

SYNAPTICS INC  
Form 10-Q  
May 07, 2008

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
FORM 10-Q

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934**

**For the quarterly period ended March 29, 2008**

Commission file number 000-49602

**SYNAPTICS INCORPORATED**

(Exact name of registrant as specified in its charter)

**Delaware**

**77-0118518**

(State or other jurisdiction  
of incorporation or organization)

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

**3120 Scott Blvd., Suite 130  
Santa Clara, California 95054**

(Address of principal executive offices) (Zip code)

**(408) 454-5100**

(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 ☐ Accelerated filer ☐ Non-accelerated filer ☐ Smaller reporting  
filer ☒ 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 ☒

Number of shares of Common Stock outstanding at May 6, 2008: 22,663,651

**SYNAPTICS INCORPORATED**  
**QUARTERLY REPORT ON FORM 10-Q**  
**FOR THE QUARTER ENDED MARCH 31, 2008**  
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CONDENSED CONSOLIDATED BALANCE SHEETS**

(in thousands, except share data)

(unaudited)

	<b>March 31, 2008</b>	<b>June 30, 2007</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 107,837	\$ 45,915
Short-term investments	77,906	219,102
Accounts receivable, net of allowances of \$364 and \$419, respectively	57,762	56,721
Inventories	20,284	12,034
Prepaid expenses and other current assets	14,250	4,245
Total current assets	278,039	338,017
Property and equipment, net	22,367	19,400
Goodwill	1,927	1,927
Other assets	17,245	13,968
	\$ 319,578	\$ 373,312
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 19,229	\$ 21,552
Accrued compensation	6,055	5,372
Income taxes payable	5,969	3,400
Other accrued liabilities	8,522	6,272
Note payable		1,500
Total current liabilities	39,775	38,096
Other liabilities	15,819	2,129
Convertible senior subordinated notes	125,000	125,000
Stockholders' equity:		
Common stock:		
\$0.001 par value; 60,000,000 shares authorized; 31,273,857 and 29,666,660 shares issued, respectively	31	30
Additional paid-in capital	216,228	180,746
Less: 8,088,100 and 3,588,100 common treasury shares, respectively, at cost	(200,745)	(72,345)
Accumulated other comprehensive loss	(4,791)	(139)
Retained earnings	128,261	99,795
Total stockholders' equity	138,984	208,087
	\$ 319,578	\$ 373,312



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**SYNAPTICS INCORPORATED AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF INCOME**

(in thousands, except per share data)

(unaudited)

	<b>Three Months Ended March 31,</b>		<b>Nine Months Ended March 31,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Net revenue	\$ 78,861	\$ 64,309	\$ 264,203	\$ 195,211
Cost of revenue (1)	46,688	39,162	155,521	117,278
Gross margin	32,173	25,147	108,682	77,933
Operating expenses:				
Research and development (1)	13,560	9,485	35,655	28,631
Selling, general, and administrative (1)	12,181	9,339	34,346	26,067
Restructuring				915
Total operating expenses	25,741	18,824	70,001	55,613
Income from operations	6,432	6,323	38,681	22,320
Interest income	2,293	2,713	8,301	8,230
Interest expense	(449)	(488)	(1,373)	(1,463)
Gain on settlement of debt			2,689	
Impairment of investment			(4,000)	
Impairment of auction rate securities investments	(2,237)		(2,237)	
Income before provision for income taxes	6,039	8,548	42,061	29,087
Provision for income taxes	3,031	2,913	13,595	9,984
Net income	\$ 3,008	\$ 5,635	\$ 28,466	\$ 19,103
Net income per share:				
Basic	\$ 0.12	\$ 0.22	\$ 1.10	\$ 0.75
Diluted	\$ 0.12	\$ 0.20	\$ 1.05	\$ 0.67
Shares used in computing net income per share:				
Basic	24,760	25,823	25,932	25,509
Diluted	25,302	29,592	27,134	29,512

(1) Amounts  
include

share-based  
compensation  
costs as follows:

