THORATEC CORP
Form 10-Q
August 10, 2010

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

(Mark one)

þ **Quarterly report pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934**
For the quarterly period ended July 3, 2010

or

o **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	**94-2340464**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
6035 Stoneridge Drive, Pleasanton, California	**94588**
(Address of principal executive offices)	**(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 þ No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ No o

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 þ	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

As of July 31, 2010, the registrant had 58,460,160 shares of common stock outstanding.

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CentriMag is a registered trademark of Levitronix LLC.

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

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PART I. FINANCIAL INFORMATION
ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

	July 3, 2010	January 2, 2010
ASSETS		
Current assets:		
Cash and cash equivalents	$ 37,435	$ 27,787
Short-term available-for-sale investments	314,724	279,174
Receivables, net of allowances of $1,086 and $322, respectively	50,798	48,058
Inventories	48,505	44,635
Deferred tax assets	12,564	12,261
Prepaid expenses and other assets	4,611	4,831
Prepaid income taxes	20,188	1,234
Assets held for sale	60,848	63,798
Total current assets	549,673	481,778
Property, plant and equipment, net	37,106	37,115
Goodwill	95,015	95,015
Purchased intangible assets, net	93,409	96,876
Long-term available-for-sale investments	24,166	24,634
Other long-term assets	9,935	12,465
Total Assets	$ 809,304	$ 747,883
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 16,187	$ 6,221
Accrued compensation	12,692	17,417
Other accrued liabilities	10,499	12,469
Senior subordinated convertible notes	133,882	
Liabilities related to assets held for sale	12,084	12,377
Total current liabilities	185,344	48,484
Senior subordinated convertible notes		131,929
Long-term deferred tax liability	28,192	31,720
Other	9,996	10,622
Total Liabilities	223,532	222,755
Shareholders equity:		
Common shares: no par, authorized 100,000; issued and outstanding 58,453 and 57,043 as of July 3, 2010 and January 2, 2010, respectively		

Additional paid-in capital	595,141	557,418
Accumulated deficit	(4,947)	(30,321)
Accumulated other comprehensive loss:		
Unrealized loss on investments	(1,355)	(648)
Cumulative translation adjustments	(3,067)	(1,321)
Total accumulated other comprehensive loss	(4,422)	(1,969)
Total Shareholders Equity	585,772	525,128
Total Liabilities and Shareholders Equity	$ 809,304	$ 747,883

See notes to unaudited condensed consolidated financial statements.

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THORATEC CORPORATION

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

	Three Months Ended		Six Months Ended	
	July 3, 2010	**July 4, 2009**	**July 3, 2010**	**July 4, 2009**
Product sales	$ 95,098	$ 69,222	$ 194,370	$ 133,851
Cost of product sales	30,579	26,780	62,150	47,051
Gross profit	64,519	42,442	132,220	86,800
Operating expenses:				
Selling, general and administrative	21,065	23,862	42,906	44,343
Research and development	11,812	10,327	31,803	21,100
Amortization of purchased intangible assets	2,468	2,359	4,880	5,082
Total operating expenses	35,345	36,548	79,589	70,525
Income from operations	29,174	5,894	52,631	16,275
Other income and (expense):				
Interest expense and other	(3,275)	(3,040)	(6,155)	(5,906)
Interest income and other	1,293	1,313	2,899	2,244
Impairment on investment	(46)		(2,046)	
Income before income taxes	27,146	4,167	47,329	12,613
Income tax expense	(9,609)	(1,281)	(16,428)	(3,558)
Net income from continuing operations	17,537	2,886	30,901	9,055
Net loss from discontinued operations (net of tax)	(1,583)	(1,054)	(2,514)	(1,596)
Net income	$ 15,954	$ 1,832	$ 28,387	$ 7,459
Net income (loss) per share Basic:				
Continuing operations	$ 0.30	$ 0.05	$ 0.54	$ 0.16
Discontinued operations	(0.02)	(0.02)	(0.05)	(0.03)
Net income	$ 0.28	$ 0.03	$ 0.49	$ 0.13
Net income (loss) per share Diluted:				
Continuing operations	$ 0.29	$ 0.05	$ 0.52	$ 0.16
Discontinued operations	(0.02)	(0.02)	(0.04)	(0.03)
Net income	$ 0.27	$ 0.03	$ 0.48	$ 0.13

Shares used to compute net income (loss) per share(1):				
Basic	57,635	55,789	57,139	55,658
Diluted	66,436	57,161	65,986	57,014

See notes to unaudited condensed consolidated financial statements.

