

THORATEC CORP
Form 10-Q
August 06, 2008

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

(Mark one)

☒ **Quarterly report pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934
For the quarterly period ended June 28, 2008**

Or

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

COMMISSION FILE NUMBER: 000-49798

THORATEC CORPORATION

(Exact name of registrant as specified in its charter)

California

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

94-2340464

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

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

94588

(Zip Code)

(925) 847-8600

(Registrant's telephone number, including area code)

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

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

Large
accelerated filer ☒

Accelerated filer ☐

Non-accelerated filer ☐

Smaller reporting company ☐

(Do not check if a smaller reporting company)

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

As of July 26, 2008, the registrant had 54,648,929 shares of common stock outstanding.

THORATEC CORPORATION

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CentriMag is a registered trademark of Levitronix LLC.

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

Table of Contents**PART I. FINANCIAL INFORMATION****ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

THORATEC CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(unaudited)
(in thousands)

	June 28, 2008	December 29, 2007
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 61,106	\$ 20,689
Short-term available-for-sale investments	135,018	197,661
Receivables, net of allowances of \$647 and \$861, respectively	55,710	45,368
Inventories	56,000	54,935
Short-term deferred tax assets	6,077	6,077
Prepaid expenses and other assets	7,613	6,379
 Total current assets	 321,524	 331,109
 Property, plant and equipment, net	 46,035	 46,477
Goodwill	98,368	98,368
Purchased intangible assets, net	115,175	121,767
Long-term deferred tax assets	2,112	62
Income tax receivable	2,800	2,755
Long-term available-for-sale investments	31,863	
Other assets	12,793	13,181
 Total Assets	 \$ 630,670	 \$ 613,719
 LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 9,536	\$ 9,770
Accrued compensation	15,666	14,314
Accrued income taxes	2,566	
Other accrued liabilities	9,125	5,289
 Total current liabilities	 36,893	 29,373
 Senior subordinated convertible notes	 143,750	 143,750
Long-term deferred tax liability	33,485	35,953
Other	6,673	6,614
 Total Liabilities	 220,801	 215,690
 Shareholders' equity:		
Common shares: no par, authorized 100,000; issued and outstanding 54,633 and 54,108 as of June 28, 2008 and December 29, 2007, respectively		

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Additional paid-in capital	464,900	458,383
Accumulated deficit	(53,073)	(61,577)
Accumulated other comprehensive (loss) income:		
Unrealized (loss) gain on investments	(2,838)	317
Cumulative translation adjustments	880	906
Total accumulated other comprehensive (loss) income	(1,958)	1,223
Total Shareholders' Equity	409,869	398,029
Total Liabilities and Shareholders' Equity	\$ 630,670	\$ 613,719

See notes to condensed consolidated financial statements.

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

	Three Months Ended		Six Months Ended	
	June	June 30,	June 28,	June 30,
	28,	2007	2008	2007
	2008			
Product sales	\$ 82,648	\$ 57,333	\$ 147,075	\$ 114,643
Cost of product sales	31,825	23,648	60,415	46,445
Gross profit	50,823	33,685	86,660	68,198
Operating expenses:				
Selling, general and administrative	23,857	19,134	44,493	41,079
Research and development	12,839	10,767	25,358	21,660
Amortization of purchased intangible assets	3,296	3,143	6,592	6,296
Total operating expenses	39,992	33,044	76,443	69,035
Income (loss) from operations	10,831	641	10,217	(837)
Other income and (expense):				
Interest expense	(1,131)	(1,074)	(2,021)	(2,142)
Interest income and other	2,281	1,766	4,459	3,953
Income before income taxes	11,981	1,333	12,655	974
Income tax (expense) benefit	(3,330)	(80)	(3,655)	4
Net income	\$ 8,651	\$ 1,253	\$ 9,000	\$ 978
Net income per share:				
Basic	\$ 0.16	\$ 0.02	\$ 0.17	\$ 0.02
Diluted	\$ 0.15	\$ 0.02	\$ 0.16	\$ 0.02
Shares used to compute net income per share:				
Basic	54,556	53,370	54,389	53,055
Diluted	62,624	54,728	62,396	54,421

See notes to condensed consolidated financial statements.

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

	Six Months Ended	
	June 28, 2008	June 30, 2007
Cash flows from operating activities:		
Net income	\$ 9,000	\$ 978
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	11,565	10,755
Investment premium amortization (net)	634	369
Write-down of investment		215
Non-cash interest and other expenses	165	542
Tax benefit related to stock options		1,961
Share-based compensation expense	5,493	6,231
Excess tax benefits from share-based compensation	(68)	(1,147)
Loss on disposal of assets	384	50
Change in net deferred tax liability	(2,412)	(925)
Changes in assets and liabilities:		
Receivables	(11,028)	538
Inventories	(2,950)	(10,094)
Prepaid expenses and other assets	(793)	(1,240)
Accounts payable and other liabilities	4,933	(5,172)
Accrued income taxes, net	3,045	(4,137)
Net cash provided by (used in) operating activities	17,968	(1,076)
Cash flows from investing activities:		
Purchases of available-for-sale investments	(98,548)	(202,283)
Sales of available-for-sale investments	78,670	144,375
Maturities of available-for-sale investments and restricted investments	44,765	1,712
Purchases of property, plant and equipment	(3,251)	(3,408)
Net cash provided by (used in) investing activities	21,636	(59,604)
Cash flows from financing activities:		
Excess income tax deficit on stock options exercises	(111)	
Proceeds from stock option exercises	871	8,612
Proceeds from stock issued under employee stock purchase plan	1,050	1,084
Excess tax benefits from share-based compensation	68	1,147
Repurchase and retirement of common shares	(1,092)	(775)
Net cash provided by financing activities	786	10,068
Effect of exchange rate changes on cash and cash equivalents	27	48
Net increase (decrease) in cash and cash equivalents	40,417	(50,564)

Cash and cash equivalents at beginning of period	20,689	67,453
Cash and cash equivalents at end of period	\$ 61,106	\$ 16,889
Supplemental disclosure of cash flow information:		
Cash paid for taxes	\$ 3,507	\$ 3,600
Cash paid for interest	\$ 1,707	\$ 1,707
Supplemental disclosure of non-cash investing and financing activities:		
Transfers of equipment from inventory to property, plant and equipment	\$ 1,685	\$ 1,977

See notes to condensed consolidated financial statements.

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

	Three Months Ended		Six Months Ended	
	June	June 30,	June	June 30,
	28,	2007	28,	2007
	2008		2008	2007
Net income	\$ 8,651	\$ 1,253	\$ 9,000	\$ 978
Other net comprehensive income (loss):				
Unrealized loss on investments (net of taxes of \$269 and \$55 for the three months ended and \$2,103 and \$55 for the six months ended June 28, 2008 and June 30, 2007, respectively)	(403)	(83)	(3,155)	(82)
Foreign currency translation adjustments	(194)	225	(26)	240
Comprehensive income	\$ 8,054	\$ 1,395	\$ 5,819	\$ 1,136

See notes to condensed consolidated financial statements.

