 23,269                   | 24,150                           |
| Total           | \$ 59,228                | \$ 54,935                        |

**8. Property, Plant and Equipment, net**

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

|                                      | September<br>27,<br>2008 | As of<br>December<br>29,<br>2007 |
|--------------------------------------|--------------------------|----------------------------------|
|                                      | (in thousands)           |                                  |
| Land, building and improvements      | \$ 16,135                | \$ 16,135                        |
| Equipment and capitalized software   | 68,350                   | 61,886                           |
| Furniture and leasehold improvements | 25,332                   | 22,804                           |
| Total                                | 109,817                  | 100,825                          |
| Less accumulated depreciation        | (61,288)                 | (54,348)                         |
|                                      | \$ 48,529                | \$ 46,477                        |

Depreciation expense for the three months ended September 27, 2008 and September 29, 2007 was \$2.8 million and \$2.3 million, respectively, and for the nine months ended September 27, 2008 and September 29, 2007 was \$7.8 million and \$6.8 million, respectively.

**9. Other Assets**

On August 23, 2006, we purchased a \$5.0 million convertible debenture from Levitronix, a company with which we have a distribution arrangement to sell Levitronix products. The convertible debenture is a long-term note receivable with an annual interest rate of 5.7%, to be accrued monthly and at the option of Levitronix, paid in cash or in-kind semi-annually on February 23 and August 23 until its maturity on August 23, 2013. We may convert the debenture at any time at our option into membership interests of Levitronix at a conversion price of \$4.2857, which may be adjusted as a result of certain corporate events. This conversion feature is not an embedded derivative under SFAS No. 133 because the membership interests of the issuer are not readily convertible to cash. If we had converted the debenture as of September 27, 2008, our ownership in Levitronix would have been less than 5%.

The \$5.0 million outstanding principal amount of the Levitronix convertible debenture plus accrued but unpaid interest of \$0.6 million thereon, is included in Other assets on our condensed consolidated balance sheet. As of September 27, 2008, the fair value of the convertible debenture, based on a discounted cash flows valuation approach using significant unobservable inputs, was approximately \$5.0 million.

**Table of Contents****10. Goodwill and Purchased Intangible Assets**

The carrying amount of goodwill was \$98.4 million as of September 27, 2008 and December 29, 2007, \$94.1 million of which is attributable to our Cardiovascular division and \$4.3 million of which is attributable to International Technidyne Corporation's (ITC) acquisition of the outstanding common shares of privately held A-VOX Systems, Inc. (Avox).

In February 2001, we merged with Thermo Cardiosystems, Inc. (TCA). Prior to the merger with TCA (the Merger), TCA was a subsidiary of Thermo Electron Corporation (TEC). The components of identifiable intangible assets related to the Merger include: patents and trademarks, core technology (Thoralon, our proprietary bio-material), and developed technology (patented technology, other than core technology, acquired in the Merger). The components of intangible assets related to the October 2006 Avox acquisition include: patents and trademarks, developed technology, and customer and distributor relationships and other. The combined components are included in purchased intangibles on the condensed consolidated balance sheets as follows:

|  | <b>As of September 27, 2008</b>      |  |                                    |
|--|--------------------------------------|--|------------------------------------|
|  | <b>Gross<br/>Carrying<br/>Amount</b> | <b>Accumulated<br/>Amortization<br/>(in thousands)</b> | <b>Net<br/>Carrying<br/>Amount</b> |
| Patents and trademarks                           | \$ 38,515                            | \$ (27,874)  | \$ 10,641                          |
| Core technology                                  | 37,485                               | (13,272)   | 24,213                             |
| Developed technology                             | 125,742                              | (49,260)   | 76,482                             |
| Customer and distributor relationships and other | 897                                  | (353)  | 544                                |
| Total purchased intangible assets                | \$ 202,639                           | \$ (90,759)  | \$ 111,880                         |

|  | <b>As of December 29, 2007</b>       |  |                                    |
|--|--------------------------------------|--|------------------------------------|
|  | <b>Gross<br/>Carrying<br/>Amount</b> | <b>Accumulated<br/>Amortization<br/>(in thousands)</b> | <b>Net<br/>Carrying<br/>Amount</b> |
| Patents and trademarks                           | \$ 38,515                            | \$ (25,086)  | \$ 13,429                          |
| Core technology                                  | 37,485                               | (11,793)   | 25,692                             |
| Developed technology                             | 125,742                              | (43,748)   | 81,994                             |
| Customer and distributor relationships and other | 897                                  | (245)  | 652                                |
| Total purchased intangible assets                | \$ 202,639                           | \$ (80,872)  | \$ 121,767                         |

Amortization expense related to purchased intangible assets was \$3.3 million and \$3.1 million for the three months ended September 27, 2008 and September 29, 2007, respectively, and \$9.9 million and \$9.4 million for the nine months ended September 27, 2008 and September 29, 2007, respectively. Our amortization expense is expected to be approximately \$13.2 million in 2008, declining to \$9.1 million by 2012. This decline in amortization expense is because of certain intangibles which will be fully amortized in 2009 and 2010. Patents and trademarks have useful lives ranging from one to thirteen years, core and developed technology assets have useful lives ranging from three to nineteen years and customer and distributor relationships and other have useful lives ranging five to ten years. Further, the adoption of FSP No. 142-3 may impact the useful life of our purchased intangible assets and the related amortization expense from our fiscal year beginning in 2009.

**11. Long-Term Debt**

In 2004, we completed the sale of \$143.8 million initial principal amount of senior subordinated convertible notes due in 2034. The convertible notes were sold to Qualified Institutional Buyers pursuant to the exemption from the registration requirements of the Securities Act of 1933, as amended, provided by Rule 144A thereunder. A portion of the proceeds were used to repurchase 4.2 million shares of our outstanding common stock for \$60 million. The balance of the proceeds has been and will be used for general corporate purposes, which may include additional stock repurchases, strategic investments or acquisitions. Principal amount of the convertible notes at maturity is \$247.4 million offset by the original issue discount of \$103.7 million and net debt issuance costs of \$4.3 million, equaling net proceeds of \$139.4 million.

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The senior subordinated convertible notes were issued at an issue price of \$580.98 per note, which is 58.098% of the principal amount at maturity of the notes. The senior subordinated convertible notes bear interest at a rate of 1.3798% per year on the principal amount at maturity, payable semi-annually in arrears in cash on May 16 and November 16 of each year, from November 16, 2004 until May 16, 2011. Beginning on May 16, 2011, the original issue discount will accrue daily at a rate of 2.375% per year on a semi-annual bond equivalent basis and, on the maturity date, a holder will receive \$1,000 per note. As a result, the aggregate principal amount of the notes at maturity will be \$247.4 million.

The deferred debt issuance costs of \$1.6 million, \$4.3 million net of \$2.7 million in amortization, are included in Other assets on the condensed consolidated balance sheet as of September 27, 2008. The deferred debt issuance costs are amortized on a straight line basis until May 2011 at which point the Company can redeem the debt. These charges are included in Interest expense on our condensed consolidated statements of operations.

Holders of the senior subordinated convertible notes may convert their convertible notes into shares of our common stock at a conversion rate of 29.4652 shares per \$1,000 principal amount of senior subordinated convertible notes, which represents a conversion price of \$19.72 per share, subject to adjustments upon the occurrence of certain events as set forth in the indenture. Holders have been and are able to convert their convertible notes at any point after the close of business on September 30, 2004 if, as of the last day of the preceding calendar quarter, the closing price of our common stock for at least 20 trading days in a period of 30 consecutive trading days ending on the last trading day of such preceding calendar quarter is more than 120% of the accreted conversion price per share of our common stock. Commencing October 1, 2008, this market price conversion feature was satisfied, such that holders of the senior subordinated convertible notes may convert their notes through the final maturity date of the notes into shares of our common stock at a conversion rate of 29.462 shares per \$1,000 principal amount of senior subordinated convertible notes, subject to adjustments as provided in the indenture. If holders elect conversion, we may, at our option, deliver shares of common stock, pay a holder in cash, or deliver a combination of shares and cash, as determined pursuant to the terms of the notes.

Additionally, holders may surrender their senior subordinated convertible notes for conversion on or before May 16, 2029 during the five business day period after any five consecutive trading day period in which the trading price per note for each day of that period was less than 98% of the product of the closing sale price of our common stock and the conversion rate on each such day. However, in such event, if on the day before any conversion the closing sale price of our common stock is greater than the accreted conversion price (i.e., the issue price of the note plus accrued original issue discount divided by the conversion rate) but less than or equal to 120% of the accreted conversion price, instead of shares of our common stock based on the conversion rate, holders will receive cash or common stock, or a combination of each at our option, with a value equal to the accreted principal amount of the notes plus accrued but unpaid interest as of the conversion date. Additionally, holders may convert their senior subordinated convertible notes if we call them for redemption or if specified corporate transactions or significant distributions to holders of our stock have occurred. As of September 27, 2008, no notes had been converted or called.

Holders may require us to repurchase all or a portion of their senior subordinated convertible notes on each of May 16, 2011, 2014, 2019, 2024 and 2029 at a repurchase price equal to 100% of the issue price, plus accrued original issue discount, if any. In addition, if we experience a change in control or a termination of trading of our common stock each holder may require us to purchase all or a portion of such holder's notes at the same price, plus, in certain circumstances, a make-whole premium. This premium is considered an embedded derivative under SFAS No. 133 and has been bifurcated from the senior subordinated convertible notes and recorded at its estimated fair value, \$0.1 million at September 27, 2008. There are significant variables and assumptions used in valuing the make-whole provision including, but not limited to, the Company's stock price, volatility of the Company's stock, the probability of our being acquired and the probability of the type of consideration used by a potential acquirer.