(1) See Note 16, Net Income (Loss) Per Share, for the computation of basic and diluted net income (loss) per share calculations using the two-class method.

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

	Six Months Ended	
	July 3, 2010	July 4, 2009
Cash flows from continuing operating activities:		
Net income from continuing operations	$ 30,901	$ 9,055
Adjustments to reconcile net income from continuing operations to net cash provided by operating activities:		
Depreciation and amortization	8,219	8,758
Investment premium amortization, net	2,492	1,329
Loss on extinguishment of senior subordinated convertible notes	99	
Non-cash expenses, net	591	547
Non-cash interest expense	4,133	3,820
Impairment on investment	2,046	
Tax benefit related to stock options	10,013	1,832
Share-based compensation expense	6,653	5,477
Excess tax benefits from share-based compensation	(9,265)	(1,594)
Loss on disposal of assets	74	104
Change in net deferred tax liability	(3,577)	(4,504)
Changes in assets and liabilities:		
Receivables	(4,325)	(1,860)
Inventories	(6,032)	(5,057)
Prepaid expenses and other assets	272	(570)
Accounts payable and other liabilities	8,328	(3,065)
Prepaid income taxes, net	(21,780)	854
Net cash provided by continuing operating activities	28,842	15,126
Cash flows from continuing investing activities:		
Purchases of available-for-sale investments	(300,576)	(90,237)
Sales of available-for-sale investments	229,863	25,808
Maturities of available-for-sale investments	32,090	44,773
Restricted cash and cash equivalents		(20,000)
Purchases of patents	(1,414)	
Purchases of property, plant and equipment	(2,133)	(4,420)
Net cash used in continuing investing activities	(42,170)	(44,076)
Cash flows from continuing financing activities:		
Excess tax benefits from share-based compensation	9,265	1,594
Proceeds from stock option exercises	21,779	2,925
Proceeds from stock issued under employee stock purchase plan	1,884	1,628
Repurchase and retirement of common shares	(4,505)	(3,100)
Extinguishment of senior subordinated convertible notes	(5,345)	

Net cash provided by continuing financing activities	23,078	3,047
Effect of exchange rate changes on cash and cash equivalents	(102)	(91)
Net increase (decrease) in cash and cash equivalents from continuing operations	9,648	(25,994)
Cash and cash equivalents from continuing operations at beginning of period	27,787	108,388
Cash and cash equivalents from continuing operations at end of period	$ 37,435	$ 82,394
Cash flows from discontinued operations:		
Net cash provided by operating activities	$ 2,495	$ 1,950
Net cash used in investing activities	(1,746)	(1,535)
Net increase in cash from discontinued operations	749	415
Bank overdraft from discontinued operations at beginning of period	(1,326)	(1,335)
Bank overdraft from discontinued operations at end of period	$ (577)	$ (920)
Supplemental disclosure of consolidated cash flow information:		
Cash paid for taxes	$ 29,562	$ 4,852
Cash paid for interest	$ 1,707	$ 1,707
Supplemental disclosure of consolidated non-cash investing and financing activities:		
Transfers of equipment from inventory	$ 2,029	$ 1,120
Purchases of property, plant and equipment through accounts payable and accrued liabilities	$ 34	$ 370

See notes to unaudited condensed consolidated financial statements.

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THORATEC CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

1. Operations and Significant Accounting Policies

Basis of Presentation

The interim unaudited condensed consolidated financial statements of Thoratec Corporation (we, our, us, or the Company) have been prepared and presented in accordance with accounting principles generally accepted in the United States of America (GAAP) and the rules and regulations of the Securities and Exchange Commission (SEC), without audit, and reflect all adjustments necessary (consisting only of normal recurring adjustments) to present fairly our financial position, results of operations and cash flows. 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 2009 consolidated financial statements, and the accompanying notes thereto, filed with the SEC in our Annual Report on Form 10-K (the 2009 Annual Report). The operating results for any interim period are not necessarily indicative of the results that may be expected for any future period.

