

THORATEC CORP
Form 10-Q
November 02, 2012
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark one)

- Quarterly report pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934**

For the quarterly period ended September 29, 2012

Or

- Transition report pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934**

For the transition period from to

COMMISSION FILE NUMBER: 000-49798

THORATEC CORPORATION

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(Exact name of registrant as specified in its charter)

California

(State or other jurisdiction of incorporation
or organization)

94-2340464

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

6035 Stoneridge Drive, Pleasanton, California

(Address of principal executive offices)

94588

(Zip Code)

(925) 847-8600

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes 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
(Do not check if smaller reporting company)

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 26, 2012, the registrant had 58,756,923 shares of common stock outstanding.

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

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

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THORATEC CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS

(unaudited)

(in thousands)

	September 29, 2012	December 31, 2011
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 148,038	\$ 42,661
Short-term available-for-sale investments	148,740	150,753
Receivables, net of allowances of \$2,031 and \$2,153, respectively	61,288	59,292
Inventories	48,256	55,691
Deferred tax assets	10,176	10,116
Income tax receivable	9,829	12,112
Prepaid expenses and other assets	10,596	6,640
Total current assets	436,923	337,265
Property, plant and equipment, net	43,153	38,928
Goodwill	191,408	191,193
Purchased intangible assets, net	84,066	92,279
Long-term available-for-sale investments	11,102	16,090
Other long-term assets	9,975	5,233
Total Assets	\$ 776,627	\$ 680,988
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 16,120	\$ 12,559
Accrued compensation	22,416	15,739
Other accrued liabilities	18,340	14,936
Total current liabilities	56,876	43,234
Long-term deferred tax liability	17,564	20,429
Other long-term liabilities	11,648	10,823
Contingent liabilities (Note 2)	17,947	22,052
Total Liabilities	104,035	96,538
Shareholders' equity:		
Common shares: no par, authorized 100,000; issued and outstanding 58,736 and 58,368 as of September 29, 2012 and December 31, 2011, respectively		
Additional paid-in capital	600,295	578,293
Retained earnings	87,916	24,190
Accumulated other comprehensive loss:		

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Unrealized loss on investments	(603)	(1,664)
Cumulative translation adjustments	(15,016)	(16,369)
Total accumulated other comprehensive loss	(15,619)	(18,033)
Total Shareholders' Equity	672,592	584,450
Total Liabilities and Shareholders' Equity	\$ 776,627	\$ 680,988

See notes to the unaudited condensed consolidated financial statements.

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THORATEC CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(unaudited)

(in thousands, except per share data)

	Three Months Ended		Nine Months Ended	
	September 29, 2012	October 1, 2011	September 29, 2012	October 1, 2011
Product sales	\$ 117,768	\$ 102,584	\$ 363,196	\$ 313,335
Cost of product sales	36,162	32,937	111,071	99,051
Gross profit	81,606	69,647	252,125	214,284
Operating expenses:				
Selling, general and administrative	28,478	25,632	91,692	77,375
Research and development	20,382	16,273	59,886	47,826
Total operating expenses	48,860	41,905	151,578	125,201
Income from operations	32,746	27,742	100,547	89,083
Other income and (expense):				
Interest expense and other		(3)	(3)	(4,650)
Interest income and other	579	283	1,401	1,526
Income before income taxes	33,325	28,022	101,945	85,959
Income tax expense	(9,070)	(9,033)	(31,396)	(28,729)
Income from continuing operations	24,255	18,989	70,549	57,230
Loss from discontinued operations (net of tax)		(1,031)		(1,031)
Net income	\$ 24,255	\$ 17,958	\$ 70,549	\$ 56,199
Net income per share-Basic:				
Continuing operations	\$ 0.41	\$ 0.32	\$ 1.20	\$ 0.97
Discontinued operations		(0.02)		(0.02)
Net income	\$ 0.41	\$ 0.30	\$ 1.20	\$ 0.95
Net income (loss) per share-Diluted:				
Continuing operations	\$ 0.41	\$ 0.31	\$ 1.18	\$ 0.95
Discontinued operations		(0.02)		(0.02)
Net income	\$ 0.41	\$ 0.29	\$ 1.18	\$ 0.93
Shares used to compute income per share:				
Basic	58,762	59,763	58,645	58,630
Diluted	59,669	60,666	59,609	63,306

See notes to the unaudited condensed consolidated financial statements.