We may redeem either in whole or in part, any of the senior subordinated convertible notes, at any time beginning May 16, 2011, by giving the holders at least 30 days notice, either in whole or in part at a redemption price equal to the sum of the issue price and the accrued original issue discount.

The senior subordinated convertible notes are subordinated to all of our senior indebtedness and structurally subordinated to all indebtedness of our subsidiaries. Therefore, in the event of a bankruptcy, liquidation or dissolution

of us or one or more of our subsidiaries and acceleration of or payment default on our senior indebtedness, holders of the convertible notes will not receive any payment until holders of any senior indebtedness we may have outstanding have been paid in full.

The aggregate fair value of the senior subordinated convertible notes at September 27, 2008, based on quoted market prices in active markets, was \$206.0 million.

**Table of Contents****12. Share-Based Compensation**

Share-based compensation expense is measured based on the grant-date fair value of the share-based awards. We recognize share-based compensation expense for the portion of the award that will ultimately be expected to vest over the requisite service period for those awards with graded vesting and service conditions. We develop an estimate of the number of share-based awards which will ultimately vest, primarily based on historical experience. SFAS No. 123(R), *Share-Based Payments*, requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

Share-based compensation included in the condensed consolidated statement of operations consists of the following:

|                                     | <b>Three Months<br/>Ended</b>     |                                   | <b>Nine Months Ended</b>          |                                   |
|-------------------------------------|-----------------------------------|-----------------------------------|-----------------------------------|-----------------------------------|
|                                     | <b>September<br/>27,<br/>2008</b> | <b>September<br/>29,<br/>2007</b> | <b>September<br/>27,<br/>2008</b> | <b>September<br/>29,<br/>2007</b> |
|                                     | <b>(in thousands)</b>             |                                   |                                   |                                   |
| Cost of product sales               | \$ 371                            | \$ 456                            | \$ 1,284                          | \$ 1,193                          |
| Selling, general and administrative | 1,511                             | 963                               | 4,747                             | 5,069                             |
| Research and development            | 593                               | 481                               | 1,936                             | 1,870                             |
|                                     | <b>\$ 2,475</b>                   | <b>\$ 1,900</b>                   | <b>\$ 7,967</b>                   | <b>\$ 8,132</b>                   |

Share-based compensation expense of \$0.5 million and \$0.7 million was capitalized to inventory as of September 27, 2008 and December 29, 2007, respectively.

We receive a tax deduction for certain stock option exercises during the period the options are exercised, generally for the excess of the fair market value of the options at the date of exercise over the exercise prices of the options. Prior to the adoption of SFAS No. 123(R), we reported all tax benefits resulting from the exercise of stock options as operating cash flows in our condensed consolidated statements of cash flows. In accordance with SFAS No. 123(R), our condensed consolidated statements of cash flows presentation reports the excess tax benefits from the exercise of stock options as financing cash flows of approximately \$3.6 million and \$1.9 million for the nine months ended September 27, 2008 and September 29, 2007, respectively, rather than operating cash flows.

Cash proceeds from the exercise of stock options were \$19.0 million and cash proceeds from our employee stock purchase plan were \$1.1 million for the nine months ended September 27, 2008. Cash proceeds from the exercise of stock options were \$13.3 million and cash proceeds from our employee stock purchase plan were \$1.1 million for the nine months ended September 29, 2007.

**Equity Plan**

In April 2006, the Board of Directors approved the 2006 Incentive Stock Plan ( 2006 Plan ), in May 2006 the 2006 Plan was amended by the Board of Directors and approved by our shareholders and in May 2008 the 2006 Plan was amended by the Board of Directors and approved by our shareholders. The 2006 Plan allows us to grant to employees and directors of, and consultants to, the Company up to a total of 5.4 million shares of stock. Each share issued from and after May 20, 2008 as restricted stock bonuses, restricted stock units, phantom stock units, performance share bonuses, or performance share units reduces the number of shares available for issuance under the 2006 Plan by one and seventy-four hundredths (1.74) shares, and each share issued as stock options, restricted stock purchases or stock appreciation rights reduces the shares available for issuance under the 2006 Plan on a share-for-share basis. During the nine months ended September 27, 2008, approximately 382,000 options were granted under the 2006 Plan at an exercise price equal to the fair market value on the date of grant, and approximately 502,000 shares of restricted stock and restricted stock units were granted under the 2006 Plan. At September 27, 2008, 3.2 million shares remained available for grant under the 2006 Plan.





**Table of Contents****Stock Options**

Upon approval in May 2006, the 2006 Plan replaced our previous common stock option plans and equity incentive plans. At September 27, 2008, we had options outstanding under the 2006 Plan and the replaced plans. Options under the 2006 Plan may be granted by the Board of Directors at the fair market value on the date of grant and generally become fully exercisable within four years after the grant date and expire between five and ten years from the date of grant. Vesting on options granted to officers will be accelerated in certain circumstances following a change in control of the Company.

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    |                       | Nine Months Ended     |                       |
|--|-----------------------|-----------------------|-----------------------|-----------------------|
|  | September 27,<br>2008 | September 29,<br>2007 | September 27,<br>2008 | September 29,<br>2007 |
| Risk-free interest rate (weighted average) | 3.12%                 | 4.45%                 | 3.25%                 | 4.79%                 |
| Expected volatility                        | 40%                   | 40%                   | 40%                   | 40%                   |
| Expected option term (years)               | 4.89 to 6.07          | 5.06 to 5.92          | 5.08 to 6.07          | 5.08 to 6.05          |
| Dividends                                  | None                  | None                  | None                  | None                  |

The risk-free interest rate is based on the United States Treasury yield curve in effect at the time of grant. The expected term of options represents the period of time that options are expected to be outstanding. We use separate assumptions for groups of employees (for example, officers) that have similar historical exercise behavior. The range above reflects the expected option impact of these separate groups.

At September 27, 2008, there was \$4.1 million of unrecognized compensation expense related to stock options which amount we expect to recognize over 1.26 years. The aggregate intrinsic value of in-the-money options outstanding was \$47.9 million, based on the closing price of the Company's common stock on September 26, 2008, the last trading day in the nine months ended September 27, 2008, of \$26.71, the aggregate intrinsic value of options exercisable was \$34.6 million and the aggregate intrinsic value of options vested and expected to vest was \$46.3 million. The intrinsic value of options exercised was \$16.7 million for the nine months ended September 27, 2008. The fair value of the options granted during the nine months ended September 27, 2008 was \$2.5 million.

Stock option activity is summarized as follows:

|   | Number of<br>Options<br>(in<br>thousands) | Weighted<br>Average<br>Exercise<br>Price Per<br>Share | Weighted<br>Average<br>Remaining<br>Contract<br>Life (years) |
|---|---|---|--|
| Outstanding options at December 29, 2007                              | 5,748                                     | \$ 15.46  | 6.19   |
| Granted   | 382                                       | 14.98   |  |
| Exercised   | (1,484)                                   | 12.77   |  |
| Forfeited or expired  | (98)                                      | 18.81   |  |
| Outstanding options at September 27, 2008                             | 4,548                                     | \$ 16.22  | 6.17   |
| Outstanding options exercisable at September 27, 2008                 | 2,972                                     | \$ 15.13  | 5.13   |
| Outstanding options vested at September 27, 2008 and expected to vest | 4,377                                     | \$ 16.16  | 6.08   |

***Restricted Stock***

The 2006 Plan allows for the issuance of restricted stock awards and restricted stock units, which awards or units may not be sold or otherwise transferred until certain restrictions have lapsed. The unearned share-based compensation related to these awards is being amortized to compensation expense over the period of the restrictions, generally four years. The expense for these awards was determined based on the market price of our shares on the date of grant applied to the total number of shares that were granted.

Share-based compensation expense related to these restricted stock grants was \$3.9 million for the nine months ended September 27, 2008. As of September 27, 2008, we had \$11.4 million of unrecognized compensation expense related to these restricted stock awards, which amount we expect to recognize over 2.76 years. The intrinsic value of the restricted stock awards outstanding was \$26.8 million. The total fair value of the shares granted during the nine months ended September 27, 2008 was \$7.4 million.

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Restricted stock activity is summarized as follows:

|   | <b>Number of<br/>Shares<br/>(in<br/>thousands)</b> |    | <b>Weighted<br/>Average<br/>Grant Date Fair<br/>Value</b> |
|---|--|----|---|
| Outstanding unvested restricted stock at December 29, 2007  | 768  | \$ | 18.29   |
| Granted   | 487  |    | 15.24   |
| Vested  | (209)  |    | 18.28   |
| Forfeited or expired  | (44)   |    | 18.00   |
| Outstanding unvested restricted stock at September 27, 2008 | 1,002  | \$ | 16.82   |

**Restricted Stock Units**

In the first nine months of 2008, we granted restricted stock units to certain of our non-U.S. employees under the 2006 Plan. As of September 27, 2008, we had \$0.3 million of unrecognized compensation expense related to these restricted stock units. The aggregate intrinsic value of the units outstanding, based on the Company's stock price on September 27, 2008, was \$0.8 million.