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

The financial information presented herein includes continuing operations, unless otherwise stated. On April 25, 2010, our board of directors made a decision to sell International Technidyne Corporation (ITC) and expects to complete this sale within a year. As such, in the second quarter of 2010, ITC has met the conditions in Financial Accounting Standards Board (FASB) Codification (ASC) 360, *Property, Plant and Equipment*, to be classified as an asset held for sale for all periods presented, as described in Note 15, Assets Held for Sale.

Revenue Recognition and Product Warranty

We recognize revenue from product sales when evidence of an arrangement exists, and title has passed (generally upon shipment) or services have been rendered, the selling price is fixed or determinable and collectability is reasonably assured. Sales to distributors are recorded when title transfers.

The majority of our products are covered by up to a one-year limited manufacturer s warranty. Estimated contractual warranty obligations are recorded when related sales are recognized and any additional amounts are recorded when such costs are probable, can be reasonably estimated and are included in Cost of product sales. The change in accrued warranty expense is summarized in the following table:

	Three Months Ended		Six Months Ended	
	July 3, 2010	July 4, 2009	July 3, 2010	July 4, 2009
	(in thousands)			
Balance at beginning of period	$ 1,777	$ 705	$ 1,706	$ 554
Accruals for warranties issued	1,182	1,122	1,931	1,900
Settlements made	(1,212)	(631)	(1,890)	(1,258)
Balance at end of period	$ 1,747	$ 1,196	$ 1,747	$ 1,196

2. Recently Issued Accounting Standards

In July 2010, the FASB issued Accounting Standards Update (ASU) No. 2010-20, *Receivables (Topic 320): Disclosures About Credit Quality of Financing Receivables and the Allowance for Credit Losses.* ASU No. 2010-20 provides accounting guidance which expands disclosures regarding the credit quality of an entity s receivables portfolio and its related allowance for credit losses. This ASU No. 2010-20 amended guidance is effective for us commencing in the third quarter of 2011. We are currently evaluating the effect of the amended guidance on our unaudited condensed consolidated financial statements.

In April 2010, the FASB issued ASU No. 2010-17, *Revenue Recognition (Topic 605): Milestone Method*. ASU No. 2010-17 provides guidance on the criteria that should be met for determining whether the milestone method of revenue recognition is appropriate. Under the milestone method of revenue recognition, consideration that is contingent upon achievement of a milestone in its entirety can be recognized as revenue in the period in which the milestone is achieved only if the milestone meets all criteria to be considered substantive. ASU No. 2010-17 provides the criteria to be met for a milestone to be considered substantive which includes that: (i) performance consideration earned by achieving the milestone be commensurate with either performance to achieve the milestone or the enhancement of the value of the item delivered as a result of a specific outcome resulting from performance to achieve the milestone; and (ii) relate to past performance and be reasonable relative to all deliverables and payment terms in the arrangement. ASU No. 2010-17 is effective on a prospective basis for us for milestones achieved on or after January 2, 2011. Earlier application is permitted. We are currently evaluating the application date and the effect of the amended guidance on our unaudited condensed consolidated financial statements.

In January 2010, the FASB issued ASU No. 2010-06, *Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements*. ASU No. 2010-06 amends ASC 820 and includes separate roll forward activity in Level 3 fair value measurements for purchases, sales, issuances and settlements. This amendment is effective after fiscal year 2010. We are currently evaluating the application of this standard on our unaudited condensed consolidated financial statements.

In October 2009, the FASB issued ASU No. 2009-13, *Revenue Recognition (Topic 605): Multiple-Deliverable Revenue Arrangements (a consensus of the FASB Emerging Issues Task Force*), which amends ASC 605-25, *Revenue Recognition: Multiple-Element Arrangements*. ASU No. 2009-13 addresses how to determine whether an arrangement involving multiple deliverables contains more than one unit of accounting and how to allocate consideration to each unit of accounting in the arrangement. This ASU replaces all references to fair value as the measurement criteria with the term selling price and establishes a hierarchy for determining the selling price of a deliverable. ASU No. 2009-13 also eliminates the use of the residual value method for determining the allocation of arrangement consideration. Additionally, ASU No. 2009-13 requires expanded disclosures. This ASU will become effective for revenue arrangements entered into or materially modified after our fiscal year 2010. Earlier application is permitted with required transition disclosures based on the period of adoption. We are currently evaluating the application date and the impact of this standard on our unaudited condensed consolidated financial statements.

