THORATEC CORP
Form 10-Q
November 10, 2003

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U.S. SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark one)

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

For the quarterly period ended September 27, 2003

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: 1-8145

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)**

Registrant s telephone number, including area code: (925) 847-8600

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act): Yes [X] No [ ]

As of November 6, 2003, registrant had 56,122,770 shares of common stock outstanding.

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PART I. FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

THORATEC CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(unaudited)
(in thousands)

	September 27, 2003	December 28, 2002
Assets		
Current Assets:		
Cash and cash equivalents	$ 62,495	$ 45,483
Receivables, net of allowances of $233 in 2003 and $238 in 2002	22,767	27,593
Inventories	36,565	38,835
Deferred tax asset and other	15,044	14,699
Total Current Assets	136,871	126,610
Property, plant and equipment, net	24,683	24,715
Long-term available-for-sale investments	40,088	30,051
Goodwill	96,492	96,492
Purchased intangible assets, net	175,211	184,282
Long-term deferred tax asset and other	4,754	6,282
Total Assets	$478,099	$468,432
Liabilities and Shareholders Equity		
Current Liabilities:		
Accounts payable and accrued expenses	$ 17,898	$ 18,638
Total Current Liabilities	17,898	18,638
Long-term deferred tax liability and other	71,773	75,454
Total Liabilities	89,671	94,092
Shareholders Equity:		
Common shares; 100,000 authorized; issued and outstanding 56,004 in 2003 and 55,037 in 2002	420,061	410,266
Deferred compensation	(2,836)	(3,735)
Accumulated deficit	(29,085)	(32,412)
Accumulated other comprehensive income:		
Cumulative foreign currency translation adjustments	176	91
Unrealized gain on investment	112	130
Total accumulated other comprehensive income	288	221

Total Shareholders Equity	388,428	373,340
Total Liabilities and Shareholders Equity	$478,099	$468,432

See notes to condensed consolidated financial statements.

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THORATEC CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(unaudited)
(in thousands, except per share data)

	Three Months Ended		Nine Months Ended	
	September 27, 2003	September 28, 2002	September 27, 2003	September 28, 2002
Product sales	$35,250	$31,105	$107,469	$91,779
Cost of product sales	14,256	13,055	43,799	39,500
Gross profit	20,994	18,050	63,670	52,279
Operating expenses:				
Selling, general and administrative	10,562	9,150	31,791	27,716
Research and development	6,100	5,916	18,640	18,902
Amortization of purchased intangible assets	3,096	3,096	9,288	9,288
Merger, restructuring and other costs		32	(124)	859
Total operating expenses	19,758	18,194	59,595	56,765
Income (loss) from operations	1,236	(144)	4,075	(4,486)
Interest and other income - net	218	536	1,379	1,022
Income (loss) before income tax expense (benefit)	1,454	392	5,454	(3,464)
Income tax expense (benefit)	567	155	2,127	(1,388)
Net income (loss)	$ 887	$ 237	$ 3,327	$ (2,076)
Net income (loss) per share, basic and diluted	$ 0.02	$ 0.00	$ 0.06	$ (0.04)
Shares used to compute net income (loss) per share:				
Basic	55,704	56,268	55,386	56,572
Diluted	57,705	56,455	56,761	56,572

See notes to condensed consolidated financial statements.

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THORATEC CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)
(in thousands)