Restricted stock unit activity is summarized as follows:

|   | <b>Number of<br/>Units<br/>(in<br/>thousands)</b> |    | <b>Weighted<br/>Average<br/>Grant Date<br/>Fair<br/>Value</b> | <b>Weighted<br/>Average<br/>Remaining<br/>Contract<br/>Life (in years)</b> |
|---|---|----|---|--|
| Outstanding units at December 29, 2007  | 21  | \$ | 18.58   | 2.82   |
| Granted                                 | 15  |    | 14.93   |  |
| Released                                | (6)   |    | 18.51   |  |
| Forfeited or expired                    | (1)   |    | 17.75   |  |
| Outstanding units at September 27, 2008 | 29  | \$ | 16.75   | 2.73   |

**Employee Stock Purchase Plan**

In May 2002, our shareholders approved the Company's Employee Stock Purchase Plan (ESPP) under which 500,000 shares of common stock was reserved for issuance. In addition, the ESPP provides for an annual, automatic increase of up to 250,000 shares in the total number of shares available for issuance thereunder on March 1 of each year, unless our Board of Directors specifies a smaller increase or no increase. Under this provision, an additional 250,000 shares were reserved for issuance under the ESPP on each of March 1, 2006 and March 1, 2008; our Board of Directors specified no increase as of March 1, 2007. Eligible employees may purchase over six month periods, a limited number of shares of the Company's common stock at 85% of the lower of the market value on the offering date (the first day of the six month period) or the market value on the purchase date (the last date of the six month period). During the nine months ended September 27, 2008, approximately 77,300 shares of common stock were issued under the ESPP. As of September 27, 2008, approximately 169,400 shares remained available for issuance under this plan.

The estimated subscription date fair value of the current offering under the ESPP is approximately \$0.3 million using the Black-Scholes option pricing model and the following assumptions:

Risk-free interest rate 1.73%

|                      |            |
|----------------------|------------|
| Expected volatility  | 40%        |
| Expected option life | 0.50 years |
| Dividends            | None       |

As of September 27, 2008, there was approximately \$0.1 million of unrecognized compensation expense related to ESPP subscriptions that began on May 1, 2008, which amount we expect to recognize during the fourth quarter of 2008.

**Table of Contents****13. Income Taxes**

Our effective income tax rates were 23% and 24% for the three months ended September 27, 2008 and September 29, 2007, respectively. Our effective income tax rates were 27% on pre-tax income for the nine months ended September 27, 2008 and 167% on pre-tax loss for the nine months ended September 29, 2007.

The tax years 2005 through 2007 remain subject to audit by certain jurisdictions in which we are subject to taxation, with the exception of New Jersey, which remains subject to audit from 2004 to 2007. However, as we had net operating losses and credits carried forward in several jurisdictions, including U.S. federal and California, certain items attributed to closed years remain subject to adjustment by the relevant tax authority through an adjustment to tax attributes carried forward to open years.

We are currently under examination by the California Franchise Tax Board for the years 2001 through 2004 and received a tentative assessment during the three months ended September 27, 2008. Although the ultimate outcome and the timing of the conclusion of this examination is unknown, we believe that adequate amounts have been provided for any adjustments that may result from the current examination and that the final outcome will not have a material adverse effect on our results of operations.

At September 27, 2008 and December 29, 2007, we reported a net deferred tax liability of approximately \$22.4 million and \$29.8 million, respectively, comprised principally of temporary differences between the financial statement and income tax bases of intangible assets.

We adopted FIN 48, *Accounting for Uncertainty in Income Taxes, an interpretation of SFAS No. 109*, on December 31, 2006. Under FIN 48, tax positions are evaluated for recognition using a more-likely-than-not recognition threshold, and those tax positions eligible for recognition are measured as the largest amount of tax benefit that is greater than fifty percent likely of being realized upon the effective settlement with a taxing authority that has full knowledge of all relevant information.

During the nine months ended September 27, 2008, we released certain foreign indirect items valued at approximately \$0.4 million which had previously offset income tax exposures as a result of the filing of a foreign return. This release was partially offset by certain return-to-provision true-ups resulting in net tax expense of approximately \$0.2 million. Our unrecognized tax benefits were not adjusted for this item since it related to an indirect benefit. However, we did reduce unrecognized tax benefits by approximately \$50,000 as a result of audit settlements and the passage of time on which certain exposures may be assessed. In addition, unrecognized tax benefits increased by approximately \$0.4 million during the three months ended September 27, 2008 primarily as a result of positions taken on certain tax returns filed in the quarter. We believe it is reasonably possible that unrecognized tax benefits will increase by approximately \$0.4 million within the next twelve months for tax positions which may be taken related to the current year.

On October 3, 2008, the Tax Extenders and Alternative Minimum Tax Relief Act of 2008 was signed into law. This bill, among other things, retroactively extended the expired federal research and development tax credit. As a result, we expect to record a tax benefit of approximately \$0.7 million in the fourth quarter of 2008 to account for the retroactive effects of the federal research credit extension.

**Table of Contents****14. Net Income (Loss) Per Share**

Basic and diluted net income per share was calculated as follows:

|  | <b>Three Months Ended</b>                    |                  | <b>Nine Months Ended</b> |                  |
|--|--|------------------|--------------------------|------------------|
|  | <b>September</b>                             | <b>September</b> | <b>September</b>         | <b>September</b> |
|  | <b>27,</b>                                   | <b>29,</b>       | <b>27,</b>               | <b>29,</b>       |
|  | <b>2008</b>                                  | <b>2007</b>      | <b>2008</b>              | <b>2007</b>      |
|  | <b>(in thousands, except per share data)</b> |                  |                          |                  |
| Net income (loss) for basic share calculation                          | \$ 7,182                                     | \$ (1,408)       | \$ 16,182                | \$ (430)         |
| Interest expense on senior subordinated convertible notes (after tax)  | 512  |                  | 1,536                    |                  |
| Net income for diluted share calculation                               | \$ 7,694                                     | \$ (1,408)       | \$ 17,718                | \$ (430)         |
| Weighted average number of common shares-basic                         | 55,328                                       | 53,808           | 54,702                   | 53,303           |
| Dilutive effect of stock-based compensation plans                      | 1,375  |                  | 987                      |                  |
| Dilutive effect on conversion of senior subordinated convertible notes | 7,290  |                  | 7,290                    |                  |
| Weighted average number of common shares-diluted                       | 63,993                                       | 53,808           | 62,979                   | 53,303           |
| Net income (loss) per common share                                     |  |                  |                          |                  |
| Basic  | \$ 0.13                                      | \$ (0.03)        | \$ 0.30                  | \$ (0.01)        |
| Diluted  | \$ 0.12                                      | \$ (0.03)        | \$ 0.28                  | \$ (0.01)        |

Basic net income per common share is computed by dividing net income by the weighted-average number of common shares outstanding during the period. Diluted net income per common share reflects the potential dilution that could occur, using the treasury stock method, if securities or other contracts to issue common stock were exercised or converted into common stock.

|  | <b>Three Months Ended</b> |                  | <b>Nine Months Ended</b> |                  |
|--|---------------------------|------------------|--------------------------|------------------|
|  | <b>September</b>          | <b>September</b> | <b>September</b>         | <b>September</b> |
|  | <b>27,</b>                | <b>29,</b>       | <b>27,</b>               | <b>29,</b>       |
|  | <b>2008</b>               | <b>2007</b>      | <b>2008</b>              | <b>2007</b>      |
|  | <b>(in thousands)</b>     |                  |                          |                  |
| Options to purchase shares not included in the computation of diluted income per share because their inclusion would be antidilutive | 506                       | 1,911            | 2,131                    | 1,907            |

The computation of diluted net income per share for the three and nine months ended September 29, 2007, excludes the effect of assuming the conversion of our senior subordinated convertible notes, which are convertible at \$19.72 per share into 7.3 million shares of common stock, because the effect would have been antidilutive.

Our share repurchase programs, which authorized us to repurchase up to a total of \$130 million of the Company's common stock, were announced on February 11, 2004 as a \$25 million program, on May 12, 2004 as a \$60 million program, on July 29, 2004 as a \$25 million program and on February 2, 2007 as a \$20 million program. No shares of our common stock were repurchased under our publicly announced repurchase programs during the three months

ended September 27, 2008 and September 29, 2007. All repurchased shares have been retired and are not included in net income per common share.

**Table of Contents****15. Business Segment and Geographical Data**

We organize and manage our business by functional operating entities. Our functional entities operate in two segments: Cardiovascular and ITC. The Cardiovascular segment designs, develops, manufactures and markets proprietary medical devices used for mechanical circulatory support and vascular graft applications. The ITC segment designs, develops, manufactures and markets proprietary point-of-care diagnostic test systems and incision devices.