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THORATEC CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(unaudited)

(in thousands)

	Three Months Ended		Nine Months Ended	
	September 29, 2012	October 1, 2011	September 29, 2012	October 1, 2011
	(in thousands)			
Net income	\$ 24,255	\$ 17,958	\$ 70,549	\$ 56,199
Unrealized gains (losses) on investments (net of taxes of \$297 and \$128 for the three months ended September 29, 2012 and October 1, 2011, respectively, and \$718 and \$9 for the nine months ended September 29, 2012 and October 1, 2011, respectively)	436	(209)	1,061	(14)
Foreign currency translation adjustments	1,188	(17,073)	1,353	(15,883)
Total other comprehensive income (loss)	1,624	(17,282)	2,414	(15,897)
Comprehensive income	\$ 25,879	\$ 676	\$ 72,963	\$ 40,302

See notes to the unaudited condensed consolidated financial statements.

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THORATEC CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)

(in thousands)

	Nine Months Ended	
	September 29, 2012	October 1, 2011
Cash flows from continuing operating activities:		
Net income	\$ 70,549	\$ 56,199
Add back: loss from discontinued operations		1,031
Net income from continuing operations	70,549	57,230
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	14,621	12,818
Investment premium amortization, net	1,628	2,935
Non-cash interest income and other	(1,623)	378
Non-cash interest expense		2,815
Tax benefit related to stock options	2,200	1,348
Share-based compensation expense	16,033	11,732
Excess tax benefits from share-based compensation	(2,212)	(1,397)
Loss on disposal of assets	57	26
Change in deferred taxes, net	(4,152)	(4,055)
Changes in assets and liabilities, net of acquisition of Levitronix Medical:		
Receivables	(2,021)	4,268
Inventories	5,220	779
Other current and non-current assets	(4,525)	(271)
Accounts payable	2,668	(1,021)
Income taxes, net	1,708	4,018
Other current and non-current liabilities	9,052	(4,490)
Operating cash flows provided by continuing operations	109,203	87,113
Operating cash flows used in discontinued operations		(165)
Cash provided by operating activities	109,203	86,948
Cash flows from investing activities:		
Purchases of available-for-sale investments	(128,080)	(236,399)
Sales and maturities of available-for-sale investments	134,216	476,264
Acquisition of a business, net of cash acquired		(109,974)
Purchases of property, plant and equipment, net	(7,308)	(5,724)
Cash provided by (used in) investing activities	(1,172)	124,167
Cash flows from financing activities:		
Payment of contingent considerations	(1,518)	
Excess tax benefits from share-based compensation	2,212	1,397
Proceeds from stock option exercises	5,222	10,212
Proceeds from stock issued under the employee stock purchase plan	1,896	1,886
Repurchase and retirement of common shares	(10,372)	(53,725)
Redemption of senior subordinated convertible notes		(164,429)
Net cash used in financing activities	(2,560)	(204,659)

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Effect of exchange rate changes on cash and cash equivalents	(94)	(568)
Net increase in cash and cash equivalents	105,377	5,888
Net cash and cash equivalents at beginning of period	42,661	56,887
Net cash and cash equivalents at end of period	\$ 148,038	\$ 62,775
Supplemental disclosure of consolidated cash flow information:		
Cash paid for income taxes	\$ 31,589	\$ 28,006
Cash paid for interest	\$ 3	\$ 1,679
Supplemental disclosure of consolidated non-cash investing and financing activities:		
Transfers of equipment from inventory	\$ 2,406	\$ 1,689
Purchases of property, plant and equipment through accounts payable and accrued liabilities	\$ 1,206	\$ 355
Extinguishment of senior subordinated convertible notes with issuance of common stock	\$	\$ 82,711
Acquisition of Levitronix:		
Current and long-term portions of contingent consideration	\$	\$ 23,570

See notes to the unaudited condensed consolidated financial statements.