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THORATEC CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

1. Basis of Presentation

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

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

2. Fair Value Measurement

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

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

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

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

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

		As of June 28, 2008			
		Quoted prices in active markets for identical assets (Level 1) (in thousands)		Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
		Total			
Assets					
Cash and cash equivalents	\$	61,106	\$	61,106	\$
Short term investments municipal bonds		135,018		135,018	
Long term investments auction rate securities		31,863			31,863
Convertible debenture (fair value for purposes of disclosure in Note 9)		5,000			5,000
		\$ 232,987	\$	61,106	\$ 135,018
			\$		\$ 36,863
Liabilities					
Mark to market on financial instruments (fair value for purposes of disclosure in Note 6)	\$	58	\$		\$ 58
Make-whole provision (fair value for purposes of disclosure in Note 11)		153			153
Senior subordinated convertible notes (fair value for purposes of disclosure in note 11)		156,201		156,201	
		\$ 156,412	\$	156,201	\$ 58
			\$		\$ 153

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

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

	Fair Value Measurement Using Significant Unobservable Inputs (Level 3)		
	Auction Rate Securities	Other Long Term Assets (in thousands)	Other Long Term Liabilities
Balance at December 29, 2007	\$	\$ 5,000	\$ 96
Transfer to Level 3	46,050		
Settlements at par	(8,850)		
Realized holding loss, included in interest income and other			116

Unrealized holding loss, included in other comprehensive loss	(5,049)			
Balance at March 29, 2008	\$ 32,151	\$ 5,000	\$	212
Realized holding gain, included in interest income and other				(59)
Unrealized holding loss, included in other comprehensive loss	(288)			
Balance at June 29, 2008	\$ 31,863	\$ 5,000	\$	153

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

Table of Contents**3. Investments in Available-for-Sale Securities**

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

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

	June 28, 2008	As of December 29, 2007
	(in thousands)	
Short-term investments		
Unrealized gains on corporate and municipal bonds (before taxes)	\$ 782	\$ 517
Unrealized loss on corporate and municipal bonds (before taxes)	(189)	
Long-term investments		
Unrealized loss on auction rate securities (before taxes)	(5,337)	
Net unrealized gain (loss) (before taxes)	\$ (4,744)	\$ 517

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

As of June 28, 2008, we owned approximately \$37.2 million of auction rate securities that are marketed by financial institutions and structured to periodically reset through auctions ranging from 7 to 35 days. The underlying collateral of the auction rate securities consists of student loans. Beginning in February of 2008, these auctions began to fail. As a result, we will not be able to access these funds until future auctions for these securities are successful, until a secondary market is established, or until these securities are called for redemption. As such, our auction rate securities are classified as long-term and are valued at \$31.9 million.

We intend and have the ability to hold these auction rate securities until the market recovers or until maturity. We do not anticipate having to sell these securities in order to operate our business. We believe that, based on our current unrestricted cash, cash equivalents and short-term available-for-sale securities with an aggregate value of \$196.1 million at June 28, 2008, the current lack of liquidity in the credit and capital markets will not have an impact on our liquidity, our cash flow or our ability to fund our operations. If the issuers of the auction rate securities are unable to successfully complete future auctions and their credit ratings deteriorate, we may in the future be required to record an impairment charge on these investments. It could conceivably take until the final maturity of the underlying notes (up to 30 years) to realize our investments' recorded value.

4. Recently Issued Accounting Pronouncements

In June 2008, the Financial Accounting Standards Board (FASB) Issued Financial Statement Position (FSP) Emerging Issues Task Force (EITF) 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities*. FSP EITF 03-6-1 clarified that all outstanding unvested share-based payment awards that contain rights to non-forfeitable dividends participate in undistributed earnings with common shareholders. Awards of this nature are considered participating securities and the two-class method of computing basic and diluted earnings per share must be applied. FSP EITF 03-6-1 is effective for financial statements issued for fiscal years and interim periods beginning after December 15, 2008. We are currently evaluating the accounting impact and disclosure requirements that this guidance will have on our consolidated results of operations or financial condition when we adopt FSP EITF 03-6-1 at the beginning of our fiscal year 2009.

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In May 2008, the FASB issued FSP Accounting Principles Board (APB) 14-1, *Accounting For Convertible Debt Instruments That May Be Settled in Cash Upon Conversion (Including Partial Cash Settlement)* that alters the accounting treatment for convertible debt instruments that allow for either mandatory or optional cash settlements. FSP APB 14-1, will impact the accounting associated with our senior subordinated convertible notes recorded at a book value of \$143.5 million. FSP APB 14-1 will require us to recognize additional (non-cash) interest expense based on the market rate for similar debt instruments without the conversion feature. Furthermore, it will require recognizing interest expense in prior periods pursuant to the required retrospective accounting treatment upon adoption. The FSP will be effective for fiscal years beginning after December 15, 2008. We are currently evaluating the accounting impact and disclosure requirements that this guidance will have on our consolidated results of operations or financial conditions when we adopt FSP APB 14-1 at the beginning of our fiscal year 2009.

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

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

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

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

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

5. Cash and cash equivalents

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

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

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

Our financial instrument contracts qualify as derivatives under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and we valued these contracts at the estimated fair value at June 28, 2008. The change in fair value of the forward currency contracts is included in Interest income and other, and offsets the foreign currency exchange gains and losses in the condensed consolidated statement of operations. The impact of these foreign currency contracts are:

	Three Months Ended		Six Months Ended	
	June 28, 2008	June 30, 2007	June 28, 2008	June 30, 2007
	(in thousands)			
Foreign currency exchange gain (loss) on foreign currency contracts	\$ (107)	\$ 41	\$ (1,147)	\$ (42)
Foreign currency exchange gain (loss) on foreign translation adjustments	122	(54)	1,230	2

As of June 28, 2008, we had forward contracts to sell euros with a notional value of 7.1 million and to purchase UK pounds with a notional value of £5.0 million, and as of June 30, 2007 we had forward contracts to sell euros with a notional value of 5.4 million and to purchase UK pounds with a notional value of £3.0 million. As of June 28, 2008, our forward contracts had an average exchange rate of one U.S. dollar to 0.6455 euros and one U.S. dollar to 0.5036 UK pounds. The forward contracts are valued based on exchange rates derived from an independent source of market participant assumptions and compiled from the best information available. As of June 28, 2008, the estimated fair value of these foreign currency contracts were \$0.1 million.

7. Inventories

Inventories consisted of the following:

	As of	
	June 28, 2008	December 29, 2007
	(in thousands)	
Finished goods	\$ 21,198	\$ 20,732
Work in process	13,613	10,053
Raw materials	21,189	24,150
Total	\$ 56,000	\$ 54,935

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

	June 28, 2008	As of December 29, 2007
	(in thousands)	
Land, building and improvements	\$ 16,135	\$ 16,135
Equipment and capitalized software	66,014	61,886
Furniture and leasehold improvements	22,764	22,804
 Total	 104,913	 100,825
Less accumulated depreciation	(58,878)	(54,348)
	 \$ 46,035	 \$ 46,477

Depreciation expense for the three months ended June 28, 2008 and June 30, 2007 was \$2.6 million and \$2.4 million, respectively and for the six months ended June 28, 2008 and June 30, 2007 was \$5.0 million and \$4.5 million, respectively.

9. Other Assets

On August 23, 2006, we purchased a \$5.0 million convertible debenture from Levitronix LLC (Levitronix), a company with which we have a distribution arrangement to sell Levitronix products. The convertible debenture is a long-term note receivable with an annual interest rate of 5.7%, to be accrued monthly and at the option of Levitronix, paid in cash or in-kind semi-annually on February 23rd and August 23rd until its maturity on August 23, 2013. We may convert the debenture at any time at our option into membership interests of Levitronix at a conversion price of \$4.2857, which may be adjusted as a result of certain corporate events. This conversion feature is not an embedded derivative under SFAS No. 133 because the membership interests of the issuer are not readily convertible to cash. If we had converted the debenture as of June 28, 2008, our ownership in Levitronix would have been less than 5%.

The \$5.0 million outstanding principal amount of the Levitronix convertible debenture plus accrued but unpaid interest of \$0.5 million thereon, is included in Other assets on our condensed consolidated balance sheet. As of June 28, 2008, the fair value of the convertible debenture, based on a discounted cash flows valuation approach using significant unobservable inputs, was approximately \$5.0 million.

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

The carrying amount of goodwill was \$98.4 million as of June 28, 2008 and December 30, 2007, \$94.1 million of which is attributable to our Cardiovascular division and \$4.3 million of which is attributable to International Technidyne Corporation's (ITC) acquisition of the outstanding common shares of privately held A-VOX Systems, Inc. (Avox).