3. 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 date of purchase. The fair value of these investments was determined by using quoted prices for identical investments in active markets.

4. 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 municipal bonds, corporate bonds, commercial paper and variable demand notes. All investments mature within two years or less from the date of purchase. Investments with maturities beyond one year may be classified as short-term, if they are available and intended for use in current operations, based on their highly liquid nature or due to the frequency with which the interest rate is reset. Investments classified as long-term available-for-sale consist of auction rate securities, whose underlying assets are student loans. In addition, our long-term investments associated with the deferred compensation plans are classified as trading and consist of the cash surrender value of our corporate owned life insurance policies.

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 loss.

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As of July 3, 2010, we had unrealized gains before tax from our investment in municipal bonds and corporate bonds of $1.3 million and unrealized losses before tax from our auction rate securities of $3.5 million.

The aggregate market value, cost basis and gross unrealized gains and losses for available-for-sale investments as of July 3, 2010 and January 2, 2010 by major security type are as follows:

	Amortized cost	Gross unrealized gains (losses) (in thousands)	Fair value
July 3, 2010:			
Short-term investments:			
Municipal bonds	$ 250,969	$ 1,028	$ 251,997
Variable demand notes	45,605		45,605
Corporate bonds	13,865	265	14,130
Commercial paper	2,992		2,992
Total	$ 313,431	$ 1,293	$ 314,724
Long-term investments:			
Auction rate securities	$ 27,700	$ (3,534)	$ 24,166
January 2, 2010:			
Short-term investments:			
Municipal bonds	$ 196,650	$ 1,526	$ 198,176
Variable demand notes	66,865		66,865
Corporate bonds	13,785	348	14,133
Total	$ 277,300	$ 1,874	$ 279,174
Long-term investments:			
Auction rate securities	$ 27,700	$ (3,066)	$ 24,634

As of July 3, 2010, we owned approximately $27.7 million face amount of auction rate securities classified as long-term. The assets underlying these investments are student loans backed by the U.S. government under the Federal Family Education Loan Program or by private insurers and are rated between A- and AAA. Historically, these securities have provided liquidity through a Dutch auction process that resets the applicable interest rate periodically every seven to thirty-five days. Beginning in February of 2008, these auctions began to fail. The principal amount of these auction rate securities will not be accessible until future auctions for these securities are successful, a secondary market is established, these securities are called for redemption, or they are paid at maturity.

As a result of these auction failures, these auction rate securities do not have a readily determinable market value. We estimated fair values as of July 3, 2010 using a discounted cash flow model based on estimated interest rates, the present value of future principal and interest payments discounted at rates considered to reflect current market conditions, and the credit quality of the underlying securities. Specifically, our management estimated the future cash flows over a five-year period, and applied a credit default rate to reflect the risk in the marketplace for these investments has arisen due to the lack of an active market.

As of July 3, 2010 we recorded an estimated cumulative unrealized loss of $3.5 million ($2.1 million, net of tax) related to the temporary impairment of the auction rate securities, which was included in accumulated other comprehensive loss within shareholders equity. In addition, our management reviews impairments and credit losses associated with its investments, including auction rate securities, to determine the classification of the impairment as temporary or other-than-temporary and to bifurcate the credit and non-credit component of other-than-temporary impairment event. We (i) do not intend to sell any of the auction rate securities prior to maturity at an amount below the original purchase value; (ii) intend to hold the investment to recovery and, based on a more-likely-than-not probability assessment, will not be required to sell the security before recovery; and (iii) deem that it is not probable that we will receive less than 100% of the principal and accrued interest from the issuer. Therefore, 100% of the impairment was charged to other comprehensive loss. Our auction rate securities are classified as long-term valued at $24.2 million using significant unobservable inputs. Subsequent to the second quarter of 2010 we liquidated $3.0 million of our auction rate securities at par value through a successful auction.

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If the issuers of the auction rate securities are unable to successfully complete future auctions and their credit ratings deteriorate, we may in the future be required to record an impairment charge to earnings on these investments. It could conceivably take until the final maturity of the underlying notes (up to 30 years) to realize the investments carrying value.