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THORATEC CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

Note 1. Operations and Significant Accounting Policies

Basis of Presentation

The interim unaudited condensed consolidated financial statements of Thoratec Corporation (we, our, us, or the Company) have been prepared and presented in accordance with accounting principles generally accepted in the United States of America (GAAP) and the rules and regulations of the Securities and Exchange Commission (SEC), without audit, and reflect all adjustments necessary (consisting only of normal recurring adjustments) to present fairly our financial position, results of operations and cash flows as of and for the periods presented. Certain information and footnote disclosures normally included in our annual financial statements, prepared in accordance with GAAP, have been condensed or omitted. The accompanying financial statements should be read in conjunction with our fiscal 2011 consolidated financial statements, and the accompanying notes thereto, filed with the SEC in our 2011 Annual Report on Form 10-K (the 2011 Annual Report). The operating results for any interim period are not necessarily indicative of the results that may be expected for any future period.

The preparation of our unaudited condensed consolidated financial statements necessarily requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities on the unaudited condensed consolidated balance sheet dates and the reported amounts of revenues and expenses for the periods presented. The actual amounts could differ from those estimated amounts.

Financial Statement Presentation Matters

Subsequent to the issuance of our condensed consolidated financial statements for the three and nine months ended October 1, 2011, management determined that amortization of core technology and developed technology should have been presented within cost of product sales. In addition, amortization of patents and trademarks for the same period has been reclassified to selling, general and administrative expenses to conform to current period presentation. Previously, amortization of these purchased intangible assets was reported as a separate line item within operating expenses.

The impact of the correction and reclassification on specific line items in our condensed consolidated statements of operations is presented below:

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	Three Months Ended		Nine Months Ended	
	October 1, 2011		October 1, 2011	
	As previously reported	As reported	As previously reported	As reported
	(in thousands)			
Cost of product sales	\$ 30,898	\$ 32,937	\$ 93,043	\$ 99,051
Gross profit	71,686	69,647	220,292	214,284
Selling, general, and administrative	25,062	25,632	76,275	77,375
Amortization of purchased intangible assets	2,609		7,108	
Total operating expenses	43,944	41,905	131,209	125,201

This had no impact on previously reported product sales, income before taxes, net income, earnings per share, or any consolidated balance sheet or statement of cash flow categories.

Note 2. Levitronix Medical

On August 3, 2011, we acquired 100 percent of the medical business of Levitronix LLC (Levitronix Medical) for an upfront cash payment of \$110 million, plus additional cash earn-out amounts (not to exceed \$40 million in aggregate) payable annually over the next four years contingent upon achievement of certain product revenue targets. The earn out is calculated based on 36 percent of sales from Levitronix Medical in excess of sales of approximately \$24 million per year over the four-year period commencing from the date of acquisition. The fair value of the contingent consideration is calculated using the discounted cash flow approach, utilizing various revenue assumptions and applying a probability to each outcome. Under our various revenue assumptions, the estimated undiscounted range of outcomes was from \$9.7 million to \$37.4 million. The fair value of the contingent consideration as of the acquisition date was estimated and recorded at \$23.6 million. The fair value of the contingent consideration is re-measured at the estimated fair value at each reporting period with the change in fair value recorded within operating expense within our condensed consolidated statements of operations. Actual amounts paid may differ from the obligations recorded. During the first quarter of 2012, we paid out \$1.5 million of the contingent consideration related to sales in 2011. As of September 29, 2012, the fair value of the contingent consideration was approximately \$22.0 million, of which \$4.1 million is included in Other current liabilities and \$17.9 million is reported in Contingent liabilities on the condensed consolidated balance sheet.

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Prior to the acquisition, we distributed and provided clinical support for the CentriMag in the U.S. under an agreement that would have expired at the end of 2011. We had also collaborated with Levitronix Medical on the development of the fully magnetically levitated motor technology employed in the HeartMate III left ventricular assist system, which is currently in preclinical testing. This acquisition allowed us to acquire the CentriMag Acute Circulatory System (CentriMag) and PediMag/PediVAS Acute Circulatory System (PediMad/PediVAS) product lines and the fully magnetically levitated patented technology related to the HeartMate III.