Business Segments:

|  | Three Months Ended       |                          | Nine Months Ended        |                          |
|--|--------------------------|--------------------------|--------------------------|--------------------------|
|  | September<br>27,<br>2008 | September<br>29,<br>2007 | September<br>27,<br>2008 | September<br>29,<br>2007 |
|  | (in thousands)           |                          |                          |                          |
| Product sales:                               |                          |                          |                          |                          |
| Cardiovascular                               | \$ 57,091                | \$ 34,016                | \$ 154,818               | \$ 103,707               |
| ITC  | 23,724                   | 22,039                   | 73,072                   | 66,991                   |
| Total product sales                          | \$ 80,815                | \$ 56,055                | \$ 227,890               | \$ 170,698               |
| Income (loss) before income taxes and other: |                          |                          |                          |                          |
| Cardiovascular (a)(c)                        | \$ 11,647                | \$ (426)                 | \$ 26,871                | \$ 1,969                 |
| ITC(a)(c)                                    | 793                      | 2,203                    | 2,870                    | 5,462                    |
| Corporate (b)(c)                             | (4,253)                  | (4,157)                  | (11,337)                 | (10,648)                 |
| Income (loss) from operations                | 8,187                    | (2,380)                  | 18,404                   | (3,217)                  |
| Other income and (expense):                  |                          |                          |                          |                          |
| Interest expense (b)                         | (1,009)                  | (1,016)                  | (3,030)                  | (3,158)                  |
| Interest income and other (b)                | 2,183                    | 2,261                    | 6,642                    | 6,214                    |
| Income (loss) before income taxes            | \$ 9,361                 | \$ (1,135)               | \$ 22,016                | \$ (161)                 |

|                | As of                    |                         |
|----------------|--------------------------|-------------------------|
|                | September<br>27,<br>2008 | December<br>29,<br>2007 |
|                | (in thousands)           |                         |
| Total assets:  |                          |                         |
| Cardiovascular | \$ 322,798               | \$ 312,691              |
| ITC            | 63,070                   | 62,642                  |
| Corporate (b)  | 284,568                  | 238,386                 |
| Total assets   | \$ 670,436               | \$ 613,719              |

(a) The Cardiovascular segment includes amortization



expense on purchased intangible assets of \$3.1 million and \$9.3 million for the three and nine months ended September 27, 2008, respectively, and \$2.9 million and \$8.8 million for the three and nine months ended September 29, 2007, respectively. The ITC segment includes amortization expense on purchased intangible assets of \$0.2 million and \$0.6 million for the three and nine months ended September 27, 2008, respectively, and \$0.2 million and \$0.6 million for the three and nine months ended September 29, 2007, respectively.

- (b) Represents unallocated costs, income and assets, not specifically identified to any particular business

segment.

- (c) Includes share-based compensation expense of \$1.4 million, \$0.7 million and \$0.4 million for Cardiovascular, ITC and Corporate, respectively, for the three months ended September 27, 2008 and \$1.2 million, \$0.6 million and \$0.1 million for Cardiovascular, ITC and Corporate, respectively, for the three months ended September 29, 2007 and share-based compensation expense of \$4.7 million, \$2.1 million and \$1.2 million for Cardiovascular, ITC and Corporate, respectively, for the nine months ended September 27, 2008 and \$4.6 million, \$2.2 million and \$1.3 million for Cardiovascular, ITC and Corporate, respectively, for the nine months ended

September 29,  
2007.

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## Geographic Areas:

The geographic composition of our product sales was as follows:

|                     | <b>Three Months Ended</b> |                  | <b>Nine Months Ended</b> |                  |
|---------------------|---------------------------|------------------|--------------------------|------------------|
|                     | <b>September</b>          | <b>September</b> | <b>September</b>         | <b>September</b> |
|                     | <b>27,</b>                | <b>29,</b>       | <b>27,</b>               | <b>29,</b>       |
|                     | <b>2008</b>               | <b>2007</b>      | <b>2008</b>              | <b>2007</b>      |
|                     | <b>(in thousands)</b>     |                  |                          |                  |
| Domestic            | \$ 61,674                 | \$ 40,956        | \$ 167,731               | \$ 125,856       |
| International       | 19,141                    | 15,099           | 60,159                   | 44,842           |
| Total product sales | \$ 80,815                 | \$ 56,055        | \$ 227,890               | \$ 170,698       |

**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, hopes, believes, intends, should, estimate, will, 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 2007 Annual Report on Form 10-K (the 2007 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 a world leader in therapies to address advanced heart failure (HF) and point-of-care diagnostics. Our business is comprised of two operating divisions: Cardiovascular and International Technidyne Corporation (ITC), a wholly owned subsidiary.

For advanced HF, our Cardiovascular division develops, manufactures and markets proprietary medical devices used for mechanical circulatory support (MCS). Our primary product lines are our ventricular assist devices (VADs): the Thoratec Paracorporeal Ventricular Assist Device (PVAD), the Thoratec Implantable Ventricular Assist Device (IVAD), the HeartMate Left Ventricular Assist System (HeartMate XVE), and the HeartMate II Left Ventricular Assist System (HeartMate II). We refer to the PVAD and the IVAD collectively as the Thoratec product line and we refer to the HeartMate XVE and the HeartMate II collectively as the HeartMate product line. The PVAD, IVAD, HeartMate XVE and HeartMate II are approved by the U.S. Food and Drug Administration (FDA) and CE Mark approved in Europe. In addition, for acute HF we market the CentriMag Blood Pumping System (CentriMag), which is manufactured by Levitronix LLC (Levitronix) and distributed by us in the U.S. under a distribution agreement with Levitronix. We also manufacture a vascular access graft for renal dialysis.

Our VADs have been clinically proven to improve patient survival and quality of life. We currently offer the widest range of products to serve this market, including VADs for acute, intermediate and chronic support. Collectively, our MCS devices are FDA-approved for the following indications: bridge-to-transplantation (BTT), long-term support for patients suffering from advanced stage HF who are not eligible for heart transplantation (Destination Therapy or DT), post-cardiotomy myocardial recovery, and support during cardiac surgery. We believe that our long-standing reputation for quality and innovation and our excellent relationships with leading cardiovascular surgeons worldwide position us to capture growth opportunities in the expanding HF market.

Our ITC division develops, manufactures and markets two product lines: point-of-care diagnostic test systems for hospital point-of-care and alternate site point-of-care markets, including diagnostic test systems that monitor blood coagulation while a patient is being administered certain anticoagulants, and that monitor blood gas/electrolytes, oxygenation and chemistry status; and incision products including devices used to obtain a patient's blood sample for diagnostic testing and screening for platelet function.

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**Our Business Model**

Our business is comprised of two operating divisions: Cardiovascular and ITC.

The product line of our Cardiovascular division is:

*Circulatory Support Products.* Our mechanical circulatory support products include the PVAD, IVAD, HeartMate XVE, HeartMate II and CentriMag for acute, intermediate and long-term mechanical circulatory support for patients with advanced HF. We also manufacture and sell small diameter grafts using our proprietary materials to address the vascular access market for hemodialysis.

The product lines of our ITC division are:

*Point-of-Care Diagnostics.* Our point-of-care products include diagnostic test systems that monitor blood coagulation while a patient is being administered certain anticoagulants, as well as monitor blood gas/electrolytes, oxygenation and chemistry status.

*Incision.* Our incision products include devices used to obtain a patient's blood sample for diagnostic testing and screening for platelet function.

**Cardiovascular Division**

VADs supplement the pumping function of the heart in patients with advanced 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 VADs.

Certain VADs are implanted internally, while others are placed outside the body. Some external devices are placed immediately adjacent to the body (paracorporeal), while other external VADs are positioned at a distance from the body (extracorporeal).

In addition to our MCS devices, we sell vascular access graft products used in hemodialysis for patients with late-stage renal disease.

Our product portfolio of implantable and external MCS devices and graft products is described below.

*The Paracorporeal Ventricular Assist Device*

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

A pneumatic power source drives the PVAD. It is designed for short-to-intermediate duration use of a few weeks to several months, although this device has supported numerous patients for nine to eighteen months. Offering left, right or biventricular support, the PVAD and the IVAD, described below, are the only biventricular support systems approved for use as BTT. This characteristic is significant since approximately 50% of bridge-to-transplant patients treated with the PVAD require right as well as left-sided ventricular assistance. The PVAD is also the only device approved for both bridge-to-transplantation and recovery following cardiac surgery. The PVAD incorporates our proprietary biomaterial, Thoralon, which has excellent tissue and blood compatibility and is resistant to blood clots.

**Table of Contents***The Implantable Ventricular Assist Device*

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

We received CE Mark approval to market the IVAD in Europe in July 2003 and FDA approval for the U.S. market in August 2004. The IVAD was approved in Canada in November 2004. The IVAD is currently the only approved implantable VAD that can provide left, right or biventricular support.

*The HeartMate XVE*

The HeartMate XVE is an implantable, pulsatile, left ventricular assist device for intermediate and longer-term MCS and is the only device approved in the U.S., Europe and Canada for long term support of patients ineligible for heart transplantation. Patients with a HeartMate XVE do not require anticoagulation drugs, other than aspirin, because of the product's incorporation of proprietary textured surfaces and tissue valves. The system is comprised of the blood pump and a wearable controller and batteries providing a high degree of patient freedom and mobility.

The HeartMate VE initially received FDA approval in September 1998 for BTT and in November 2002 for DT. The enhanced version of the product, called the HeartMate XVE, received FDA approval in December 2001 for BTT. In April 2003, the HeartMate XVE received FDA approval for DT.

*The HeartMate II*

The HeartMate II is an implantable, electrically powered, continuous flow, left ventricular assist device consisting of a miniature rotary blood pump designed to provide intermediate and long-term MCS. The HeartMate II is designed to improve survival and quality of life and to provide five to ten years of circulatory support for a broad range of advanced HF patients. Significantly smaller than the HeartMate XVE and with only one moving part, the HeartMate II is simpler and designed to operate more quietly than pulsatile devices. In April 2008, we received FDA approval for the HeartMate II for BTT. In addition, the HeartMate II is in a Phase II pivotal trial in the U.S. for Destination Therapy. The device received CE Mark approval in November 2005, allowing for its commercial sale in Europe.