	Nine Months Ended	
	September 27, 2003	September 28, 2002
Cash flows from operating activities:		
Net income (loss)	$ 3,327	$ (2,076)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	13,981	12,711
Amortization of deferred compensation	903	1,000
Change in net deferred tax liability	(703)	(3,552)
Changes in assets and liabilities:		
Receivables	4,925	6,032
Inventories	2,356	(12,977)
Prepaid expenses and other assets	(1,720)	(1,195)
Accounts payable and other liabilities	1,087	82
Net cash provided by operating activities	24,156	25
Cash flows from investing activities:		
Purchases of available-for-sale investments	(14,138)	(34,336)
Sales of available-for-sale investments	6,708	
Reclassification from restricted cash and cash equivalents		45,884
Purchases of property, plant and equipment	(4,169)	(5,460)
Net cash provided by (used in) investing activities	(11,599)	6,088
Cash flows from financing activities:		
Proceeds from exercise of stock options and issuance of shares under ESPP	7,844	643
Proceeds from common stock offering		15,356
Repayment of convertible debentures		(54,838)
Repurchase of common stock		(18,336)
Net cash provided by (used in) financing activities	7,844	(57,175)
Effect of exchange rate changes on cash	50	148
Net increase (decrease) in cash and cash equivalents	20,451	(50,914)
Cash and cash equivalents at beginning of period	42,044	91,726
Cash and cash equivalents at end of period	$ 62,495	$ 40,812
Supplemental Cash Flow Disclosure:		
Cash paid for taxes	$ 726	$ 227
Cash paid for interest	$	$ 839
Supplemental Disclosure of Non-Cash Investing and Financing Activities:		
Reclassification of assembled workforce, net of taxes	$	$ 1,334
Tax benefit related to stock option exercises	$ 1,948	$ 147

See notes to condensed consolidated financial statements.

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THORATEC CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(unaudited)
(in thousands)

	Three Months Ended		Nine Months Ended	
	September 27, 2003	September 28, 2002	September 27, 2003	September 28, 2002
Net income (loss)	$ 887	$ 237	$ 3,327	$ (2,076)
Other net comprehensive income (loss):				
Unrealized gain (loss) on investments	(37)	56	(18)	56
Foreign currency translation adjustments	29	25	85	75
Comprehensive income (loss)	$ 879	$ 318	$ 3,394	$ (1,945)

See notes to condensed consolidated financial statements.

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THORATEC CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
(in thousands, unless otherwise stated)

1. Basis of Presentation and Significant Accounting Policies

The interim condensed consolidated financial statements of Thoratec Corporation, referred to as 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, or the SEC, without audit and reflect all adjustments necessary (consisting only of normal recurring adjustments) to present fairly our financial position at September 27, 2003 and December 28, 2002, our results of operations for the three-month and nine-month periods ended September 27, 2003 and September 28, 2002 and cash flows for the nine-month periods ended September 27, 2003 and September 28, 2002. 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 2002 consolidated financial statements filed with the SEC in our Annual Report on Form 10-K. 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 included herein 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 consolidated balance sheet dates and the reported amounts of revenues and expenses for the periods presented.

We have made certain reclassifications of 2002 amounts to conform to the current presentation.

Stock Based Compensation

We account for stock-based compensation to employees using the intrinsic value method in accordance with APB No. 25, Accounting for Stock Issued to Employees. Accordingly, no accounting recognition is given to stock options granted at fair market value until they are exercised. Upon exercise, net proceeds, including tax benefits realized, are recorded in shareholders equity. Similarly, no accounting recognition is given to our recently implemented employee stock purchase plan until a purchase occurs. Upon purchase, net proceeds are recorded in common stock. Under fair value recognition provisions of SFAS No. 123, the fair value of each option granted as a stock option or as an option to purchase shares under the employee stock purchase plan is estimated using the Black-Scholes option-pricing model. If compensation cost for our stock-based plans had been determined based on the fair value at the grant dates for awards under those plans, consistent with the method of SFAS No. 123, our reported net income (loss) would have been adversely affected, as shown in the following table (in thousands, except per share data):

	Three Months Ended		Nine Months Ended	
	September 27, 2003	**September 28, 2002**	**September 27, 2003**	**September 28, 2002**
Net income (loss):				
As reported	$ 887	$ 237	$ 3,327	$ (2,076)
Add: Stock-based compensation expense included in reported net income, net of related tax effects		(32)	4	59
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(1,985)	(2,352)	(5,433)	(6,878)
Pro forma	$ (1,098)	$ (2,147)	$ (2,102)	$ (8,895)