In accordance with accounting standards for business combinations, we accounted for the acquisition of Levitronix Medical under the acquisition method. Under the acquisition method, the assets and liabilities assumed at the date of acquisition are recorded in the consolidated financial statements at their respective fair values at the acquisition date. The excess of the purchase price over the fair value of the acquired net assets has been recorded as goodwill in the amount of \$113.0 million. Levitronix Medical's results of operations are included in the consolidated financial statements from the date of acquisition.

The determination of the estimated fair value of the acquired assets and liabilities requires management to make significant estimates and assumptions. We determined the fair value by applying established valuation techniques, based on information that management believed to be relevant to this determination. We also hired independent third parties to assist in the valuation of purchased intangible assets, goodwill and contingent consideration.

The purchase price consideration of cash and the fair value of the contingent earn-out consideration were as follows:

	(in thousands)	
Cash	\$	110,000
Contingent consideration earn-out		23,570
Total fair value consideration	\$	133,570

The following table summarizes the purchase price allocation of the fair value of the assets acquired and liabilities assumed at the date of acquisition:

	(in thousands)	Amortization Period
Assets		
Short-term:		
Cash and cash equivalents	\$ 26	
Accounts receivable	2,300	
Inventory	6,179	
Other current assets	11	
Long-term:		
Property, plant and equipment	185	
Identifiable purchased intangible assets		
Developed technology	6,270	3 to 10 years
Patents and trademarks	2,700	10 years
Pre-existing license agreements	2,300	7 years
Customer based relationships and other	4,270	3 to 6 years

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Goodwill	113,034
Deferred tax asset	1,144
Total Assets	138,419
Liabilities	
Short-term:	
Accrued liabilities	1,419
Warranty accrual	161
Contingent liabilities	580
Long-term:	
Deferred tax liability	3,269
Contingent liabilities	22,990
Net Assets Purchased	\$ 110,000

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All straight-line methods of amortization above are based on the expected pattern of future benefits related to those respective intangible assets.

We expensed \$3.6 million for all legal, consulting and other costs directly related to the acquisition and have recorded these costs as a component of selling, general and administrative expenses in 2011.

Goodwill of approximately \$113.0 million represents the excess of the purchase price over the fair value of the underlying net tangible and intangible assets and represents the future economic benefits of maintaining the access to the U.S. CentriMag market and expected synergies. The majority of goodwill is deductible for U.S. tax purposes, but non-deductible for foreign tax purposes.

The following table includes unaudited pro forma financial information for the nine months ended October 1, 2011 as if the acquisition of Levitronix Medical had occurred as of the beginning of the 2010 period. The pro forma financial information is provided for comparative purposes only and is not necessarily indicative of what actual results would have been had the acquisition occurred as of the beginning of 2010 period, nor does it give effect to synergies, cost savings, fair market value adjustments, profit in inventory, immaterial depreciation expense and other changes expected to result from the acquisition. Accordingly, the pro forma financial results do not purport to be indicative of consolidated results of operations as of the date hereof, for any period ended on the date hereof, or for any other future date or period.

	Nine Months Ended October 1, 2011 (in thousands)
Product sales	\$ 320,677
Net Income from continuing operations	58,132

The consolidated pro forma results include the following non-recurring pro forma adjustments that were directly attributable to the acquisition:

- Amortization expense related to the acquired intangible assets of \$1.7 million for the nine months ended October 1, 2011.
- Fair value adjustment related to inventory was excluded from the pro forma results above for the nine months ended October 1, 2011, as the fair value adjustment was recorded in 2010 as if the inventory as of the acquisition date was sold in the 2010 period.
- Intercompany revenues were excluded from the pro forma consolidated results of operations as if Levitronix Medical operations had been consolidated at the beginning of fiscal 2010.

Pro forma adjustments were tax-effected using our effective tax rate for the nine months ended October 1, 2011.

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

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

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

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

We review the fair value hierarchy classification on a quarterly basis. Changes in the ability to observe valuation inputs may result in a reclassification of levels of certain securities within the fair value hierarchy. We recognize transfers into and out of levels within the fair value hierarchy in which the actual event or change in circumstances that caused the transfer occurs. There were no transfers among Level 1, Level 2, and Level 3 during either the nine months ended September 29, 2012 or the nine months ended October 1, 2011.