Cost of revenue	\$ 377	\$ 160	\$ 966	\$ 492
Research and development	\$1,797	\$1,262	\$4,556	\$3,736
Selling, general, and administrative	\$2,680	\$1,966	\$7,146	\$6,169

*See notes to condensed consolidated financial statements (unaudited).*

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**SYNAPTICS INCORPORATED AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(in thousands)

(unaudited)

	<b>Nine Months Ended March 31,</b>	
	<b>2008</b>	<b>2007</b>
<b>Cash flows from operating activities</b>		
Net income	\$ 28,466	\$ 19,103
Adjustments to reconcile net income to net cash provided by operating activities:		
Share-based compensation costs	12,668	10,397
Deferred taxes from share-based compensation	308	(1,106)
Tax benefit realized from share-based compensation		7,843
Excess tax benefit from share-based compensation		(7,246)
Depreciation of property and equipment	2,750	1,637
Impairment of software, property, and equipment costs	210	102
Amortization of debt issuance costs	645	645
Gain on settlement of debt	(2,689)	
Impairment of investment	4,000	
Impairment of auction rate securities investments	2,237	
Changes in operating assets and liabilities:		
Accounts receivable, net	(1,041)	(15,069)
Inventories	(8,250)	885
Prepaid expenses and other current assets	524	(917)
Other assets	4,772	4,038
Accounts payable	(2,323)	1,644
Accrued compensation	176	(553)
Income taxes	5,041	(8,661)
Other accrued liabilities	3,439	2,966
Other liabilities	(67)	(1,008)
Net cash provided by operating activities	50,866	14,700
<b>Cash flows from investing activities</b>		
Purchases of short-term investments	(165,994)	(197,307)
Proceeds from sales and maturities of short-term investments	288,055	206,342
Purchases of property and equipment	(5,927)	(3,953)
Net cash provided by investing activities	116,134	5,082
<b>Cash flows from financing activities</b>		
Purchase of treasury stock	(128,400)	(32,346)
Proceeds from issuance of common stock upon exercise of options and stock purchase plan	23,322	14,050
Excess tax benefit from share-based compensation		7,246

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Net cash used in financing activities	(105,078)	(11,050)
Net increase in cash and cash equivalents	61,922	8,732
Cash and cash equivalents at beginning of period	45,915	38,724
Cash and cash equivalents at end of period	\$ 107,837	\$ 47,456

**Supplemental disclosures of cash flow information**

Cash paid for interest	\$ 469	\$ 469
Cash paid for income taxes	\$ 2,673	\$ 8,281

*See notes to condensed consolidated financial statements (unaudited).*

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**SYNAPTICS INCORPORATED AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
(unaudited)

**1. Basis of Presentation**

The accompanying unaudited condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC") and U.S. generally accepted accounting principles. However, certain information or footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles have been condensed or omitted pursuant to such SEC rules and regulations. In our opinion, the financial statements include all adjustments, which are of a normal and recurring nature, necessary for the fair presentation of the results of the interim periods presented. The results of operations for the interim periods are not necessarily indicative of the operating results for the full fiscal year or any future period. These financial statements should be read in conjunction with the audited consolidated financial statements and related notes included in our annual report on Form 10-K for the fiscal year ended June 30, 2007.

The consolidated financial statements include our financial statements and those of our wholly owned subsidiaries. All significant intercompany balances and transactions have been eliminated upon consolidation.

Our fiscal year is the 52- or 53-week period ending on the last Saturday in June. Fiscal 2007 was a 53-week period ending on June 30, 2007 and fiscal 2008 will be a 52-week period ending on June 28, 2008. The quarterly periods presented in this report were 13-week periods for the three-month period ended March 29, 2008 and March 30, 2007 and 39-week and 40-week periods for the nine-month period ended March 29, 2008 and March 30, 2007, respectively. For ease of presentation, the accompanying consolidated financial statements have been shown as ending on March 31 and calendar quarter end dates for all annual, interim, and quarterly financial statement captions, unless otherwise indicated.