*The CentriMag*

The CentriMag, manufactured by Levitronix, is approved to provide MCS for up to six hours for patients suffering from severe, but potentially reversible, cardiac failure and is based on Levitronix's magnetically levitated bearingless motor technology. We entered into a distribution agreement with Levitronix in August 2007, with an initial term effective through December 2011, to distribute the CentriMag in the U.S. The CentriMag is 510(k) cleared by the FDA for use in patients requiring short-term extracorporeal circulatory support during cardiac surgery and Levitronix has CE Mark approval in Europe to market the product to provide support for up to thirty days. Levitronix has recently commenced a U.S. pivotal trial to demonstrate safety and effectiveness of the CentriMag for periods of support up to thirty days. In October 2008, Levitronix received approval from the FDA for a humanitarian device exemption for the CentriMag Right Ventricular Assist System for temporary circulatory support up to fourteen days for patients in cardiogenic shock due to acute right ventricular failure.

*Vascular Graft Products*

The Vectra Vascular Access Graft was approved for sale in the U.S. in December 2000 and in Europe in January 1998. It is designed for use as a shunt between an artery and a vein, primarily to provide access to the bloodstream for renal hemodialysis patients requiring frequent needle punctures during treatment.

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### **ITC Division**

Our product portfolio of point-of-care diagnostic test systems and incision products includes the following:

#### ***Hospital point-of-care***

##### ***The HEMOCHRON Whole Blood Coagulation System***

The HEMOCHRON Whole Blood Coagulation System ( HEMOCHRON ) is used to quantitatively monitor a patient's coagulation status while the patient is being administered anticoagulants. It may be used in various hospital settings. For instance, it is used in the cardiovascular operating room and cardiac catheterization lab to monitor the drug Heparin, and in an anticoagulation clinic to monitor the drug warfarin. The system consists of a small portable instrument and disposable test cuvettes or tubes and delivers results in minutes.

##### ***The IRMA TRUpoint Blood Analysis System***

The IRMA TRUpoint Blood Analysis System ( IRMA ) is used to quantitatively monitor a patient's blood gas, electrolyte and chemistry status. This instrument is a self-contained, portable system which uses disposable test cartridges and delivers results in minutes.

##### ***The AVOXimeter Whole Blood Co-Oximeter/Oximeter System***

The AVOXimeter Whole Blood Co-Oximeter/Oximeter System ( AVOXimeter ) is used to assess a patient's oxygenation status and is commonly used in the cardiac catheterization lab, the intensive care unit ( ICU ), the neonatal intensive care unit ( NICU ) and the emergency department. This portable instrument uses small, single-use test cuvettes and delivers results in less than ten seconds.

Our integrated data management system connects the HEMOCHRON, IRMA and AVOXimeter products.

#### ***Alternate site point-of-care***

##### ***The ProTime Microcoagulation System***

The ProTime Microcoagulation System ( ProTime ) is designed to safely monitor blood clotting activity in patients on anticoagulation therapy, specifically warfarin. The system can be prescribed for patient use at home or can be used in the physician's office or clinic. The system consists of a portable, quantitative instrument and disposable test cuvettes and delivers results in minutes.

##### ***The Hgb Pro Professional Hemoglobin Testing System***

The Hgb Pro Professional Hemoglobin Testing System ( Hgb Pro ) is used by professionals, mainly in the doctor's office, to test for anemia. Hgb Pro delivers quick results from a small blood sample placed on a disposable test strip inserted into a hand-held test meter.

The ProTime and Hgb Pro products are sold into the alternate site non-hospital point-of-care segment of the market comprised of physicians' offices, long-term care facilities, clinics, visiting nurse associations and home healthcare companies.

#### ***Incision Products***

The Tenderfoot Heel Incision Device ( Tenderfoot ), the Tenderlett Finger Incision Device ( Tenderlett ) and the Surgicutt Bleeding Time Device ( Surgicutt ) are used by medical professionals to obtain a patient's blood sample for diagnostic testing. The Tenderfoot is a heel stick used for infant testing, the Tenderlett is used for finger incisions and the Surgicutt is used to perform screening tests to determine platelet function. These devices feature permanently retracting blades for safe incision with minimal pain, as compared to traditional lancets, which puncture the skin.

These products are sold to both the hospital point-of-care and alternate site point-of-care segments of the market. These products offer certain advantages, command a premium over the competition and are sold in the higher end of the market. Our growth in this segment is limited due to lower priced products competing for the same customers.



**Table of Contents****Critical Accounting Policies and Estimates**

We have identified the policies and estimates below as critical to our business operations and the understanding of our results of operations. The impact of, and any associated risks related to, these policies and estimates on our business operations are discussed below. For a more detailed discussion on the application of these and other accounting policies and estimates, see the notes to the condensed consolidated financial statements included in this Quarterly Report on Form 10-Q and our 2007 Annual Report filed with the SEC. Preparation of financial statements in accordance with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount of assets, liabilities, revenue and expenses and the disclosure of contingent assets and liabilities. There can be no assurance that actual results will not differ from those estimates and assumptions.

***Revenue Recognition***

We recognize revenue from product sales for our Cardiovascular and ITC business divisions when evidence of an arrangement exists, title has passed (generally upon shipment) or services have been rendered, the selling price is fixed or determinable and collectability is reasonably assured. Sales to distributors are recorded when title transfers upon shipment. A reserve for sales returns is recorded for sales through the distributor applying reasonable estimates of product returns based upon historical experience.

We recognize sales of certain Cardiovascular division products to first-time customers when we have determined that the customer has the ability to use the products. These sales frequently include the sale of products and training services under multiple element arrangements. Training is not considered essential to the functionality of the products. The amount of revenue under these arrangements allocated to training is based upon fair market value of the training, which is typically performed on our behalf by third party providers. The amount of product sales allocated to the Cardiovascular division products is made using the fair value method. Under this method, the total value of the arrangement is allocated to the training and the Cardiovascular division products based on the relative fair market value of the training and products.

In determining when to recognize revenue, management makes decisions on such matters as the fair values of the product and training elements when sold together, customer credit worthiness and warranty reserves. If any of these decisions proves incorrect, the carrying value of these assets and liabilities on our condensed consolidated balance sheets or the recorded product sales could be significantly different, which could have a material adverse effect on our results of operations for any fiscal period.

***Reserves***

We maintain allowances for doubtful accounts for estimated losses resulting from the inability of our customers to make payments owed to us for product sales and training services. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

The majority of our products are covered by up to a two-year limited manufacturer's warranty from the date of shipment or installation. Estimated contractual warranty obligations are recorded when the related sales are recognized and any additional amounts are recorded when such costs are probable and can be reasonably estimated, at which time they are included in Cost of product sales in our condensed consolidated statements of operations. In determining the warranty reserve estimate, management makes judgments and estimates on such matters as repair costs and probability of warranty obligations.

Estimated excess and obsolete inventory reserves are recorded when inventory levels exceed projected sales volume for a certain period of time. In determining the excess obsolete reserve, management makes judgments and estimates on matters such as forecasted sales volume. If sales volume differs from projection, adjustments to these reserves may be required.

Management must make judgments to determine the amount of reserves to accrue. If any of these decisions proves incorrect, our condensed consolidated financial statement could be materially and adversely affected.

***Income Taxes***

We make certain estimates and judgments in determining income tax expense for financial statement purposes. These estimates and judgments occur in the calculation of tax credits, benefits, and deductions, such as tax benefits from our non-U.S. operations and in the calculation of certain tax assets and liabilities, which arise from differences in the timing of revenue and expense for tax and financial statement purposes.



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We record a valuation allowance to reduce our deferred income tax assets to the amount that is more-likely-than-not to be realized. In evaluating our ability to recover our deferred income tax assets we consider all available positive and negative evidence, including our operating results, on-going tax planning and forecasts of future taxable income on a jurisdiction by jurisdiction basis. In the event we were to determine that we would be able to realize our deferred income tax assets in the future in excess of their net recorded amount, we would make an adjustment to the valuation allowance which would reduce the provision for income taxes. Conversely, in the event that all or part of the net deferred tax assets are determined not to be realizable in the future, an adjustment to the valuation allowance would be charged to earnings in the period such determination is made.

We believe we have provided adequate reserves for anticipated tax audit adjustments by United States federal, state and local, as well as foreign, tax authorities based on our estimate of whether, and the extent to which, additional taxes, interest and penalties may be due. If events occur which indicate payment of these amounts is unnecessary, the reversal of the liabilities would result in tax benefits being recognized in the period when we determine the accrued liabilities are no longer warranted. If our estimate of tax liabilities proves to be less than the ultimate assessment, a further charge to expense would result.

***Evaluation of Purchased Intangibles and Goodwill for Impairment***

In accordance with Statement of Financial Accounting Standards ( SFAS ) No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, we periodically evaluate the carrying value of long-lived assets to be held and used, including intangible assets subject to amortization, when events or circumstances warrant such a review. The carrying value of a long-lived asset to be held and used is considered impaired when the anticipated separately identifiable undiscounted cash flows from such an asset are less than the carrying value of the asset. In that event, a loss is recognized based on the amount by which the carrying value exceeds the fair value of the long-lived asset. Fair value is determined primarily using the anticipated cash flows discounted at a rate commensurate with the risk involved. Management must make estimates of these future cash flows, if necessary, and the approximate discount rate, and if any of these estimates proves incorrect, the carrying value of these assets on our condensed consolidated balance sheets could become significantly impaired.

In accordance with SFAS No. 142, *Goodwill and Other Intangible Assets*, such assets with indefinite lives are not amortized but are subject to annual impairment tests. If there is an apparent impairment, a new fair value would be determined. If the new fair value is less than the carrying amount, an impairment loss would be recognized.