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

	Total Fair Value	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	(in thousands)			
As of September 29, 2012:				
Assets:				
Cash equivalents:				
Money market funds	\$ 121,657	\$ 121,657		\$
Commercial paper	2,858		2,858	
Municipal bonds	1,780		1,780	
Short-term investments:				
Municipal bonds	106,845		106,845	
Variable demand notes	20,405		20,405	
Corporate bonds	15,488		15,488	
Commercial paper	3,995	3,995		
Bank deposits	2,007	2,007		

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Prepaid expenses and other assets:			
Foreign exchange contracts	3,173		3,173
Long-term investments:			
Auction rate securities	11,102		11,102
Other long-term assets:			
Investments included in our deferred compensation plan	1,754		1,754
Marketable equity securities	3,570	3,570	
Liabilities:			
Other accrued liabilities:			
Mark-to-market on foreign exchange contracts	282		282
Contingent consideration (\$4.1 million included in Other accrued liabilities; \$17.9 million included in Contingent liabilities)	\$ 22,052	\$	\$ 22,052

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	Total Fair Value	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
(in thousands)				
As of December 31, 2011:				
Assets:				
Cash equivalents:				
Money market funds	\$ 37,986	\$ 37,986	\$	\$
Short-term investments:				
Municipal bonds	97,560		97,560	
Variable demand notes	48,800		48,800	
Corporate bonds	4,393		4,393	
Prepaid expenses and other assets:				
Foreign exchange contracts	674		674	
Long-term investments:				
Auction rate securities	16,090			16,090
Other long-term assets:				
Investments included in our deferred compensation plan	2,171		2,171	
Liabilities:				
Contingent consideration (\$1.5 million included in Other accrued liabilities; \$22.1 million included in Contingent liabilities)	\$ 23,570	\$	\$	\$ 23,570

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

Financial assets and liabilities are considered Level 3 when their fair values are determined using pricing models, discounted cash flow methodologies, or similar techniques, and at least one significant model assumption or input is unobservable. Level 3 financial assets include the auction rate securities for which there is limited market activity such that the determination of fair value requires significant judgment or estimation. The auction rate securities were valued using a discounted cash flow model over a five-year period based on estimated interest rates, the present value of future principal payments, and interest payments discounted at rates considered to reflect the current market conditions and the credit quality of auction rate securities. In addition, Level 3 financial liabilities include the contingent consideration related to the acquisition of Levitronix Medical because the fair value includes significant management judgment or estimation. The contingent consideration was valued using discounted cash flow models for five revenue scenarios that include a base case (the most likely scenario), two scenarios that incorporate the likelihood of achieving lower revenues than the estimated base case, and two scenarios that incorporate the likelihood of achieving higher revenues than the estimated base case. To calculate the fair value of the contingent consideration, the probability of the fair value of each scenario was weighted.

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

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(in thousands)			
As of September 29, 2012:				
Short-term investments:				
Municipal bonds	\$ 106,715	\$ 146	\$ (16)	\$ 106,845
Variable demand notes	20,405			20,405
Commercial paper	3,996		(1)	3,995
Bank deposits	2,000	7		2,007
Corporate bonds	15,466	22		15,488
Total short-term	\$ 148,582	\$ 175	\$ (17)	\$ 148,740
Long-term investments:				
Auction rate securities	\$ 12,700		\$ (1,598)	\$ 11,102
Other long-term assets:				
Marketable equity securities	2,996	574		3,570
Total long-term	\$ 15,696	\$ 574	\$ (1,598)	\$ 14,672
As of December 31, 2011:				
Short-term investments:				
Municipal bonds	\$ 97,406	\$ 160	\$ (6)	\$ 97,560
Variable demand notes	48,800			48,800
Corporate bonds	4,398	2	(7)	4,393
Total short-term investments	\$ 150,604	\$ 162	\$ (13)	\$ 150,753
Long-term investments:				
Auction rate securities	\$ 18,900		\$ (2,810)	\$ 16,090

As of September 29, 2012, we owned approximately \$12.7 million face amount of auction rate securities classified as long-term. The assets underlying these investments are student loans backed by the U.S. government under the Federal Family Education Loan Program or by private insurers and are rated between AAA and BB. Historically, these securities have provided liquidity through a Dutch auction process that resets the applicable interest rate periodically every seven to thirty-five days. Beginning in February of 2008, these auctions began to fail. The principal amount of these auction rate securities will not be accessible until future auctions for these securities are successful, a secondary market is established, these securities are called for redemption, or they are paid at maturity.