*Use of Estimates*

The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue, cost of revenue, expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates, including those related to allowances for returns and doubtful accounts, cost of revenue, inventories, product warranty, share-based compensation costs, provision for income taxes, income taxes payable, investments, and contingencies. We base our estimates on historical experience, applicable laws and regulations, and various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

**2. Revenue Recognition**

We recognize revenue from product sales when there is persuasive evidence that an arrangement exists, delivery has occurred and title has transferred, the price is fixed or determinable, and collection is reasonably assured. We accrue for estimated sales returns and other allowances, based on historical experience, at the time we recognize revenue. We record contract revenue for research and development as we provide the services under the terms of the contract. We recognize non-refundable contract fees for which no further performance obligations exist and for which there is no continuing involvement by us on the earlier of when the payments are received or when collection is assured.

**3. Net Income Per Share**

We present basic and diluted net income per share amounts in conformity with Statement of Financial Accounting Standards ("SFAS") 128, "Earnings Per Share," for all periods presented.

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The following table presents the computation of basic and diluted net income per share (in thousands, except per share amounts):

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2008	2007	2008	2007
Numerator:				
Net income	\$ 3,008	\$ 5,635	\$ 28,466	\$ 19,103
Interest expense and amortization of debt issuance costs on convertible notes (net of tax)		266		798
Net income for diluted net income per share	\$ 3,008	\$ 5,901	\$ 28,466	\$ 19,901
Denominator:				
Shares, basic	24,760	25,823	25,932	25,509
Effect of dilutive share-based awards	542	1,295	1,202	1,529
Effect of convertible notes		2,474		2,474
Shares, diluted	25,302	29,592	27,134	29,512
Net income per share:				
Basic	\$ 0.12	\$ 0.22	\$ 1.10	\$ 0.75
Diluted	\$ 0.12	\$ 0.20	\$ 1.05	\$ 0.67

Basic net income per share amounts for each period presented have been computed using the weighted average number of shares of common stock outstanding.

The diluted net income per share amounts do not include the effect of 2,704,908, 2,300,946, 817,709, and 2,531,225 share-based awards that were outstanding during the three-month period ended March 31, 2008 and 2007 and the nine-month period ended March 31, 2008 and 2007, respectively. These share-based awards were not included in the computation of diluted net income per share because the proceeds to be received, if any, from such share-based awards combined with the average unamortized compensation costs adjusted for the hypothetical tax benefit or deficiency creditable or chargeable, respectively, to additional paid-in capital, were greater than the average market price of our common stock, and therefore, their effect would have been antidilutive.

As a result of our irrevocable election in April 2007 to cash settle the principal amount of our convertible notes, no shares of common stock will be issued to settle the principal, and cash or common stock may be used to settle the value in excess of the principal. In our calculation of net income per share, we used the if converted method through the date of our election to cash settle the principal of our convertible notes upon conversion and we used the treasury stock method subsequent to the date of our election. We will include diluted shares underlying the notes in our diluted net income per share calculation only when the average closing stock price for the accounting period exceeds the conversion price of the notes, which is \$50.53 per share. Accordingly, diluted net income per share amounts for each period presented have been computed (1) using the weighted average number of potentially dilutive shares issuable in connection with our share-based compensation plans under the treasury stock method, (2) through April 2007 using the weighted average number of shares issuable in connection with our convertible debt under the if-converted method, and (3) from April 2007 using the weighted average number of potentially dilutive shares issuable in connection with our convertible debt under the treasury stock method, when dilutive.

**4. Cash Equivalents, Short-Term Investments, and Auction Rate Securities Investments**

Cash equivalents consist of highly liquid investments with original maturities of three months or less. Short-term investments consist of marketable securities and are classified as securities available for sale under SFAS 115,

Accounting for Certain Investments in Debt and Equity Securities. Such securities are reported at fair value, with unrealized gains and losses, net of taxes, excluded from earnings and shown separately as a component of accumulated other comprehensive income or loss within stockholders' equity. We may pay a premium or receive a discount upon the purchase of marketable securities. Interest earned on marketable securities and amortization of discounts received and accretion of premiums paid on the purchase of marketable securities are included in interest income. We determine realized gains and losses on the sale of marketable securities using the specific identification method.