***Valuation of Share-Based Awards***

We account for share-based compensation in accordance with the fair value recognition provisions of SFAS No. 123(R) *Share-Based Payment*. Under SFAS No. 123(R), share-based compensation cost is measured at the grant date based on the value of the award and is recognized as expense over the vesting period. Determining the fair value of option awards at the grant date requires judgment, including estimating the expected term of stock options, the expected volatility of our stock, expected forfeitures and expected dividends. The computation of the expected volatility assumption used in the Black-Scholes option pricing model for option grants is based on historical volatility. When establishing the expected life assumption, we review annual historical employee exercise behavior of option grants with similar vesting periods. In addition, judgment is also required in estimating the amount of share-based awards that are expected to be forfeited. If actual results differ significantly from these estimates, share-based compensation expense and our results of operations could be materially affected.

***Fair Value Measurements***

We adopted the provisions of SFAS No. 157, *Fair Value Measurements*, on December 30, 2007. SFAS No. 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability ( exit price ) in an orderly transaction between market participants at the measurement date.

In determining fair value, we use various approaches, including market, income and/or cost approaches, and each of these approaches requires certain inputs. SFAS No. 157 establishes a hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that observable inputs be used when available. Observable inputs are inputs that market participants would use in pricing the asset or liability developed based on market data obtained from sources independent of us. Unobservable inputs are inputs that reflect our assumptions as compared to the assumptions market participants would use in pricing the

asset or liability developed based on the best information available in the circumstances. The hierarchy is broken down into three levels based on the reliability of inputs as follows:

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Level 1-Valuations based on quoted prices in active markets for identical assets or liabilities that we have the ability to access. Assets and liabilities utilizing Level 1 inputs include broker-dealer quote securities that can be traded in an active market. We used Level I assumptions for our cash and cash equivalents, for auction rate securities called at par in April 2008 and for the straight convertible debt feature of our senior subordinated convertible debt notes, except for the make-whole provision using a Level 3 input, described below. Since valuations are based on quoted prices that are readily and regularly available in an active market, a significant degree of judgment is not required.

Level 2-Valuations based on quoted prices of similar investments in active markets, of similar or identical investments in markets that are not active or model based valuations for which all significant inputs and value drivers are observable, directly or indirectly. Assets and liabilities utilizing Level 2 inputs include primarily municipal bonds.

Level 3-Valuations based on inputs that are unobservable and significant to the overall fair value measurement. Assets and liabilities utilizing Level 3 inputs include certain auction rate securities, our Levitronix convertible debenture and the make-whole feature of our senior subordinated convertible notes. Given the current credit market illiquidity for auction rate securities, our estimates are subject to significant judgment by management.

Fair value is a market-based measure considered from the perspective of a market participant who holds the asset or owes the liability rather than an entity-specific measure. Therefore, even when market assumptions are not readily available, our own assumptions are set to reflect those that market participants would use in pricing the asset or liability at the measurement date. See Note 2 to the condensed consolidated financial statements for further information about our financial assets that are accounted for at fair value.

Due to the uncertainty inherent in the valuation process, estimates of fair value may differ significantly from the values that would have been obtained had an active market for the securities existed, and the differences could be material. Additionally, changes in the market environment and other events that may occur over the life of the investments may cause the gains or losses ultimately realized on these investments to be different than the valuations currently assigned. There is no single standard for determining fair value in good faith, as fair value depends upon circumstances of each individual case. In general, fair value is the amount that we might reasonably expect to receive upon the current sale of the security in an arms-length transaction in the security's principal market.

**Results of Operations**

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

|   | <b>Three Months Ended</b> |                  | <b>Nine Months Ended</b> |                  |
|---|---------------------------|------------------|--------------------------|------------------|
|   | <b>September</b>          | <b>September</b> | <b>September</b>         | <b>September</b> |
|   | <b>27,</b>                | <b>29,</b>       | <b>27,</b>               | <b>29,</b>       |
|   | <b>2008</b>               | <b>2007</b>      | <b>2008</b>              | <b>2007</b>      |
| Product sales                               | 100%                      | 100%             | 100%                     | 100%             |
| Cost of product sales                       | 40                        | 42               | 41                       | 41               |
| Gross profit                                | 60                        | 58               | 59                       | 59               |
| Operating expenses:                         |                           |                  |                          |                  |
| Selling, general and administrative         | 29                        | 37               | 30                       | 36               |
| Research and development                    | 17                        | 19               | 17                       | 19               |
| Amortization of purchased intangible assets | 4                         | 6                | 4                        | 6                |
| Total operating expenses                    | 50                        | 62               | 51                       | 61               |
| Income (loss) from operations               | 10                        | (4)              | 8                        | (2)              |
| Interest expense                            | (1)                       | (2)              | (1)                      | (2)              |

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|                            |     |      |     |   |
|----------------------------|-----|------|-----|---|
| Interest income and other  | 3   | 4    | 3   | 4 |
| Income before income taxes | 12  | (2)  | 10  |   |
| Income tax expense         | (3) | (1)  | (3) |   |
| Net income (loss)          | 9%  | (3)% | 7%  | % |

See Note 15 to our unaudited condensed consolidated financial statements in this Quarterly Report on Form 10-Q for data presented by business segment.

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**Three months ended September 27, 2008 and September 29, 2007**

***Product Sales***

Product sales in the third quarter of 2008 were \$80.8 million compared to \$56.1 million in the third quarter of 2007. The primary components of the total \$24.7 million increase in product sales were the following:

Cardiovascular product sales increased by \$23.0 million primarily due to higher sales from our HeartMate product line. These higher sales resulted from increased HeartMate II volume, partly attributable to increased implant activity subsequent to the FDA BTT commercial approval in April 2008, a commercial price increase for HeartMate II in North America and the addition of seventeen new HeartMate II centers. In addition, favorable foreign currency translation contributed to our increased product sales.

ITC product sales increased by \$1.7 million primarily due to higher international sales of our Alternate Site product line, partly offset by the decrease of our sales of the incision product line.

Sales originating outside of the U.S. and U.S. export sales accounted for approximately 24% and 27% of our total product sales in the third quarter of 2008 and 2007, respectively.

***Gross Profit***

Gross profit in the third quarter of 2008 was \$48.8 million compared to \$32.3 million in the third quarter of 2007. As a percentage of product sales, gross margin in the third quarter of 2008 and 2007 was 60% and 58%, respectively. The increase in gross margin percentage was primarily due to the following:

Cardiovascular gross margin percentage increased by 4% primarily due to HeartMate II commercial price increases and favorable foreign currency translations partially offset by the increased percentage of non-pump product sales.

ITC division gross margin percentage decreased by 5% due to unfavorable geographic and product mix and unfavorable manufacturing variances.

***Selling, General and Administrative***

Selling, general and administrative expenses in the third quarter of 2008 were \$23.9 million, or 30% of product sales, compared to \$20.9 million, or 37% of product sales, in the third quarter of 2007. The \$3.0 million increase in expenses was primarily attributable to the following:

Cardiovascular costs increased by \$2.8 million in the third quarter of 2008 as compared to the third quarter of 2007 primarily due to market development initiatives, commercialization efforts around the HeartMate II and higher compensation expense.

ITC costs decreased by \$0.2 million in the third quarter of 2008 as compared to the third quarter of 2007 primarily due to lower consulting expenses.

Corporate costs increased by \$0.4 million in the third quarter of 2008 as compared to the third quarter of 2007 primarily due to higher compensation and various other corporate expenses.

***Research and Development***

Research and development expenses in the third quarter of 2008 were \$13.4 million, or 17% of product sales, compared to \$10.7 million, or 19% of product sales, in the third quarter of 2007. Of the \$2.7 million increase, our Cardiovascular and ITC divisions incurred \$1.9 million and \$0.8 million, respectively, in additional expenses in the third quarter of 2008 as compared to the third quarter of 2007. Our research and development costs are largely project driven, and fluctuate based on the level of project activity planned and subsequently approved and conducted. The increase in costs at our Cardiovascular division was primarily due to increased research and development costs associated with the HeartMate product line peripheral enhancements. The increase in costs at our ITC division was primarily due to new product development.

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***Amortization of Purchased Intangible Assets***

Amortization of purchased intangible assets in the third quarter of 2008 was \$3.3 million as compared to \$3.1 million in the third quarter of 2007. The \$0.2 million increase in amortization expense resulted from decreasing the useful estimated lives of certain of our intangible assets at our Cardiovascular division at the beginning of fiscal year 2008.

***Interest Expense***

Interest expense was \$1.0 million in the third quarter of each of 2008 and 2007. Interest expense includes amortization of debt issuance costs related to our senior subordinated convertible notes of \$0.2 million for each of the third quarters of 2008 and 2007.

***Interest Income and Other***

Interest income and other for the third quarter of 2008 was \$2.2 million as compared to \$2.3 million for the third quarter of 2007. Interest income was \$1.9 million for the third quarter of 2008 and \$2.0 million for the third quarter of 2007.

***Income Taxes***

Our effective income tax rates were 23% on pre-tax income for the third quarter of 2008 and 24% on pre-tax loss for the third quarter of 2007. The 47% increase in our effective tax rate for the three month period in 2008 as compared to the same period in 2007 was primarily related to an increase in projected pre-tax earnings, partially offset by a decrease in non-deductible expenses, specifically related to our Incentive Stock Options.

***Nine months ended September 27, 2008 and September 29, 2007***

***Product Sales***

Product sales in the first nine months of 2008 were \$227.9 million compared to \$170.7 million in the first nine months of 2007. The primary components of the total \$57.2 million increase in product sales were the following:

Cardiovascular product sales increased by \$51.1 million primarily due to higher sales from our HeartMate product line. The higher sales resulted from increased HeartMate II volume partially attributable to implant activity subsequent to the FDA BTT approval, and stocking revenue associated with the addition of forty-three new HeartMate II centers, along with a commercial price increase on our HeartMate II in North America. Additionally, favorable foreign currency translation contributed to our increased product sales.