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

	As of June 28, 2008		
	Gross Carrying Amount	Accumulated Amortization (in thousands)	Net Carrying Amount
Patents and trademarks	\$ 38,515	\$ (26,945)	\$ 11,570
Core technology	37,485	(12,779)	24,706
Developed technology	125,742	(47,422)	78,320
Customer and distributor relationships and other	897	(318)	579
Total purchased intangible assets	\$ 202,639	\$ (87,464)	\$ 115,175

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

Amortization expense related to purchased intangible assets was \$3.3 million and \$3.1 million for the three months ended June 28, 2008 and June 30, 2007, respectively, and \$6.6 million and \$6.3 million for the six months ended June 28, 2008 and June 30, 2007, respectively. Our amortization expense is expected to be approximately \$13.2 million in 2008, declining to \$9.1 million by 2012. This decline in amortization expense is because of certain intangibles which will be fully amortized in 2009 and 2010. Patents and trademarks have useful lives ranging from one to thirteen years, core and developed technology assets have useful lives ranging from three to sixteen years and customer and distributor relationships and other have useful lives ranging five to ten years. Further, the adoption of FSP No. 142-3 may impact the useful life of our purchased intangible assets and the related amortization expense from our fiscal year beginning in 2009.

Table of Contents**11. Long-Term Debt**

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

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

The deferred debt issuance costs of \$1.8 million, \$4.3 million net of \$2.5 million in amortization, are included in Other assets on the condensed consolidated balance sheet as of June 28, 2008. The deferred debt issuance costs are amortized on a straight line basis until May 2011 at which point the Company can redeem the debt. These charges are included in Interest expense on our condensed consolidated statements of operations.

Holders of the senior subordinated convertible notes may convert their convertible notes into shares of our common stock at a conversion rate of 29.4652 shares per \$1,000 principal amount of senior subordinated convertible notes, which represents a conversion price of \$19.72 per share, subject to adjustments upon the occurrence of certain events. Holders have been and are able to convert their convertible notes at any point after the close of business on September 30, 2004 if, as of the last day of the preceding calendar quarter, the closing price of our common stock for at least 20 trading days in a period of 30 consecutive trading days ending on the last trading day of such preceding calendar quarter is more than 120% of the accreted conversion price per share of our common stock. Holders may surrender their senior subordinated convertible notes for conversion on or before May 16, 2029 during the five business day period after any five consecutive trading day period in which the trading price per note for each day of that period was less than 98% of the product of the closing sale price of our common stock and the conversion rate on each such day. However, in such event, if on the day before any conversion the closing sale price of our common stock is greater than the accreted conversion price (i.e., the issue price of the note plus accrued original issue discount divided by the conversion rate) but less than or equal to 120% of the accreted conversion price, instead of shares of our common stock based on the conversion rate, holders will receive cash or common stock, or a combination of each at our option, with a value equal to the accreted principal amount of the notes plus accrued but unpaid interest as of the conversion date. Additionally, holders may convert their senior subordinated convertible notes if we call them for redemption or if specified corporate transactions or significant distributions to holders of our stock have occurred. As of June 28, 2008, no notes had been converted or called.

Holders may require us to repurchase all or a portion of their senior subordinated convertible notes on each of May 16, 2011, 2014, 2019, 2024 and 2029 at a repurchase price equal to 100% of the issue price, plus accrued original issue discount, if any. In addition, if we experience a change in control or a termination of trading of our common stock each holder may require us to purchase all or a portion of such holder's notes at the same price, plus, in certain circumstances, a make-whole premium. This premium is considered an embedded derivative under SFAS No. 133 and has been bifurcated from the senior subordinated convertible notes and recorded at its estimated fair value, \$0.2 million at June 28, 2008. There are significant variables and assumptions used in valuing the make-whole provision including, but not limited to, the Company's stock price, volatility of the Company's stock, the probability of our being acquired and the probability of the type of consideration used by a potential acquirer.

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

the sum of the issue price and the accrued original issue discount.

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The senior subordinated convertible notes are subordinated to all of our senior indebtedness and structurally subordinated to all indebtedness of our subsidiaries. Therefore, in the event of a bankruptcy, liquidation or dissolution of us or one or more of our subsidiaries and acceleration of or payment default on our senior indebtedness, holders of the convertible notes will not receive any payment until holders of any senior indebtedness we may have outstanding have been paid in full.

The aggregate fair value of the senior subordinated convertible notes at June 28, 2008, based on quoted market prices in active markets, was \$156.2 million.

12. Share-Based Compensation

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

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

	Three Months Ended		Six Months Ended	
	June 28, 2008	June 30, 2007	June 28, 2008	June 30, 2007
	(in thousands)			
Cost of product sales	\$ 574	\$ 381	\$ 913	\$ 738
Selling, general and administrative	1,562	1,757	3,236	4,105
Research and development	596	591	1,343	1,389
	\$ 2,732	\$ 2,729	\$ 5,492	\$ 6,232

Share-based compensation expense of \$0.5 million and \$0.7 million, respectively, was capitalized to inventory as of June 28, 2008 and June 30, 2007, respectively.

We receive a tax deduction for certain stock option exercises during the period the options are exercised, generally for the excess of the fair market value of the options at the date of exercise over the exercise prices of the options. Prior to the adoption of SFAS No. 123(R), we reported all tax benefits resulting from the exercise of stock options as operating cash flows in our condensed consolidated statements of cash flows. In accordance with SFAS No. 123(R), our condensed consolidated statements of cash flows presentation reports the excess tax benefits from the exercise of stock options as financing cash flows of approximately \$68,000 and \$1.1 million for the six months ended June 28, 2008 and June 30, 2007, respectively, rather than operating cash flows.

Cash proceeds from the exercise of stock options were \$0.9 million and cash proceeds from our employee stock purchase plan were \$1.1 million for the six months ended June 28, 2008. Cash proceeds from the exercise of stock options were \$8.6 million and cash proceeds from our employee stock purchase plan were \$1.1 million for the six months ended June 30, 2007.

Equity Plan

In April 2006, the Board of Directors approved the 2006 Incentive Stock Plan (2006 Plan), in May 2006 the 2006 Plan was amended by the Board of Directors and approved by our shareholders and in May 2008 the 2006 Plan was amended by the Board of Directors and approved by our shareholders. The 2006 Plan allows us to grant to employees and directors of, and consultants to, the Company up to a total of 5.4 million shares of stock. Each share issued from and after May 20, 2008 as restricted stock bonuses, restricted stock units, phantom stock units, performance share bonuses, or performance share units reduces the number of shares available for issuance under the 2006 Plan by one and seventy-four hundredths (1.74) shares, and each share issued as stock options, restricted stock purchases or stock

appreciation rights reduces the shares available for issuance under the 2006 Plan on a share-for-share basis. During the six months ended June 28, 2008, 379,880 options were granted under the 2006 Plan at an exercise price equal to the fair market value on the date of grant, and 481,460 shares of restricted stock and restricted stock units were granted under the 2006 Plan. At June 28, 2008, 3.2 million shares remained available for grant under the 2006 Plan.

Table of Contents***Stock Options***

Upon approval in May 2006, the 2006 Plan replaced our previous common stock option plans and equity incentive plans. At June 28, 2008 we had options outstanding under the 2006 Plan and the replaced plans. Options under the 2006 Plan may be granted by the Board of Directors at the fair market value on the date of grant and generally become fully exercisable within four years after the grant date and expire between five and ten years from the date of grant. Vesting on options granted to officers will be accelerated in certain circumstances following a change in control of the Company.