As of September 29, 2012, we had recorded an estimated cumulative unrealized loss of \$1.6 million (\$1.0 million, net of tax) related to the temporary impairment of the auction rate securities, which was included in accumulated other comprehensive income within the consolidated shareholders' equity. In addition, our management reviews impairments and credit loss associated with our investments, including auction rate securities, to determine the classification of the impairment as temporary or other-than-temporary and to bifurcate the credit and non-credit component of an other-than-temporary impairment event. We (i) do not intend to sell any of the auction rate securities prior to maturity at an amount below the original purchase value; (ii) intend to hold the investment to recovery and, based on a more-likely-than-not probability assessment, will not be required to sell the security before recovery; and (iii) deem that it is not probable that we will receive less than 100% of the principal and accrued interest from the issuer. Therefore, 100% of the impairment was charged to other comprehensive income (loss). Our auction rate securities are primarily classified as long-term and are valued at \$11.1 million using significant unobservable inputs. Further, we continue to liquidate investments in auction rate securities as opportunities arise. Approximately \$6.2 million of our auction rate securities were settled at par during the nine months ended September 29, 2012.

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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 to earnings on these investments. It could conceivably take until the final maturity of the underlying notes (up to 30 years) to realize the investments' fair value.

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

	September 29, 2012	December 31, 2011
	(in thousands)	
Deferred compensation plan	\$ 4,206	\$ 3,763

The unrealized gain before tax from the change in the value of the deferred compensation plan was \$0.3 million during the nine months ended September 29, 2012 and October 1, 2011.

The amortized cost and fair value of available-for-sale debt investments, by contractual maturity, were as follows as of September 29, 2012:

	Amortized Cost	Fair Value
	(in thousands)	
Maturing within 1 year	\$ 101,772	\$ 101,826
Maturing after 1 year through 5 years	46,810	46,914
Short-term available-for-sale investments	148,582	148,740
Maturing after 5 years	12,700	11,102
	\$ 161,282	\$ 159,842

The following table provides a rollforward of the fair value, as determined by Level 3 inputs, of the auction rate securities during the nine months ended September 29, 2012:

	Auction Rate Securities (in thousands)
Balance as of December 31, 2011	\$ 16,090
Settlements at par	(6,200)
Unrealized holding gain on auction rate securities, included in other comprehensive income	1,212
Balance as of September 29, 2012	\$ 11,102

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

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The following table provides a rollforward of the fair value, as determined by Level 3 inputs, of contingent consideration during the nine months ended September 29, 2012:

		Contingent Consideration (in thousands)
Balance as of December 31, 2011	\$	23,570
Payments		(1,518)
Change in fair value		
Balance as of September 29, 2012	\$	22,052

The following table presents quantitative information about the inputs and valuation methodologies used for our fair value measurements classified in Level 3 of the fair value hierarchy as of September 29, 2012:

	Fair Value at September 29, 2012 (in millions)	Valuation Technique	Significant Unobservable Input	weighted average (range)
Auction rate securities	\$ 11.1	Discounted cash flow	Discount rate	0.62% (0.62%)
			Market credit spread	3.31% (0.53% - 4.15%)
			Liquidity factor	0.45% (0.45%)
Contingent consideration	\$ 22.0	Multiple outcome discounted cash flow	Revenue	\$ 39.5 million (\$25.5 million to \$46.7 million)
			Discount rate	1.67% (1.17% to 2.24%)
			Probability of occurrence	20% (10% to 50%)

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Auction rate securities

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

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

Contingent consideration

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

The fair value of the contingent consideration is calculated on a quarterly basis by management based on a collaborative effort of our operation, finance and accounting groups. Potential valuation adjustments are made as additional information becomes available, including the progress toward achieving revenue targets as compared to initial projections, the impact of market competition, and changes in actual and projected product mix and average selling price, with the impact of such adjustments being recorded in the condensed consolidated statement of operations. No adjustments were made for the nine months ended September 29, 2012.