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Our investment portfolio includes \$48.6 million cost basis of auction rate securities ( ARS ) of which \$43.6 million have failed to settle in auctions. Our portfolio of ARS includes \$43.6 million that are triple A rated and \$5.0 million that are double A rated. Since August 2007, \$18.5 million of these ARS investments have failed to settle in auctions and since February 2008, \$25.1 million have failed to settle in auctions. These failures generally resulted in the interest rates resetting from Libor plus 50 basis points to Libor plus 150 basis points on the regularly scheduled auction dates, which represents a premium interest rate over alternative short-term investments. However, these investments are not currently liquid and in the event we need to access these funds, we will not be able to do so without a loss of principal, unless a future auction on these investments is successful.

As there are currently no active markets for our various failed ARS investments, we have estimated the fair value of these investments as of March 31, 2008 based on a trinomial discounted cash flow analysis. The analysis considered, among other factors, the collateral underlying the security investments, creditworthiness of the counterparty, timing of expected future cash flows, and the probability of a successful auction in a future period. When possible, our failed ARS investments were compared to other observable market data or securities with similar characteristics. As a result, we have reduced the carrying value of these investments by \$7.3 million; of which \$2.2 million was accounted for as other-than-temporary impairment with a corresponding charge to income; and \$5.1 million was accounted for as temporary impairment through other comprehensive income or loss.

As of March 31, 2008, none of our ARS investments were in default and all of our ARS investments continue to pay interest. The following table sets forth the various types of failed ARS investments we hold, including the amount and type of impairment, the carrying value, our classification as short-term or non-current and the balance sheet account where the carrying value is included (in thousands).

	Cost Basis	Amount	Impairment Type	Carrying Value	Classification	Balance Sheet Account
Student loans	\$ 10,000	\$ 334	Temporary	\$ 9,666	Short term	Short-term investments
Closed end muni and corporate funds	15,125	719	Temporary	14,406	Short term	Short-term investments
Credit linked notes	13,500	4,017	Temporary	9,483	Non-current	Other assets
Contingent capital notes	5,000	2,237	Other-than-temporary	2,763	Non-current	Other assets
Total failed ARS	\$ 43,625	\$ 7,307		\$ 36,318		

At the present time, the primary issue affecting all of our ARS investments is that of liquidity. We have accounted for certain of our failed ARS investments as short-term as we anticipate those particular ARS markets will recover or be restructured without loss to us in the next 12 months. Recovery of the other ARS markets in which we maintain investments, will likely exceed 12 months. Accordingly, our ARS investments in those markets have been classified as non-current. Based on our ability to access our cash and other short-term investments, our expected operating cash flows, and our other sources of cash, we believe we have the ability to hold these investments until the value recovers or the investments mature. We will continue to evaluate our accounting for these investments quarterly.

**5. Inventories**

Inventories are stated at the lower of cost (first-in, first-out method) or market (estimated net realizable value) and consisted of the following (in thousands):

	March 31, 2008	June 30, 2007
Raw materials	\$ 17,640	\$ 10,187
Finished goods	2,644	1,847
	\$ 20,284	\$ 12,034

Periodically, we purchase inventory from our manufacturing subcontractors when a customer's delivery schedule is delayed or a customer's order is cancelled. In those circumstances in which our customer has cancelled its order and we purchase inventory from our manufacturing subcontractors, we consider a write-down to reduce the carrying value of the inventory purchased to its net realizable value. We charge write-downs to reduce the carrying

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value of obsolete, slow moving, and non-usable inventory to net realizable value to cost of revenue. The effect of these write-downs is to establish a new cost basis in the related inventory, which is not subsequently written up.

**6. Product Warranties, Indemnifications, and Legal Proceedings***Product Warranties*

We generally warrant our products for a period of 12 months or more from the date of sale and estimate probable product warranty costs at the time we recognize revenue. Factors that affect our warranty liability include historical and anticipated rates of warranty claims, materials usage, and service delivery costs. Warranty costs incurred have not been material in recent years. However, we assess the adequacy of our warranty obligations periodically and adjust the accrued warranty liability on the basis of our estimates.