The fair value of each option is estimated at the date of grant using the Black-Scholes option pricing model with the following assumptions:

	Three Months Ended		Six Months Ended	
	June 28, 2008	June 30, 2007	June 28, 2008	June 30, 2007
Risk-free interest rate (weighted average)	3.10%	4.73%	3.25%	4.81%
Expected volatility	40%	40%	40%	40%
Expected option term (years)	5.09 to 6.07	5.02 to 6.06	5.09 to 6.07	5.08 to 6.06
Dividends	None	None	None	None

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

At June 28, 2008, there was \$5.2 million of unrecognized compensation expense related to stock options. The aggregate intrinsic value of in-the-money options outstanding was \$18.8 million, based on the closing price of the Company's common stock on June 27, 2008, the last trading day in the six months ended June 28, 2008, of \$17.62, and the aggregate intrinsic value of options exercisable was \$17.1 million. The intrinsic value of options exercised was \$0.4 million for the six months ended June 28, 2008. The fair value of the options granted during the six months ended June 28, 2008 was \$2.4 million.

Stock option activity is summarized as follows:

	Number of Options (in thousands)	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contract Life (years)
Outstanding options at December 29, 2007	5,748	\$ 15.46	6.19
Granted	380	14.97	
Exercised	(78)	11.58	
Forfeited or expired	(79)	18.81	
Outstanding options at June 28, 2008	5,971	\$ 15.43	5.97
Outstanding options exercisable at June 28, 2008	4,353	\$ 14.40	5.08
Outstanding options vested at June 28, 2008 and expected to vest	5,766	\$ 15.35	5.87

Table of Contents***Restricted Stock***

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

Share-based compensation expense related to these restricted stock grants was \$2.5 million for the six months ended June 28, 2008. As of June 28, 2008, we had \$12.4 million of unrecognized compensation expense related to these restricted stock awards, which amount we expect to recognize over 2.99 years. The total fair value of the shares granted during the six months ended June 28, 2008 was \$7.0 million.

Restricted stock activity is summarized as follows:

	Number of Shares (in thousands)	Weighted Average Grant Date Fair Value
Outstanding unvested restricted stock at December 29, 2007	768	\$ 18.29
Granted	467	15.02
Vested	(196)	18.20
Forfeited or expired	(33)	18.38
Outstanding unvested restricted stock at June 28, 2008	1,006	\$ 16.79

Restricted Stock Units

In the first six months of 2008, we granted restricted stock units to certain of our non-U.S. employees under the 2006 Plan. As of June 28, 2008, we had \$0.3 million of unrecognized compensation expense related to these restricted stock units. The aggregate intrinsic value of the units outstanding, based on the Company's stock price on June 28, 2008, was \$0.5 million.

Restricted stock unit activity is summarized as follows:

	Number of Units (in thousands)	Weighted Average Grant Date Fair Value	Weighted Average Remaining Contract Life (in years)
Outstanding units at December 29, 2007	21	\$ 18.58	2.82
Granted	14	14.84	
Released	(6)	18.61	
Forfeited or expired			
Outstanding units at June 28, 2008	29	\$ 16.74	2.97

Table of Contents***Employee Stock Purchase Plan***

In May 2002, our shareholders approved the Company's Employee Stock Purchase Plan (ESPP) under which 500,000 shares of common stock was reserved for issuance. In addition, the ESPP provides for an annual, automatic increase of up to 250,000 shares in the total number of shares available for issuance thereunder on March 1st of each year, unless our Board of Directors specifies a smaller increase or no increase. Under this provision, an additional 250,000 shares were reserved for issuance under the ESPP on each of March 1, 2006 and March 1, 2008; our Board of Directors specified no increase as of March 1, 2007. Eligible employees may purchase over six month periods, a limited number of shares of the Company's common stock at 85% of the lower of the market value on the offering date (the first day of the six month period) or the market value on the purchase date (the last date of the six month period). During the six months ended June 28, 2008, approximately 64,900 shares of common stock were issued under the ESPP. As of June 28, 2008, approximately 169,400 shares remained available for issuance under this plan.

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

Risk-free interest rate	1.73%
Expected volatility	40%
Expected option life	0.50 years
Dividends	None

As of June 28, 2008, there was approximately \$0.2 million of unrecognized compensation expense related to ESPP subscriptions that began on May 1, 2008, which amount we expect to recognize during the fourth quarter of 2008.

13. Income Taxes

Our effective income tax rates were 28% and 6%, for the three months ended June 28, 2008 and June 30, 2007, respectively. Our effective income tax rates were an expense of 29% and a benefit of 0.4%, for the six months ended June 28, 2008 and June 30, 2007, respectively.

The tax years 2004 through 2007 remain subject to audit by certain jurisdictions in which we are subject to taxation, with the exception of California and New Jersey, which remain subject to audit from 2003 to 2007, and the UK, which remains subject to audit from 2005 through 2007. However, as we had net operating losses and credits carried forward in several jurisdictions, including U.S. federal and California, certain items attributed to closed years remain subject to adjustment by the relevant tax authority through an adjustment to tax attributes carried forward to open years.

At June 28, 2008 and December 29, 2007, we reported a net deferred tax liability of approximately \$25.3 million and \$29.8 million, respectively, comprised principally of temporary differences between the financial statement and income tax bases of intangible assets.

We adopted FIN 48, *Accounting for Uncertainty in Income Taxes, an interpretation of SFAS No. 109*, on December 31, 2006. Under FIN 48, tax positions are evaluated for recognition using a more-likely-than-not recognition threshold, and those tax positions eligible for recognition are measured as the largest amount of tax benefit that is greater than fifty percent likely of being realized upon the effective settlement with a taxing authority that has full knowledge of all relevant information. During the six months ended June 28, 2008, we released certain foreign indirect items valued at approximately \$0.4 million which had previously offset income tax exposures as a result of the filing of a foreign return. This release was partially offset by certain return-to-provision true-ups resulting in net tax expense of approximately \$0.2 million. Our unrecognized tax benefits were not adjusted for this item since it related to an indirect benefit. However, we did reduce unrecognized tax benefits by approximately \$50,000 as a result of audit settlements and the passage of time on which certain exposures may be assessed. We believe it is reasonably possible that unrecognized tax benefits approximating \$0.1 million will be reduced as a result of the filing of income tax returns in a foreign jurisdiction within the next twelve months.

Table of Contents**14. Net Income Per Share**

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

	Three Months Ended		Six Months Ended	
	June 28, 2008	June 30, 2007	June 28, 2008	June 30, 2007
	(in thousands, except per share data)			
Net income for basic share calculation	\$ 8,651	\$ 1,253	\$ 9,000	\$ 978
Interest expense on senior subordinated convertible notes (after tax)	512		1,024	
Net income for diluted share calculation	\$ 9,163	\$ 1,253	\$ 10,024	\$ 978
Weighted average number of common shares-basic	54,556	53,370	54,389	53,055
Dilutive effect of stock-based compensation plans	778	1,358	717	1,366
Dilutive effect on conversion of senior subordinated convertible notes	7,290		7,290	
Weighted average number of common shares-diluted	62,624	54,728	62,396	54,421
Net income per common share				
Basic	\$ 0.16	\$ 0.02	\$ 0.17	\$ 0.02
Diluted	\$ 0.15	\$ 0.02	\$ 0.16	\$ 0.02

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

	Three Months Ended		Six Months Ended	
	June 28, 2008	June 30, 2007	June 28, 2008	June 30, 2007
	(in thousands)			
Options to purchase shares not included in the computation of diluted income per share because their inclusion would be antidilutive	2,411	1,992	2,486	1,977

The computation of diluted net income per share for the three and six months ended June 30, 2007, excludes the effect of assuming the conversion of our senior subordinated convertible notes, which are convertible at \$19.72 per share into 7.3 million shares of common stock, because the effect would have been antidilutive for the three and six month periods in 2007.

Our share repurchase programs, which authorized us to repurchase up to a total of \$130 million of the Company's common stock, were announced on February 11, 2004 as a \$25 million program, on May 12, 2004 as a \$60 million program, on July 29, 2004 as a \$25 million program and on February 2, 2007 as a \$20 million program. No shares of our common stock were repurchased under our publicly announced repurchase programs during the three months ended June 28, 2008 and June 30, 2007. All repurchased shares have been retired and are not included in net income

per common share.