Assets and Liabilities That Are Measured at Fair Value on a Nonrecurring Basis

Non-financial assets such as goodwill, intangible assets, and property, plant, and equipment are evaluated for impairment and adjusted to fair value using Level 3 inputs, only when an impairment is recognized. Fair values are considered Level 3 when management makes significant assumptions in developing a discounted cash flow model based upon a number of considerations including projections of revenues, earnings and a discount rate. In addition, in evaluating the fair value of goodwill impairment, further corroboration is obtained using our market capitalization. No impairment was recorded in either the nine months ended September 29, 2012 or the nine months ended October 1, 2011.

Note 4. Foreign Exchange Instruments

We utilize foreign currency forward exchange contracts and options with recognized financial institutions to manage our exposure to the impact of fluctuations in foreign currency exchange rates on certain intercompany balances and foreign currency denominated sales and purchase transactions. We do not use derivative financial instruments for speculative or trading purposes. These forward contracts are not designated as hedging instruments for accounting purposes. Principal hedged currencies include the Euro, British Pound Sterling, U.S. Dollar and Swiss Franc. The periods of these forward contracts range from 30 days to nine months and the notional amounts are intended to be consistent with changes in the underlying exposures. We intend to exchange foreign currencies for U.S. Dollars at maturity.

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

	September 29, 2012	December 31, 2011
Forward contracts:		
Euro (sell)	11.3 million	9.6 million
British Pound Sterling (sell)	£ 1.4 million	£ 0.8 million
U.S. Dollar (sell)	\$ 5.2 million	\$ 3.6 million
U.S. Dollar (buy)	\$ 77.6 million	\$ 76.2 million
U.S. Dollar (buy)	\$ 10.8 million	\$ 9.1 million
U.S. Dollar (sell)	\$ 8.3 million	\$

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

	September 29, 2012	
	Prepaid expenses and other assets	Other accrued liabilities
	(in thousands)	
Derivatives not designated as hedging instruments (forward contracts)	\$ 3,173	\$ 282

	December 31, 2011	
	Prepaid expenses and other assets	Other accrued liabilities
	(in thousands)	
Derivatives not designated as hedging instruments (forward contracts)	\$ 674	\$

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

	Three Months Ended		Nine Months Ended	
	September 29, 2012	October 1, 2011	September 29, 2012	October 1, 2011
	(in thousands)			
Foreign currency exchange gain (loss) on foreign contracts	\$ (2,462)	\$ 238	\$ (130)	\$ 365
Foreign currency transactions gain (loss)	2,617	61	308	(785)

Note 5. Balance Sheet Information

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

Inventories consisted of the following:

	September 29, 2012	December 31, 2011
	(in thousands)	
Finished goods	\$ 17,437	\$ 20,911
Work in process	9,522	11,296
Raw materials	21,297	23,484
Total	\$ 48,256	\$ 55,691

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

	September 29, 2012	December 31, 2011
	(in thousands)	
Land, building and improvements	\$ 20,283	\$ 20,116
Equipment and capitalized software	43,935	38,829
Furniture and leasehold improvements	25,834	23,406
Total	90,052	82,351
Less accumulated depreciation	(46,899)	(43,423)
Total	\$ 43,153	\$ 38,928

Depreciation expense was \$2.2 million and \$6.4 million for the three and nine months ended September 29, 2012, respectively, and \$2.0 million and \$5.7 million for the three and nine months ended October 1, 2011, respectively.