ITC product sales increased by \$6.1 million due primarily to higher international and domestic sales of our Alternate Site products and HEMOCHRON product lines.

Sales originating outside of the U.S. and U.S. export sales accounted for approximately 26% of our total product sales in each of the first nine months of 2008 and 2007.

***Gross Profit***

Gross profit in the first nine months of 2008 was \$135.4 million compared to \$100.5 million in the first nine months of 2007. As a percentage of product sales, gross margin for each of the first nine months of 2008 and 2007 was 59%. The primary components were the following:

Cardiovascular gross margin percentage increased by 1% primarily due to increased HeartMate II prices in North America, favorable foreign currency translations, partially offset by the increased percentage of non-pump revenue and unfavorable manufacturing variances.

ITC division gross margin percentage decreased by 5% due to unfavorable geographic and product mix and increased unfavorable manufacturing variances.



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***Selling, General and Administrative***

Selling, general and administrative expenses in the first nine months of 2008 were \$68.3 million, or 30% of product sales, compared to \$62.0 million, or 36% of product sales, in the first nine months of 2007. This \$6.3 million increase in expenses was primarily attributable to the following:

Cardiovascular costs increased by \$5.7 million in the first nine months of 2008 as compared to the first nine months of 2007 primarily due to market development initiatives, commercialization efforts around the HeartMate II and higher compensation expense.

ITC costs increased by \$0.4 million in the first nine months of 2008 as compared to the first nine months of 2007 primarily due to higher sales and marketing personnel and travel cost.

Corporate costs increased by \$0.2 million during the first nine months of 2008 as compared to the first nine months of 2007 primarily due to higher compensation expense during the first nine months of 2008, which was partially offset by higher consulting fees incurred during the first nine months of 2007 related to a stock option review that did not recur .

***Research and Development***

Research and development expenses in the first nine months of 2008 were \$38.8 million, or 17% of product sales, compared to \$32.4 million, or 19% of product sales, in the first nine months of 2007. Our Cardiovascular and ITC divisions accounted for \$4.7 million and \$1.7 million, respectively, of the \$6.4 million increase. Research and development costs are largely project driven, and fluctuate based on the level of project activity planned and subsequently approved and conducted. The increase in costs at our Cardiovascular division was primarily due to increased research and development costs associated with Phase II of the HeartMate II pivotal trial and HeartMate product line peripheral enhancements. The increase in costs at our ITC division was primarily due to new product development.

***Amortization of Purchased Intangible Assets***

Amortization of purchased intangible assets in the first nine months of 2008 was \$9.9 million as compared to \$9.4 million in the first nine months of 2007. The \$0.5 million increase in amortization expense resulted from decreasing the useful estimated lives of certain of our intangible assets at our Cardiovascular division at the beginning of fiscal year 2008.

***Interest Expense***

Interest expense was \$3.0 million in the first nine months of 2008 as compared to \$3.2 million in the first nine months of 2007. Interest expense includes amortization of debt issuance costs related to our senior subordinated convertible notes of \$0.5 million for the first nine months of each of 2008 and 2007.

***Interest Income and Other***

Interest income and other for the first nine months of 2008 was \$6.6 million as compared to \$6.2 million for the first nine months of 2007. Interest income was \$6.2 million and \$5.9 million in the first nine months of 2008 and 2007, respectively. This increase in interest income of \$0.3 million was due to higher investment balances in our portfolio and higher short-term interest rates as a result of the auction failures with higher than market interest rates on our auction rate securities. The remaining \$0.1 million increase related to increase in royalty income and gains from foreign currency translation.

**Table of Contents*****Income Taxes***

Our effective income tax rates were 27% on pre-tax income for the nine months ended September 27, 2008 and 167% on pre-tax loss for the nine months ended September 29, 2007, respectively. The 194% increase in our effective tax rate for the nine month period in 2008 as compared to the same period in 2007 was primarily due to a significant increase in projected profit taxed at the statutory tax rates, and a release of reserves recorded under FIN 48, *Accounting for Uncertainty in Income Taxes, an interpretation of SFAS No. 109*, related to indirect items accrued for certain foreign exposures partially offset by a return-to-provision true-up for foreign returns.

***Liquidity and Capital Resources***

At September 27, 2008, we had net working capital of \$315.6 million compared with \$301.7 million at December 29, 2007. Cash and cash equivalents on September 27, 2008 were \$65.5 million compared to \$20.7 million on December 29, 2007. The increase in cash and cash equivalents was mainly due to proceeds from cash from operations and the exercise of stock options, partially offset by purchases of property, plant and equipment.

Cash provided by operating activities for the nine months ended September 27, 2008 was \$29.9 million. This amount includes net income for the period of \$16.2 million increased by positive non-cash adjustments to net income of approximately \$25.5 million, and a net decrease of approximately \$11.8 million from changes in assets and liabilities. The positive non-cash adjustments to net income were primarily due to \$17.7 million for depreciation and amortization, \$8.0 million related to share-based compensation expense, and \$5.4 million of tax benefit related to stock options partially offset by \$4.5 million in changes to net deferred tax liabilities and \$3.6 million related to excess tax benefits from share-based compensation. The change in assets and liabilities were primarily due to a \$13.8 million increase in receivables, a \$7.0 million increase in inventory and a \$3.4 million decrease in income taxes payable, partially offset by a \$12.1 million increase in accounts payable.

Investing activities for the nine months ended September 27, 2008 used cash of \$7.5 million, primarily attributable to a \$6.9 million used for purchases of property, plant and equipment, net of \$2.4 million in transfers of drivers and demonstration equipment from inventory into fixed assets. The purchased property, plant and equipment included \$3.6 million for leasehold improvements related to the expansion of our manufacturing facility and purchases of management information systems equipment at our Cardiovascular division and \$3.3 million for facility expansion costs at our ITC division.

Financing activities for the nine months ended September 27, 2008 provided cash of \$22.4 million, due to net proceeds of stock option exercises as a result of the increase in our stock price and proceeds from the employee stock purchase plan purchases partially offset by repurchases of restricted stock for payment of income withholding taxes due upon vesting.

As of September 27, 2008, we owned approximately \$37.2 million of auction rate securities that are marketed by financial institutions and are periodically reset through auctions ranging from 7 to 35 days. The underlying collateral of the auction rate securities consists of student loans. Beginning in February of 2008, these auctions began to fail. As a result, we will not be able to access these funds until future auctions for these securities are successful, until a secondary market is established, or until these securities are called for redemption. As such, our auction rate securities are classified as long-term and are valued at \$30.6 million using significant unobservable inputs. Based on our expected operating cash flows, and our other sources of cash, we do not anticipate the potential lack of liquidity of these investments will affect our ability to execute our current business plan.

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

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

|   | <b>Auction Rate<br/>Securities</b> |
|---|------------------------------------|
| Balance at December 29, 2007                                  | \$                                 |
| Transfer to Level 3   | 46,050                             |
| Settlements at par  | (8,850)                            |
| Unrealized holding loss, included in other comprehensive loss | (5,049)                            |
| Balance at March 29, 2008                                     | \$ 32,151                          |
| Unrealized holding loss, included in other comprehensive loss | (288)                              |
| Balance at June 28, 2008                                      | \$ 31,863                          |
| Unrealized holding loss, included in other comprehensive loss | (1,309)                            |
| Balance at September 27, 2008                                 | \$ 30,554                          |

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

We intend and have the ability to hold these auction rate securities until the market recovers or until maturity. We do not anticipate having to sell these securities in order to operate our business. We believe that, based on our current unrestricted cash, cash equivalents and short-term marketable security balances of \$224.9 million at September 27, 2008, the current lack of liquidity in the credit and capital markets will not have an impact on our liquidity, our cash flow or our ability to fund our operations. If the issuers of the auction rate securities are unable to successfully complete future auctions and their credit ratings deteriorate, we may in the future be required to record an impairment charge on these investments. It could conceivably take until the final maturity of the underlying notes (up to 30 years) to realize our investments recorded value.

In 2004, we completed the sale of \$143.8 million initial principal amount of senior subordinated convertible notes due in 2034. The senior subordinated convertible notes were issued at an issue price of \$580.98 per note, which is 58.098% of the principal amount at maturity of the notes. The senior subordinated convertible notes bear interest at a rate of 1.3798% per year on the principal amount at maturity, payable semi-annually in arrears in cash on May 16 and November 16 of each year, from November 16, 2004 until May 16, 2011. Holders of the senior subordinated convertible notes may convert their convertible notes into shares of our common stock at a conversion rate of 29.4652 shares per \$1,000 principal amount of senior subordinated convertible notes, which represents a conversion price of \$19.72 per share, subject to adjustments upon the occurrence of certain events as set forth in the indenture. Holders have been and are able to convert their convertible notes at any point after the close of business on September 30, 2004 if, as of the last day of the preceding calendar quarter, the closing price of our common stock for at least 20 trading days in a period of 30 consecutive trading days ending on the last trading day of such preceding calendar quarter is more than 120% of the accreted conversion price per share of our common stock. Commencing October 1,

2008, this market price conversion feature was satisfied, such that holders of the senior subordinated convertible notes may convert their notes through the final maturity date of the notes into shares of our common stock at a conversion rate of 29.462 shares per \$1,000 principal amount of senior subordinated convertible notes, subject to adjustments as provided in the indenture. If holders elect conversion, we may, at our option, deliver shares of common stock, pay a holder in cash, or deliver a combination of shares and cash, as determined pursuant to the terms of the notes.