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

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

Business Segments:

	Three Months Ended		Six Months Ended	
	June 28, 2008	June 30, 2007	June 28, 2008	June 30, 2007
	(in thousands)			
Product sales:				
Cardiovascular	\$ 57,506	\$ 34,153	\$ 97,727	\$ 69,691
ITC	25,142	23,180	49,348	44,952
Total product sales	\$ 82,648	\$ 57,333	\$ 147,075	\$ 114,643
Income (loss) before income taxes and other:				
Cardiovascular (a)(c)	\$ 13,399	\$ 1,268	\$ 15,225	\$ 2,395
ITC(a)(c)	1,272	1,861	2,077	3,259
Corporate (b)(c)	(3,840)	(2,488)	(7,085)	(6,491)
Income (loss) from operations	10,831	641	10,217	(837)
Other income and (expense):				
Interest expense (b)	(1,131)	(1,074)	(2,021)	(2,142)
Interest income and other (b)	2,281	1,766	4,459	3,953
Income before income taxes	\$ 11,981	\$ 1,333	\$ 12,655	\$ 974

	As of	
	June 28, 2008	December 29, 2007
	(in thousands)	
Total assets:		
Cardiovascular	\$ 320,288	\$ 312,691
ITC	62,468	62,642
Corporate (b)	247,914	238,386
Total assets	\$ 630,670	\$ 613,719

(a) The Cardiovascular segment includes amortization

expense on
purchased
intangible assets
of \$3.1 million
and \$6.2 million
for the three and
six months
ended June 28,
2008,
respectively,
and \$2.9 million
and \$5.9 million
for the three and
six months
ended June 30,
2007,
respectively.

The ITC
segment
includes
amortization
expense on
purchased
intangible assets
of \$0.2 million
and \$0.4 million
for both of the
three and six
months ended
June 28, 2008
and June 30,
2007,
respectively.

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

(c) Includes SFAS
No. 123(R)
expense of
\$1.6 million,
\$0.7 million and
\$0.4 million for
Cardiovascular,

ITC and
Corporate,
respectively, for
the three months
ended June 28,
2008 and
\$1.5 million,
\$0.8 million and
\$0.6 million for
Cardiovascular,
ITC and
Corporate,
respectively, for
the three months
ended June 30,
2007 and SFAS
No. 123(R)
expense of \$3.2
million,
\$1.4 million and
\$0.8 million for
Cardiovascular,
ITC and
Corporate,
respectively, for
the six months
ended June 28,
2008 and
\$3.4 million,
\$1.6 million and
\$1.2 million for
Cardiovascular,
ITC and
Corporate,
respectively, for
the six months
ended June 30,
2007.

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Geographic Areas:

The geographic composition of our product sales was as follows:

	Three Months Ended		Six Months Ended	
	June 28, 2008	June 30, 2007	June 28, 2008	June 30, 2007
	(in thousands)			
Domestic	\$ 60,684	\$ 41,222	\$ 106,057	\$ 84,900
International	21,964	16,111	41,018	29,743
Total product sales	\$ 82,648	\$ 57,333	\$ 147,075	\$ 114,643

Table of Contents**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS****Forward-Looking Statements**

This Quarterly Report on Form 10-Q includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These statements can be identified by the words expects, projects, hopes, believes, intends, should, estimate, will, may, anticipates, plans, could and other similar words. Actual results, events or performance could differ materially from these forward-looking statements based on a variety of factors, many of which are beyond our control.

Therefore, readers are cautioned not to put undue reliance on these statements. Factors that could cause actual results or conditions to differ from those anticipated by these and other forward-looking statements include those more fully described in the Risk Factors section of our 2007 Annual Report on Form 10-K (the 2007 Annual Report) and in other documents we file with the Securities and Exchange Commission (SEC). These forward-looking statements speak only as of the date hereof. We are not under any obligation, and we expressly disclaim any obligation, to publicly release any revisions or updates to these forward-looking statements that may be made to reflect events or circumstances after the date hereof, or to reflect the occurrence of unanticipated events.

The following presentation of management's discussion and analysis of our financial condition and results of operations should be read together with our unaudited condensed consolidated financial statements included in this Quarterly Report on Form 10-Q.

OVERVIEW

Thoratec Corporation (we, our, us, or the Company) is a world leader in therapies to address advanced heart failure (HF) and point-of-care diagnostics. Our business is comprised of two operating divisions: Cardiovascular and International Technidyne Corporation (ITC), a wholly owned subsidiary.

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

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

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

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Our Business Model

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

The product line of our Cardiovascular division is:

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

The product lines of our ITC division are:

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

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

Cardiovascular Division

VADs supplement the pumping function of the heart in patients with advanced HF. In most cases, a cannula connects the left ventricle of the heart to a blood pump. Blood flows from the left ventricle to the pump chamber via the cannula, powered by an electric or air driven mechanism that drives the blood through another cannula into the aorta. From the aorta, the blood then circulates throughout the body. Mechanical or tissue valves enable unidirectional flow in some devices. Currently, the power source remains outside the body for all FDA-approved VADs.

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

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

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

The Paracorporeal Ventricular Assist Device

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

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

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The Implantable Ventricular Assist Device

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

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

The HeartMate XVE

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

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

The HeartMate II

The HeartMate II is an implantable, electrically powered, continuous flow, left ventricular assist device consisting of a miniature rotary blood pump designed to provide intermediate and long-term MCS. The HeartMate II is designed to improve survival and quality of life and to provide five to ten years of circulatory support for a broad range of advanced HF patients. Significantly smaller than the HeartMate XVE and with only one moving part, the HeartMate II is simpler and designed to operate more quietly than pulsatile devices. As of June 30, 2008, more than 1,600 patients worldwide have been implanted with the HeartMate II. In April 2008, we received FDA approval for the HeartMate II for BTT. In addition, the HeartMate II is in a Phase II pivotal trial in the U.S. for Destination Therapy. The device received CE Mark approval in November 2005, allowing for its commercial sale in Europe.

The CentriMag

The CentriMag, manufactured by Levitronix, is approved to provide MCS for up to six hours for patients suffering from severe, but potentially reversible, cardiac failure and is based on Levitronix's magnetically levitated bearingless motor technology. We entered into a distribution agreement with Levitronix in August 2007, with an initial term effective through December 2011, to distribute the CentriMag in the U.S. The CentriMag is 510(k) cleared by the FDA for use in patients requiring short-term extracorporeal circulatory support during cardiac surgery and Levitronix has CE Mark approval in Europe to market the product to provide support for up to thirty days. Levitronix is currently in discussion with the FDA regarding an Investigational Device Exemption (IDE) to begin a pivotal trial to demonstrate safety and effectiveness of the CentriMag for longer periods of support.

Vascular Graft Products

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

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ITC Division

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

Hospital point-of-care

The HEMOCHRON Whole Blood Coagulation System

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

The IRMA TRUpoint Blood Analysis System

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

The AVOXimeter Whole Blood Co-Oximeter/Oximeter System

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

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

Alternate site point-of-care

The ProTime Microcoagulation System

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

The Hgb Pro Professional Hemoglobin Testing System

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

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

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Incision Products

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

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

Critical Accounting Policies and Estimates

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

Revenue Recognition

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

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

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

Reserves

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

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

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

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

Income Taxes

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

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

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

Evaluation of Purchased Intangibles and Goodwill for Impairment

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

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

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Valuation of Share-Based Awards

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

Fair Value Measurements

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

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

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

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

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

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

Due to the uncertainty inherent in the valuation process, estimates of fair value may differ significantly from the values that would have been obtained had an active market for the securities existed, and the differences could be material. Additionally, changes in the market environment and other events that may occur over the life of the investments may cause the gains or losses ultimately realized on these investments to be different than the valuations

currently assigned. There is no single standard for determining fair value in good faith, as fair value depends upon circumstances of each individual case. In general, fair value is the amount that we might reasonably expect to receive upon the current sale of the security in an arms-length transaction in the security's principal market.