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Warranty provision, included in Other accrued liabilities on the condensed consolidated balance sheets, and the changes in the balances were as follows for the nine months ended September 29, 2012 and October 1, 2011:

	September 29, 2012	October 1, 2011
	(in thousands)	
Balance, beginning of the period	\$ 2,452	\$ 3,057
Additions	1,132	1,968
Settlements	(1,308)	(2,131)
Balance, end of the period	\$ 2,276	\$ 2,894

Note 6. Goodwill and Intangible Assets, net

The carrying amount of goodwill and the changes in the balances for the nine months ended September 29, 2012 were as follows (in thousands):

Balance, beginning of the period	\$ 191,193
Foreign currency translation impact	215
Balance, end of the period	\$ 191,408

In February 2001, we merged with Thermo Cardiosystems, Inc. The components of identifiable intangible assets related to the merger included patents and trademarks, core technology (Thoralon, our proprietary bio-material), and developed technology (patented technology, other than core technology, acquired in the merger).

As a result of the our acquisition of Levitronix Medical in August 2011, we recorded patents and trademarks of \$2.7 million, developed technology of \$6.3 million, pre-existing license agreements of \$2.3 million, and customer based relationships and other of \$4.3 million.

Purchased Intangible Assets, Net consisted of the following:

	Gross Amount	As of September 29, 2012 Accumulated Amortization (in thousands)	Net Amount
Patents and trademarks	\$ 43,526	\$ (33,192)	\$ 10,334
Core technology	37,180	(20,903)	16,277
Developed technology	128,058	(74,913)	53,145
Pre-existing license agreement	2,300	(383)	1,917
Customer based relationships and other	4,261	(1,900)	2,361
	215,325	(131,291)	84,034
	32		32

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Foreign currency translation impact						
Total purchased intangible assets	\$	215,357	\$	(131,291)	\$	84,066

		As of December 31, 2011		
	Gross Amount	Accumulated Amortization (in thousands)	Net Amount	
Patents and trademarks	\$ 43,531	\$ (31,836)	\$ 11,695	
Core technology	37,180	(19,445)	17,735	
Developed technology	128,072	(69,262)	58,810	
Pre-existing license agreement	2,300	(145)	2,155	
Customer based relationships and other	4,270	(493)	3,777	
	215,353	(121,181)	94,172	
Foreign currency translation impact				
	(1,893)		(1,893)	
Total purchased intangible assets	\$ 213,460	\$ (121,181)	\$ 92,279	

Amortization of intangible assets above is based on a straight-line method, which represents the expected pattern of future benefits related to those respective intangible assets. Amortization expense related to identifiable intangible assets was \$2.7 million and \$8.2 million for the three and nine months ended September 29, 2012, respectively, and \$2.6 million and \$7.1 million for the three and nine months ended October 1, 2011, respectively.

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

	(in thousands)	
Fiscal year:		
Remainder of 2012	\$	2,832
2013		11,327
2014		10,277
2015		10,068
2016		10,020
Thereafter		39,542
Total	\$	84,066

Note 7. Debt and Other Financing Arrangements*Senior Subordinated Convertible Notes*

In 2004, we completed the sale of \$143.8 million of 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.

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 bore 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.

Holder of the senior subordinated convertible notes were able to 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. If holders elected conversion, we could elect, at our option, to 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.

Holder could 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. On March 31, 2011, pursuant to our rights under the terms of the convertible notes we gave notice of our intention to redeem all of our outstanding senior subordinated convertible notes on May 17, 2011. During the second quarter of 2011, prior to or on May 16, 2011, noteholders converted 243,367 notes, and we elected to pay \$164.4 million in cash and issue 2,397,535 shares with an estimated fair value at conversion of \$82.7 million. In addition, on May 17, 2011, we redeemed the remaining outstanding 15 notes for cash. We accounted for the extinguishment in accordance with accounting standards, and there was no gain or loss reported for the fiscal year ended December 31, 2011. The difference of \$105.7 million between the fair value of the aggregate consideration paid of \$247.1 million and the face value of the senior subordinated convertible notes of \$141.4 million was recorded to additional paid-in capital.

In accordance with accounting standards for certain convertible debt instruments that may be settled in cash or other assets, or partially in cash, upon conversion, we recorded the long-term debt and equity components on the senior subordinated convertible notes separately. This accounting pronouncement increased interest expense associated with our senior subordinated convertible notes by adding a non-cash component to amortize a debt discount calculated based on the difference between the cash coupon rate (2.375% per year) of the senior subordinated convertible notes and the effective interest rate on debt borrowing (9% per year). The discount, which represents the non-cash interest expense, classif