Basic and diluted earnings (loss) per share:				
As reported	$ 0.02	$ 0.00	$ 0.06	$ (0.04)
Pro forma	$ (0.02)	$ (0.04)	$ (0.04)	$ (0.16)

2. Merger of Thoratec and TCA

Our merger with Thermo Cardiosystems Inc., or TCA, was completed on February 14, 2001 which we refer to as the Merger. The Merger was accounted for under the purchase method of accounting and was treated as a reverse acquisition because the shareholders of TCA owned the majority of our common stock after the Merger. TCA was considered the acquiror for accounting and financial reporting purposes. Due to the reverse acquisition, Thoratec s assets and liabilities were recorded based upon their estimated fair market values at the date of acquisition.

As a result of the Merger, $76.9 million relating to in-process research and development, or IPR&D, was expensed in the first quarter of 2001. The one-time write-off of IPR&D related to four technology projects that were in development, had not reached technological feasibility, had no alternative future use and for which successful development was uncertain. One of the projects was completed in 2002. There have been no significant developments subsequent to the Merger related to the current status of any of the three remaining IPR&D projects that would result in material changes to the assumptions or resulting valuation performed at the time of the Merger. Development of IPR&D projects continues and while the timing of completion of these projects may vary due to the highly regulated and technical nature of our products, current estimates remain materially consistent with our initial estimates.

3. New Accounting Pronouncements

In April 2002, the FASB issued SFAS No. 145, (Rescission of FASB Statements 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections) which, among other things, changed the presentation of gains and losses on the extinguishment of debt. Any gain or loss on extinguishment of debt that does not meet the criteria in Accounting Principle Board, or APB, Opinion No. 30, Reporting the Results of Operations - Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions , shall be included in operating earnings and not presented separately as an extraordinary item. We adopted SFAS No. 145 at the beginning of fiscal year 2003. Upon adoption, we reclassified the extraordinary loss on extinguishment of debt incurred in the first quarter of 2002 of $515 to Interest and Other Income-Net.

In June 2002, the FASB issued SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities. The Company will apply the provisions of SFAS No. 146 for any restructuring activities initiated after December 31, 2002.

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In November 2002, the Emerging Issues Task Force, or EITF, reached a consensus regarding EITF Issue No. 00-21, Revenue Arrangements with Multiple Deliverables. The guidance provided is effective for contracts entered into on or after July 1, 2003. The adoption of this statement did not have a material effect upon our consolidated financial statements.

In November 2002, the FASB issued Financial Interpretation, or FIN, No. 45, Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others. We adopted the disclosure provisions of FIN No. 45 effective as of fiscal year end 2002. We do not expect that the recognition provisions of FIN No. 45 will have a material impact upon our consolidated financial statements.

In April 2003, the FASB issued SFAS No. 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities.* This statement is effective for contracts entered into or modified after June 30, 2003. We adopted SFAS No. 149 effective July 1, 2003. The adoption of this statement did not have a material effect upon our consolidated financial statements.

In May 2003, the FASB issued SFAS No. 150, *Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity.* The adoption of this statement is not expected to have an impact on our financial position, results of operations or cash flows.

4. Financial Instruments

We have a foreign currency exchange risk management program principally designed to mitigate the change in value of assets and liabilities that are denominated in non-functional currencies. Forward exchange contracts that generally have terms of three months or less are used to hedge these non-functional currency exposures on the Company s books. The derivatives used in the foreign currency exchange risk management program are not designated as cash flow or fair value hedges under SFAS 133. These contracts are recorded on the balance sheet at fair value in Deferred Tax Asset and Other current assets. Changes in the fair value of the contracts and the underlying exposures being hedged are included concurrently in Interest and Other Income Net . At September 27, 2003, the fair value was $4,600, and the change from the notional value was insignificant.

5. Inventories

Inventories consist of the following:

	September 27, 2003	December 28, 2002
Finished goods	$12,161	$17,498
Work in process	11,393	6,645
Raw materials	13,011	14,692
Total	$36,565	$38,835

6. Property, Plant and Equipment

Property, plant, and equipment consist of the following:

	September 27,	Decem