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

	Three Months Ended		Six Months Ended	
	June 28, 2008	June 30, 2007	June 28, 2008	June 30, 2007
Product sales	100%	100%	100%	100%
Cost of product sales	38	41	41	40
Gross profit	62	59	59	60
Operating expenses:				
Selling, general and administrative	29	33	30	36
Research and development	16	19	17	19
Amortization of purchased intangible assets	4	6	5	6
Total operating expenses	49	58	52	61
Income (loss) from operations	13	1	7	(1)
Interest expense	(1)	(2)	(1)	(2)
Interest income and other	3	3	3	4
Income before income taxes	15	2	9	1
Income tax expense	(4)		(3)	
Net income	11%	2%	6%	1%

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

Three months ended June 28, 2008 and June 30, 2007***Product Sales***

Product sales in the second quarter of 2008 were \$82.6 million compared to \$57.3 million in the second quarter of 2007. The primary components of the total \$25.3 million increase in product sales were the following:

Cardiovascular product sales increased by \$23.3 million primarily due to higher sales from our HeartMate product line. These higher sales resulted from increased HeartMate II volume, partly attributable to FDA BTT commercial approval in April 2008, including the addition of twenty-six U.S. centers, and commercial price increase on our HeartMate II pumps. In addition, favorable foreign currency translation contributed to our increased product sales.

ITC product sales increased by \$2.0 million primarily due to higher international sales of our Alternate Site products, AVOXimeter and HEMOCHRON product lines.

Sales originating outside of the U.S. and U.S. export sales accounted for approximately 27% and 28% of our total product sales in the second quarter of 2008 and 2007, respectively.

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Gross Profit

Gross profit in the second quarter of 2008 was \$50.8 million compared to \$33.7 million in the second quarter of 2007. As a percentage of product sales, gross margin in the second quarter of 2008 and 2007 was 62% and 59%, respectively. The increase in gross margin percentage was primarily due to the following:

Cardiovascular gross margin percentage increased by 4% primarily due to HeartMate II pump price increases, improved manufacturing variances, favorable pump product mix, and favorable foreign currency translations.

ITC division gross margin percentage decreased by 5% due to unfavorable geographic mix, product mix and competitive pricing pressure on our skin incision business during the second quarter of 2008 as compared to the second quarter of 2007, in addition to a favorable variance from returned units in 2007.

Selling, General and Administrative

Selling, general and administrative expenses in the second quarter of 2008 were \$23.9 million, or 29% of product sales, compared to \$19.1 million, or 33% of product sales, in the second quarter of 2007. The \$4.8 million increase in expenses was primarily attributable to the following:

Cardiovascular costs increased by \$3.0 million in the second quarter of 2008 as compared to the second quarter of 2007 primarily due to market development initiatives, commercialization efforts around the HeartMate II and higher compensation expense.

ITC costs increased by \$0.4 million in the second quarter of 2008 as compared to the second quarter of 2007 primarily due to higher compensation and consulting expenses.

Corporate costs increased by \$1.4 million in the second quarter of 2008 as compared to the second quarter of 2007 primarily due to higher compensation and various other corporate expenses.

Research and Development

Research and development expenses in the second quarter of 2008 were \$12.8 million, or 16% of product sales, compared to \$10.8 million, or 19% of product sales, in the second quarter of 2007. Of the \$2.0 million increase, our Cardiovascular and ITC divisions incurred \$1.6 million and \$0.4 million, respectively, in additional expenses, quarter over quarter. Research and development costs are largely project driven, and depend on the level of project activity planned and subsequently approved and conducted. The increase in costs at our Cardiovascular division was primarily due to regulatory and clinical costs associated with the HeartMate product line peripheral enhancements. The increase in costs at our ITC division was primarily due to new product development.

Amortization of Purchased Intangible Assets

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

Interest Expense

Interest expense was \$1.1 million in the second quarter of each of 2008 and 2007. Interest expense includes amortization of debt issuance costs related to our senior subordinated convertible notes of \$0.2 million for each of the second quarters of 2008 and 2007.

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Interest Income and Other

Interest income and other for the second quarter of 2008 was \$2.3 million as compared to \$1.8 million for the second quarter of 2007. Interest income was \$2.1 million and \$1.9 million in the second quarters of 2008 and 2007, respectively. This increase in interest income of \$0.2 million was due to higher investment balances in our portfolio and higher short-term interest rates as a result of the auction failures, with higher than market interest rates on our auction rate securities. The remaining \$0.3 million increase related to increase of \$0.1 million in the value of the make-whole provision on our senior subordinated convertible notes during the second quarter of 2008 and an impairment loss from an investment of \$0.2 million during the second quarter of 2007.

Income Taxes

Our effective income tax rates were 28% and 6%, for the second quarter of 2008 and 2007, respectively. The 22% increase in our effective tax rate for the three month period in 2008 as compared to the same period in 2007 was primarily related to an increase in projected pre-tax earnings and the absence of research and development tax credits in 2008, which will be recognized in a future period upon Congressional approval.

Our effective tax rate is calculated based on the statutory tax rates imposed on projected annual pre-tax income or loss in various jurisdictions. Since relatively small changes in our forecasted profitability for 2008 can significantly affect our projected annual effective tax rate, we believe our tax rate will be dependent on our profitability and could fluctuate significantly.

Six months ended June 28, 2008 and June 30, 2007

Product Sales

Product sales in the first half of 2008 were \$147.1 million compared to \$114.6 million in the first half of 2007. The primary components of the total \$32.5 million increase in product sales were the following:

Cardiovascular product sales increased by \$28.0 million primarily due to higher sales from our HeartMate product line. These higher sales resulted from increased HeartMate II volume partly attributable to FDA BTT approval, including the addition of twenty-six U.S. centers, and commercial price increase on our HeartMate II pumps. In addition, favorable foreign currency translation contributed to our increased product sales.

ITC product sales increased by \$4.5 million due primarily to higher international and domestic sales of our Alternate Site products and HEMOCHRON product lines.

Sales originating outside of the U.S. and U.S. export sales accounted for approximately 28% and 26% of our total product sales in the first half of 2008 and 2007, respectively.

Gross Profit

Gross profit in the first half of 2008 was \$86.7 million compared to \$68.2 million in the first half of 2007. As a percentage of product sales, gross margin in the first half of 2008 and 2007 was 59% and 60%, respectively. The decrease in gross margin percentage was primarily due to the following:

Cardiovascular gross margin percentage was the same for the first half of 2008 and 2007. The major fluctuations in 2008 were the HeartMate II pump price increased and favorable foreign currency translations, offset by less favorable manufacturing variances.

ITC division gross margin percentage decreased by 4% due to unfavorable geographic and product mix during the first half of 2008 in comparison to the first half of 2007, in addition to favorable manufacturing variances.

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Selling, General and Administrative

Selling, general and administrative expenses in the first half of 2008 were \$44.5 million, or 30% of product sales, compared to \$41.1 million, or 36% of product sales, in the first half of 2007. The \$3.4 million increase in expenses was primarily attributable to the following:

Cardiovascular costs increased by \$3.0 million in the first half of 2008 as compared to the first half of 2007 primarily due to market development initiatives, commercialization efforts around the HeartMate II and higher compensation expense.

ITC costs increased by \$0.6 million in the first half of 2008 as compared to the first half of 2007 primarily due to higher sales and marketing personnel and travel cost

Corporate costs decreased by \$0.2 million during the first half of 2008 as compared to the first half of 2007 primarily due to consulting fees during the first half of 2007 related to a stock option review that did not recur in the first half of 2008, offset by higher compensation expense during the first half of 2008.