Changes in our accrued warranty liability (included in other accrued liabilities) for the nine-month period ended March 31, 2008 and 2007 were as follows (in thousands):

	Nine Months Ended March 31,	
	2008	2007
Beginning accrued warranty	\$ 325	\$ 357
Provision for product warranties	424	539
Cost of warranty claims and settlements	(385)	(470)
Ending accrued warranty	\$ 364	\$ 426

*Indemnifications*

In connection with certain third-party agreements, we are obligated to indemnify the third party in connection with any technology infringement by us. We have also entered into indemnification agreements with our officers and directors. Maximum potential future payments cannot be estimated because these agreements do not have a maximum stated liability. However, historical costs related to these indemnification provisions have not been significant. We have not recorded any liability in our consolidated financial statements for such indemnification obligations.

*Legal Proceedings*

In March 2006, Elantech Devices Corporation ( Elantech ) filed a Complaint for Patent Infringement against us claiming that we infringed one of its patents and seeking damages, attorneys' fees, and a permanent injunction against us infringing or inducing others to infringe the patent. In April 2006, we filed our Answer to the Complaint and Counterclaims against Elantech, claiming that Elantech has infringed and induced infringement of four of our patents and seeking damages, attorneys' fees, and a permanent injunction against infringing or inducing others to infringe.

Elantech responded to our counterclaim denying liability and counterclaimed seeking an injunction and damages for alleged violations of California law. We subsequently filed a motion to dismiss the Elantech counterclaims that was granted in July 2006 with leave to amend the counterclaims after the adjudication of the patent infringement claims.

The Elantech patent relates to recognizing and providing an indication of the presence of multiple fingers on a touchpad. We have previously developed additional ways to detect multiple fingers and have our own related patents. The Elantech infringement claims involve two versions of our software code ( Type 1 Code and Type 2 Code ) in certain products in which multiple finger detection is enabled.

In October 2007, the Court heard oral arguments on our motion for summary judgment of noninfringement of the Elantech patent and Elantech's cross-motion for summary judgment of infringement. The Court granted our motion for partial summary judgment of noninfringement as to products containing Type 1 Code and denied our motion for partial summary judgment of noninfringement as to products containing Type 2 Code. In addition, the Court denied Elantech's motion for summary judgment that our Type 1 and Type 2 Codes infringe Elantech's intellectual property. The Court indicated, however, that it would grant summary judgment of infringement for products implementing the Type 2 Code with enabled finger counting functionality.



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In November 2007, Elantech moved for partial summary judgment that products implementing the Type 2 Code with enabled finger counting functionality infringe the Elantech patent. In December 2007, Elantech moved for entry of a preliminary injunction against us importing, using, selling, or offering to sell certain products implementing the Type 2 Code with enabled finger counting functionality.

In December 2007, we filed a Complaint for Patent Infringement against Elantech claiming that Elantech infringed one of our patents relating to detecting the presence of multiple fingers on a touchpad and seeking damages, attorneys fees, and an injunction. In January 2008, we moved for entry of summary judgment for infringement of the four Synaptics patents.

In March 2008, the Court, based on its infringement ruling, filed an order preliminarily enjoining us from making, using, selling, importing into or offering to sell within the United States touchpad products containing our Type 2 firmware code with enabled multiple finger counting functionality. We do not believe any aspect of the Court's decision will have a material effect on our business. We are not shipping any products that utilize the contested code. As a result, the preliminary injunction will have no impact on us, our business, or our customers. Although the contested code is no longer used in our products, we do not believe the contested code infringes the Elantech patent and we have appealed the Court's infringement ruling.

In April, 2008, the Court granted our motion for partial summary judgment holding that use of the corner tap, scrolling, edge motion, and drag features of Elantech's touchpad products infringe four of our patents.

We intend to vigorously defend our patents and pursue our counterclaims. We have not recorded any liability associated with Elantech's claims pursuant to SFAS No. 5 Accounting for Contingencies, and have expensed as incurred all legal fees associated with the legal proceedings.