**Off Balance Sheet Arrangements**

We maintain an Irrevocable Standby Letter of Credit as part of our workers' compensation insurance program. The Letter of Credit is not collateralized. The Letter of Credit automatically renews on June 30th of each year, unless terminated by one of the parties. At September 27, 2008, our Letter of Credit balance was approximately \$850,000.

**Contractual Obligations**

As of September 27, 2008, the liability for uncertain tax positions was \$8.1 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 nine months ended September 27, 2008 there were no other material changes outside our normal course of business to our contractual obligations reported in our 2007 Annual Report.

**Table of Contents****ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK****Interest Rate Risk**

Our investment portfolio is made up of marketable investments in money market funds, auction rate securities, U.S. Treasury securities and debt instruments of government agencies, local municipalities, and high quality corporate issuers. All investments are carried at fair market value and are treated as available-for-sale. Investments with maturities beyond one year may be classified as short-term based on their highly liquid nature due to the frequency with which the interest rate is reset and because such marketable securities represent the investment of cash that is available for current operations. Our auction rate securities that are not liquid are treated as long term. Our holdings of the securities of any one issuer, except government agencies, do not exceed 10% of the portfolio. If interest rates rise, the market value of our investments may decline, which could result in a loss if we are forced to sell an investment before its scheduled maturity. If interest rates were to rise or fall from current levels by 25 basis points and by 50 basis points, the change in our net unrealized gain or loss on investments would be \$0.4 million and \$0.8 million, respectively. We do not utilize derivative financial instruments to manage interest rate risks.

Our senior subordinated convertible notes and the Levitronix convertible debenture do not bear interest rate risk as the notes were issued at a fixed rate of interest.

**Foreign Currency Rate Fluctuations**

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

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

Our financial instrument contracts qualify as derivatives under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and we valued these contracts at the estimated fair value at September 27, 2008. The change in fair value of the forward currency contracts is included in Interest income and other, and offsets the foreign currency exchange gains and losses in the condensed consolidated statement of operations. The impacts of these foreign currency contracts were:

|  | <b>Three Months Ended</b> |                  | <b>Nine Months Ended</b> |                  |
|--|---------------------------|------------------|--------------------------|------------------|
|  | <b>September</b>          | <b>September</b> | <b>September</b>         | <b>September</b> |
|  | <b>27,</b>                | <b>29,</b>       | <b>27,</b>               | <b>29,</b>       |
|  | <b>2008</b>               | <b>2007</b>      | <b>2008</b>              | <b>2007</b>      |
|  | <b>( in thousands)</b>    |                  |                          |                  |
| Foreign currency exchange gain (loss) on foreign currency contracts      | \$ 325                    | \$ (346)         | \$(822)                  | \$ (388)         |
| Foreign currency exchange (loss) gain on foreign translation adjustments | (302)                     | 431              | 928                      | 433              |

As of September 27, 2008, we had forward contracts to sell euros with a notional value of 6.4 million and to purchase UK pounds with a notional value of £4.6 million, and as of September 29, 2007 we had forward contracts to sell euros with a notional value of 6.8 million and to purchase UK pounds with a notional value of £4.0 million. As of September 27, 2008, our forward contracts had an average exchange rate of one U.S. dollar to 0.6799 euros and one U.S. dollar to 0.5351 UK pounds. The forward contracts are valued based on exchange rates derived from an independent source of market participant assumptions and compiled from the best information available. As of

September 27, 2008, the estimated fair value of these foreign currency contracts was \$0.1 million.

The potential fair value gain or loss for a hypothetical 10% change in foreign currency exchange rates at September 27, 2008 would be approximately \$1.8 million.

**Table of Contents****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 September 27, 2008. 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 any 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 September 27, 2008 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 to Internal Controls***

There have been no changes in our internal controls over financial reporting during the quarter ended September 27, 2008 that have materially affected or are reasonably likely to materially affect our internal control over financial reporting.

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

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

We intend to review and evaluate the design and effectiveness of our disclosure controls and procedures on an ongoing basis and to improve our controls and procedures over time and to correct any deficiencies that we may discover in the future. While our Chief Executive Officer and Chief Financial Officer have concluded that, as of

September 27, 2008, 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.



**Table of Contents****PART II. OTHER INFORMATION****ITEM 1A. RISK FACTORS**

In addition to the other information set forth in this Quarterly Report, you should carefully consider the factors discussed in Part I, Item 1A. Risk Factors in our 2007 Annual Report, except as stated below, which could materially affect our business, financial condition or future results. The risks described in our 2007 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.

The following risk factor reflects a material change to the Risk Factors set forth in our 2007 Annual Report on Form 10-K for the fiscal year ended December 29, 2007,

***If we fail to obtain approval from the FDA and from foreign regulatory authorities, we cannot market and sell our products under development in the U.S. and in other countries, and if we fail to adhere to ongoing FDA Quality System Regulations, or our products experience certain adverse events, the FDA may withdraw our market clearance or take other action.***

Before we can market new products in the U.S., we must obtain PMA approval or 510(k) clearance from the FDA. This process is lengthy and uncertain. In the U.S., one must obtain clearance from the FDA of a 510(k) pre-market notification or approval of a more extensive submission known as a PMA application. If the FDA concludes that any of our products do not meet the requirements to obtain clearance under Section 510(k) of the Federal Food, Drug, and Cosmetic Act, then we will be required to file a PMA application. The process for a PMA application is lengthy, expensive and typically requires extensive pre-clinical and clinical trial data.

We may not obtain clearance of a 510(k) notification or approval of a PMA application with respect to any of our products on a timely basis, if at all. If we fail to obtain timely clearance or approval for our products, we will not be able to market and sell them, thereby harming our ability to generate sales. The FDA also may limit the claims that we can make about our products. We also may be required to obtain clearance of a 510(k) notification or a PMA Supplement from the FDA before we can market products which have already been cleared, but which have since been modified or we subsequently wish to market for new disease indications.

The FDA also requires us to adhere to Quality System Regulations, which include production design controls, testing, quality control, and storage and documentation procedures. The FDA may at any time inspect our facilities to determine whether we have adequate compliance. Compliance with Quality System Regulations for medical devices is difficult and costly. In addition, we may not be found compliant as a result of future changes in, or interpretations of, regulations by the FDA or other regulatory agencies. If we do not achieve compliance, the FDA may withdraw marketing clearance, require product recall or take other enforcement action, which in each case would harm our business. Any change or modification to a device is required to be made in compliance with Quality System Regulations, which compliance may cause interruptions or delays in the marketing and sale of our products. The FDA also requires us to submit reports regarding deaths, serious injuries and certain malfunctions relating to our products and in response to such instances of death, serious injury or malfunctions, the FDA may withdraw marketing clearance, require product recall or take other enforcement action, which in each case would harm our business, if not appropriately addressed or remediated by us.

Sales of our products outside the U.S. are subject to foreign regulatory requirements that vary from country to country. The time required to obtain approvals from foreign countries may be longer or shorter than that required for FDA approval, and requirements for foreign licensing may differ from FDA requirements. In any event, if we fail to obtain the necessary approvals to sell any of our products in a foreign country, or if any obtained approval is revoked or suspended, we will not be able to sell those products there.

The federal, state and foreign laws and regulations regarding the manufacture and sale of our products are subject to future changes, as are administrative interpretations and policies of regulatory agencies. If we fail to comply with applicable federal, state or foreign laws or regulations, we could be subject to enforcement actions. Enforcement actions could include product seizures, recalls, withdrawal of clearances or approvals, and civil and criminal penalties, which in each case would harm our business.

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

There were no unregistered sales of our equity securities during the three months ended September 27, 2008.

The following table sets forth certain information about our common stock repurchased during the three months ended September 27, 2008:

|  | <b>Total<br/>number<br/>of<br/>shares<br/>purchased<br/>(2)</b> | <b>Average<br/>price<br/>paid<br/>per share<br/>(in thousands, except per share data)</b> | <b>Total<br/>number<br/>of shares<br/>purchased<br/>under<br/>publicly<br/>announced<br/>programs<br/>(1)</b> | <b>Approximate<br/>value of<br/>shares<br/>authorized to<br/>be<br/>purchased<br/>under<br/>publicly<br/>announced<br/>programs</b> |
|--|---|---|---|---|
| June 29, 2008 through July 26, 2008        | 1.8   | \$ 16.99  |   | \$  |
| July 27, 2008 through August 23, 2008      | 1.6   | 21.61   |   |   |
| August 24, 2008 through September 27, 2008 | 1.3   | 27.04   |   |   |
| Total                                      | 4.7   | \$ 21.31  |   | \$  |

(1) Our share repurchase programs, which authorized us to repurchase up to a total of \$130 million of the Company's common shares, were announced on February 11, 2004 as a \$25 million program, on May 12, 2004 as a \$60 million program, on July 29, 2004 as a \$25 million program and on February 2,

2006 as a \$20 million program. These programs authorize us to acquire shares in the open market or in privately negotiated transactions and do not have an expiration date. No shares were repurchased under these programs during the three and nine months ended September 27, 2008.

- (2) Shares purchased that were not part of our publicly announced repurchase programs represent the surrender value of shares of restricted stock 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.

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**ITEM 6. EXHIBITS**

- 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.
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**SIGNATURES**

In accordance with the requirements of the 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: November 5, 2008

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

Date: November 5, 2008

/s/ David V. Smith  
David V. Smith  
Chief Financial Officer

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**EXHIBIT INDEX**

| <b>Number</b> | <b>Description</b>                                    |
|---------------|---|
| 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. |