Research and Development

Research and development expenses in the first half of 2008 were \$25.4 million, or 17% of product sales, compared to \$21.7 million, or 19% of product sales, in the first half of 2007. Of the \$3.7 million increase, our Cardiovascular and ITC divisions accounted for \$2.8 million and \$0.9 million, respectively. Research and development costs are largely project driven, and depend on the level of project activity planned and subsequently approved and conducted. The increase in costs at our Cardiovascular division was primarily due to regulatory and clinical costs associated with Phase II of the HeartMate II pivotal trial and HeartMate product line peripheral enhancements. The increase in costs at our ITC division was primarily due to new product development.

Amortization of Purchased Intangible Assets

Amortization of purchased intangible assets in the first half of 2008 was \$6.6 million as compared to \$6.3 million in the first half of 2007. The \$0.3 million increase in amortization expense resulted from decreasing the useful estimated lives of certain of our intangible assets at our Cardiovascular division at the beginning of fiscal year 2008.

Interest Expense

Interest expense was \$2.0 million in the first half of 2008 as compared to \$2.1 million in the first half of 2007. Interest expense includes amortization of debt issuance costs related to our senior subordinated convertible notes of \$0.3 million for the first half of each of 2008 and 2007.

Interest Income and Other

Interest income and other for the first half of 2008 was \$4.5 million as compared to \$4.0 million for the first half of 2007. Interest income was \$4.3 million and \$3.9 million in the first half of 2008 and 2007, respectively. This increase in interest income of \$0.4 million was due to higher investment balances in our portfolio and higher short-term interest rates as a result of the auction failures with higher than market interest rates on our auction rate securities. The remaining \$0.1 million increase related to gains from foreign currency translation.

Income Taxes

Our effective income tax rates were 29% for the six months ended June 28, 2008 and a benefit of 0.4% for the six months ended June 30, 2007, respectively. The 29% increase in our effective tax rate for the six month period in 2008 as compared to the same period in 2007 was primarily due to a significant increase in projected profit taxed at the statutory tax rates, a release of reserves recorded under FIN 48, *Accounting for Uncertainty in Income Taxes, an interpretation of SFAS No. 109*, related to certain foreign exposures, and the absence of research and development tax credits in 2008, which will be recognized in a future period upon Congressional approval.

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Our effective tax rate is calculated based on the statutory tax rates imposed on projected annual pre-tax income or loss in various jurisdictions. Since relatively small changes in our forecasted profitability for 2008 can significantly affect our projected annual effective tax rate, we believe our tax rate will be dependent on our profitability and could fluctuate significantly.

Liquidity and Capital Resources

At June 28, 2008, we had net working capital of \$284.6 million compared with \$301.7 million at December 29, 2007. Cash and cash equivalents on June 28, 2008 were \$61.1 million compared to \$20.7 million on December 29, 2007. The increase in cash and cash equivalents was mainly due to an increase in net sales of available-for-sale investments, cash provided by operations, proceeds from the exercise of stock options and employee stock purchase plan, partially offset by purchases of property, plant and equipment and repurchases of restricted stock for payment of income withholding taxes due upon vesting.

Cash provided by operating activities for the six months ended June 28, 2008 was \$18.0 million. This amount includes net income for the period of \$9.0 million increased by positive non-cash adjustments to net income of approximately \$15.8 million, and a net decrease of approximately \$6.8 million from changes in assets and liabilities. The positive non-cash adjustments to net income were primarily due to \$11.6 million for depreciation and amortization, \$5.5 million related to share-based compensation expense, partially offset by \$2.4 million in changes to net deferred tax liabilities. The change in assets and liabilities were primarily due to an \$11.0 million increase in receivables, a \$3.0 million increase in inventory and a \$0.8 million increase in prepaid expenses and other assets, partially offset by a \$5.0 million increase in accounts payable and a \$3.0 million increase in income taxes payable.

Investing activities for the six months ended June 28, 2008 provided cash of \$21.6 million, primarily due to net sales and maturities of \$24.9 million from available-for-sale investments, partially offset by \$3.3 million for purchases of property, plant and equipment, net of \$1.7 million in transfers of drivers and demonstration equipment from inventory into fixed assets. The purchased property, plant and equipment included \$1.6 million for leasehold improvements and purchases of management information systems equipment at our Cardiovascular division and \$1.7 million for facility expansion costs at our ITC division.

Financing activities for the six months ended June 28, 2008 provided cash of \$0.8 million, from net proceeds of stock option and employee stock purchase plan purchases partially offset by repurchases of restricted stock for payment of income withholding taxes due upon vesting.

As of June 28, 2008, we owned approximately \$37.2 million of auction rate securities that are marketed by financial institutions and are periodically reset through auctions ranging from 7 to 35 days. The underlying collateral of the auction rate securities consists of student loans. Beginning in February of 2008, these auctions began to fail. As a result, we will not be able to access these funds until future auctions for these securities are successful, until a secondary market is established, or until these securities are called for redemption. As such, our auction rate securities are classified as long-term and are valued at \$31.9 million using significant unobservable inputs. Based on our expected operating cash flows, and our other sources of cash, we do not anticipate the potential lack of liquidity of these investments will affect our ability to execute our current business plan.

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

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

	Fair Value Measurement Using Significant Unobservable Inputs (Level 3)		
	Auction Rate Securities	Other Long Term Assets (in thousands)	Other Long Term Liabilities
Balance at December 29, 2007	\$	\$ 5,000	\$ 96
Transfer to Level 3	46,050		
Settlements at par	(8,850)		
Realized holding loss, included in interest income and other			116
Unrealized holding loss, included in other comprehensive loss	(5,049)		
Balance at March 29, 2008	\$ 32,151	\$ 5,000	\$ 212
Realized holding gain, included in interest income and other			(59)
Unrealized holding loss, included in other comprehensive loss	(288)		
Balance at June 29, 2008	\$ 31,863	\$ 5,000	\$ 153

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

We intend and have the ability to hold these auction rate securities until the market recovers or until maturity. We do not anticipate having to sell these securities in order to operate our business. We believe that, based on our current unrestricted cash, cash equivalents and short-term marketable security balances of \$196.1 million at June 28, 2008, the current lack of liquidity in the credit and capital markets will not have an impact on our liquidity, our cash flow or our ability to fund our operations. If the issuers of the auction rate securities are unable to successfully complete future auctions and their credit ratings deteriorate, we may in the future be required to record an impairment charge on these investments. It could conceivably take until the final maturity of the underlying notes (up to 30 years) to realize our investments recorded value.

Off Balance Sheet Arrangements

We maintain an Irrevocable Standby Letter of Credit as part of our workers compensation insurance program. The Letter of Credit is not collateralized. The Letter of Credit automatically renews on June 30th of each year, unless terminated by one of the parties. At June 28, 2008, our Letter of Credit balance was approximately \$660,000.

Contractual Obligations

As of June 28, 2008, the liability for uncertain tax positions was \$7.5 million including interest and penalties. Due to the high degree of uncertainty regarding the timing of potential future cash flows associated with these liabilities, we are unable to make a reasonably reliable estimate of the amount and period in which these liabilities might be paid.

During the six months ended June 28, 2008 there were no other material changes outside our normal course of business to our contractual obligations reported in our 2007 Annual Report.

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

Our investment portfolio is made up of marketable investments in money market funds, auction rate securities, U.S. Treasury securities and debt instruments of government agencies, local municipalities, and high quality corporate issuers. All investments are carried at fair market value and are treated as available-for-sale. Investments with maturities beyond one year may be classified as short-term based on their highly liquid nature due to the frequency with which the interest rate is reset and because such marketable securities represent the investment of cash that is available for current operations. Our auction rate securities that are not liquid are treated as long term. Our holdings of the securities of any one issuer, except government agencies, do not exceed 10% of the portfolio. If interest rates rise, the market value of our investments may decline, which could result in a loss if we are forced to sell an investment before its scheduled maturity. If interest rates were to rise or fall from current levels by 25 basis points and by 50 basis points, the change in our net unrealized gain or loss on investments would be \$0.4 million and \$0.7 million, respectively. We do not utilize derivative financial instruments to manage interest rate risks.