**7. Convertible Senior Subordinated Notes**

In December 2004, we issued an aggregate of \$125 million of 0.75% Convertible Senior Subordinated Notes maturing December 1, 2024 (the Notes) in a private offering pursuant to Rule 144A under the Securities Act of 1933, as amended. In connection with issuing the Notes, we incurred debt issuance costs of \$4.3 million, consisting primarily of the initial purchasers' discount and costs related to legal, accounting, and printing, which are being amortized over five years. We expect to use the net proceeds for working capital and general corporate purposes and potentially for future acquisitions.

The Notes bear interest at a rate of 0.75% per annum payable on December 1 and June 1 of each year. However, we will pay additional contingent interest on the Notes if the average trading price of the Notes is at or above 120% of the principal amount of the Notes for a specified period beginning with the six-month period commencing December 1, 2009. The amount of contingent interest payable on the Notes with respect to a six-month period, for which contingent interest applies, will equal 0.375% per annum of the average trading price of the Notes for a specified five-trading-day period preceding such six-month period.

As a result of our irrevocable election in April 2007 to cash settle the principal amount of the Notes, no shares of common stock will be issued to settle the principal amount of the Notes, and cash or common stock may be used to settle the value of the Notes in excess of \$125 million, if any. In our calculation of net income per share, we used the if converted method through the date of our election to cash settle the principal of our convertible notes upon conversion and we used the treasury stock method subsequent to the date of our election. We will include diluted shares underlying the Notes in our diluted net income per share calculation only when the average closing stock price for the accounting period exceeds the conversion price of the Notes, which is \$50.53 per share.

The Notes may be converted (1) if, during any calendar quarter commencing after December 31, 2004, the last reported sale price of our common stock for at least 20 trading days in the period of 30 consecutive trading days ending on the last trading day of the preceding calendar quarter is greater than or equal to 120% of the applicable conversion price on such last trading day; (2) on or after January 1, 2020; (3) if we have called the Notes for redemption; or (4) during prescribed periods, upon the occurrence of specified corporate transactions or fundamental changes. On or after December 1, 2009, we may redeem for cash all or a portion of the Notes at a redemption price of 100% of the principal amount of the Notes plus accrued and unpaid interest, including contingent interest and additional interest, if any. Noteholders have the right to require us to repurchase all or a portion of their Notes for cash on December 1, 2009, December 1, 2014, and December 1, 2019 at a price equal to 100% of the principal amount of

the Notes to be

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purchased plus accrued and unpaid interest, including contingent interest and additional interest, if any. As of March 31, 2008, none of the conditions for conversion of the Notes had occurred.

The Notes are unsecured senior subordinated obligations and rank junior in right of payment to all of our existing and future senior indebtedness, equal in right of payment with all of our existing and future indebtedness or other obligations that are not, by their terms, either senior or subordinated to the Notes, including trade debt and other general unsecured obligations that do not constitute senior or subordinated indebtedness, and senior in right of payment to all of our future indebtedness that, by its terms, is subordinated to the Notes. There are no financial covenants in the Notes.

Interest expense includes the amortization of debt issuance costs. We recorded \$449,000 of interest expense on the Notes during each of the three-month periods ended March 31, 2008 and 2007 and \$1.3 million during each of the nine-month periods ended March 31, 2008 and 2007.

**8. Share-Based Compensation**

The purpose of our various share-based compensation plans is to attract, motivate, retain, and reward high-quality employees, directors, and consultants by enabling such persons to acquire or increase their proprietary interest in our common stock in order to strengthen the mutuality of interests between such persons and our stockholders and to provide such persons with annual and long-term performance incentives to focus their best efforts in the creation of stockholder value. Consequently, share-based compensatory awards issued subsequent to the initial award to our employees and consultants are determined primarily on individual performance. Our share-based compensation plans with outstanding awards consist of our 1996 Stock Option Plan, our 2000 Nonstatutory Stock Option Plan, our 2001 Incentive Compensation Plan, and our 2001 Employee Stock Purchase Plan.

Share-based compensation and the related tax benefit recognized in our consolidated statements of income for the three- and nine-month periods ended March 31, 2008 and 2007 were as follows (in thousands):