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

Foreign Currency Rate Fluctuations

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

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

Our financial instrument contracts qualify as derivatives under SFAS No. 133, and we valued these contracts at the estimated fair value at June 28, 2008. The change in fair value of the forward currency contracts is included in Interest income and other, and offsets the foreign currency exchange gains and losses in the condensed consolidated statement of operations. The impact of these foreign currency contracts are:

	Three Months Ended		Six Months Ended	
	June 28, 2008	June 30, 2007	June 28, 2008	June 30, 2007
	(in thousands)			
Foreign currency exchange gain (loss) on foreign currency contracts	\$ (107)	\$ 41	\$ (1,147)	\$ (42)
Foreign currency exchange gain (loss) on foreign translation adjustments	122	(54)	1,230	2

As of June 28, 2008, we had forward contracts to sell euros with a notional value of 7.1 million and to purchase UK pounds with a notional value of £5.0 million, and as of June 30, 2007 we had forward contracts to sell euros with a notional value of 5.4 million and to purchase UK pounds with a notional value of £3.0 million. As of June 28, 2008, our forward contracts had an average exchange rate of one U.S. dollar to 0.6455 euros and one U.S. dollar to 0.5036 UK pounds. The forward contracts are valued based on exchange rates derived from an independent source of market participant assumptions and compiled from the best information available. As of June 28, 2008, the estimated fair value of these foreign currency contracts were \$0.1 million, recorded in Other assets. The potential fair value gain or loss for a hypothetical 10% change in foreign currency exchange rates at June 28, 2008 would be approximately

\$2.1 million.

Table of Contents**ITEM 4. CONTROLS AND PROCEDURES**

Attached as exhibits to this Form 10-Q are certifications of our Chief Executive Officer and Chief Financial Officer, which are required in accordance with Rule 13a-14 of the Securities Exchange Act of 1934, as amended (the Exchange Act). This Controls and Procedures section includes information concerning the controls and controls evaluation referred to in the certifications.

Disclosure Controls and Procedures

An evaluation was performed under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rule 13a-15(e) under the Exchange Act, as of June 28, 2008. The evaluation of our disclosure controls and procedures included a review of our processes and implementation and the effect on the information generated for use in this Quarterly Report on Form 10-Q. In the course of this evaluation, we sought to identify any significant deficiencies or material weaknesses in our disclosure controls and procedures, to determine whether we had identified any acts of fraud involving personnel who have a significant role in our disclosure controls and procedures, and to confirm that any necessary corrective action, including process improvements, was taken. This type of evaluation is done quarterly so that our conclusions concerning the effectiveness of these controls can be reported in our periodic reports filed with the SEC. The overall goals of these evaluation activities are to monitor our disclosure controls and procedures and to make modifications as necessary. We intend to maintain these disclosure controls and procedures, modifying them as circumstances warrant.

Based on that evaluation, our management, including the Chief Executive Officer and Chief Financial Officer, concluded that as of June 28, 2008 the Company's disclosure controls and procedures, as defined in Rule 13a-15(e) under the Exchange Act, were effective to provide reasonable assurance that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms, and to provide reasonable assurance that such information is accumulated and communicated to our management, including our principal executive officer, as appropriate to allow timely decisions regarding required disclosures.

Changes to Internal Controls

There have been no changes in our internal controls over financial reporting during the quarter ended June 28, 2008 that have materially affected or are reasonably likely to materially affect our internal control over financial reporting.

Inherent Limitations on Controls and Procedures

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

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We intend to review and evaluate the design and effectiveness of our disclosure controls and procedures on an ongoing basis and to improve our controls and procedures over time and to correct any deficiencies that we may discover in the future. While our Chief Executive Officer and Chief Financial Officer have concluded that, as of June 28, 2008, the design of our disclosure controls and procedures, as defined in Rule 13a-15(e) under the Exchange Act, was effective, future events affecting our business may cause us to significantly modify our disclosure controls and procedures.

PART II. OTHER INFORMATION**ITEM 1A. RISK FACTORS**

In addition to the other information set forth in this Quarterly Report, you should carefully consider the factors discussed in Part I, Item 1A. Risk Factors in our 2007 Annual Report, which could materially affect our business, financial condition or future results. The risks described in our 2007 Annual Report are not the only risks facing us. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

ITEM 2: UNREGISTERED SALE OF EQUITY SECURITIES AND USE OF PROCEEDS

There were no unregistered sales of our equity securities during the three months ended June 28, 2008.

The following table sets forth certain information about our common stock repurchased during the three months ended June 28, 2008:

	Total number of shares purchased	Average price paid per share (in thousands, except per share data)	Total number of shares purchased under publicly announced programs (1)	Approximate value of shares authorized to be purchased under publicly announced programs
	(2)		(1)	
March 30, 2008 through April 26, 2008	3.5	\$ 15.36		\$
April 27, 2008 through May 24, 2008	1.7	16.11		
May 25, 2008 through June 28, 2008	2.6	17.66		
Total	7.8	\$ 16.27		\$

(1) Our share repurchase programs, which authorized us to repurchase up to a total of \$130 million of the Company's

common shares, were announced on February 11, 2004 as a \$25 million program, on May 12, 2004 as a \$60 million program, on July 29, 2004 as a \$25 million program and on February 2, 2006 as a \$20 million program. These programs authorize us to acquire shares in the open market or in privately negotiated transactions and do not have an expiration date. No shares were repurchased under these programs during the three and six months ended June 28, 2008.

- (2) Shares purchased that were not part of our publicly announced repurchase programs represent the surrender value of shares of restricted stock used to pay income taxes due upon vesting, and do not reduce the dollar value that

may yet be
purchased under
our publicly
announced
repurchase
programs.

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The annual meeting of shareholders was held on May 20, 2008. The following items were voted upon and approved at the meeting:

1. To elect the following directors to serve for the ensuing year until their successors are elected:

	Number of Votes	
	For	Withheld
Gerhard F. Burbach	42,626,960	5,541,657
Howard E. Chase	42,607,967	5,560,650
J. Daniel Cole	42,631,209	5,537,408
Steven H. Collis	42,132,624	6,035,993
Neil F. Dimick	42,183,779	5,984,838
Elisha W. Finney	42,905,274	5,263,343
D. Keith Grossman	42,591,048	5,577,569
J. Donald Hill	41,707,848	6,460,769
Daniel M. Mulvena	41,758,549	6,410,068

2. To approve the amendment of the Thoratec Corporation 2006 Incentive Stock Plan:

	Number of Votes
For	38,299,562
Against	4,118,019
Abstain	831,562
Broker Non-Votes	4,919,384

3. To ratify of the appointment of Deloitte & Touche LLP as the Company's independent auditors for its fiscal year ending January 3, 2009:

	Number of Votes
For	47,794,327
Against	347,707
Abstain	26,583

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ITEM 6. EXHIBITS

31.1 Section 302 Certification of Chief Executive Officer.

31.2 Section 302 Certification of Chief Financial Officer.

32.1 Section 906 Certification of Chief Executive Officer.

32.2 Section 906 Certification of Chief Financial Officer.

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SIGNATURES

In accordance with the requirements of the Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

THORATEC CORPORATION

Date: August 6, 2008

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

Date: August 6, 2008

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

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EXHIBIT INDEX

Number	Description
31.1	Section 302 Certification of Chief Executive Officer.
31.2	Section 302 Certification of Chief Financial Officer.
32.1	Section 906 Certification of Chief Executive Officer.
32.2	Section 906 Certification of Chief Financial Officer.