The aggregate market value of our trading investments included in our deferred compensation plan as of July 3, 2010 and January 2, 2010 were as follows:

	July 3, 2010	January 2, 2010
	(in thousands)	
Deferred compensation plan	$ 2,357	$ 2,436

The investments associated with the deferred compensation plans are included in Other long-term assets on our condensed consolidated balance sheets at the fair value of the cash surrender value of our corporate owned life insurance policies. The realized loss before tax from the change in the fair value of the cash surrender value for the three months ended July 3, 2010 of approximately $0.2 million and for the six months ended July 3, 2010 of approximately $80,000 is included in Interest income and other.

5. Fair Value Measurements

ASC 820, *Fair Value Measurements and Disclosure,* 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 used various approaches, including market, income and/or cost approaches, and each of these approaches requires certain inputs. Fair value measurement 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 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 based on the best information available in the circumstances.

We value our financial and nonfinancial assets and liabilities based on the observability of inputs used in the valuation of such assets and liabilities using the following fair value hierarchy. The fair value hierarchy ranks the quality and reliability of the information used to determine fair values. Financial and nonfinancial assets and liabilities carried or disclosed at fair value were classified and disclosed in one of the following three categories:

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

Level 2: 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.

Level 3: Inputs that are unobservable and significant to the overall fair value measurement.

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

	July 3, 2010				
	Assets and liabilities at carrying value	Total fair value	Quoted prices in active markets for identical assets (Level 1) (in thousands)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Assets					
Short-term investments:					
Municipal bonds	$ 251,997	$ 251,997	$	$ 251,997	$
Variable demand notes	45,605	45,605		45,605	
Corporate bonds	14,130	14,130		14,130	
Commercial paper	2,992	2,992		2,992	
Prepaid expenses and other assets mark to market on foreign exchange instruments (Note 6)	3	3		3	
Long-term investments auction rate securities	24,166	24,166			24,166
Other long-term assets deferred compensation plan	2,357	2,357		2,357	
Liabilities					
Make-whole provision (Note 10)	15	15			15

	January 2, 2010				
	Assets and liabilities at carrying value	Total fair value	Quoted prices in active markets for identical assets (Level 1) (in thousands)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Assets					
Short-term investments:					
Municipal bonds	$ 198,176	$ 198,176	$	$ 198,176	$
Variable demand notes	66,865	66,865		66,865	
Corporate bonds	14,133	14,133		14,133	
	8	8		8	

Prepaid expenses and other assets mark to market on foreign exchange instruments (Note 6)					
Long-term investments auction rate securities	24,634	24,634			24,634
Other long-term assets deferred compensation plan	2,436	2,436		2,436	
Liabilities					
Make-whole provision (Note 10)	23	23			23

Assets measured at fair value on a recurring basis using significant unobservable Level 3 inputs consist of securities with an auction reset feature (auction rate securities) whose underlying assets are student loans issued by various tax-exempt state agencies, most of which are supported by federal government guarantees and some of which are supported by private insurers. To estimate the fair value of the auction rate securities, the present value of future cash flows are estimated by discounting future principal and interest payments over a five year period. Significant inputs which vary by issuer include (1) basis point spread of 0.54% per annum (2) credit default rate which ranges from 1.35% to 6.59% and (3) discount yield rate of 1.82%.

Our short-term available-for-sale investments, which are recorded at fair value, are valued using quoted prices of similar or like securities that are traded in active markets. Our foreign exchange instruments are measured at fair value using internal models based on observable market inputs such as forward prices and exchange rates. Our long-term available-for-sale investments are measured at fair value based on unobservable market inputs using a discounted cash flow model based on estimated interest rates, the present value of future principal and interest payments discounted at rates considered to reflect current market conditions, and the credit quality of the underlying securities. Our carrying value of investments on our deferred compensation plan is recorded at fair value of similar securities that are traded in markets that are not active.

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The make-whole provision is measured at fair value, using valuation techniques, based on an internal model using observable inputs such as our stock price, the volatility of our stock, and unobservable inputs such as the probability of the Company being acquired and the probability of the type of consideration used by a potential acquirer.

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	Liabilities
	(in thousands)	
Balance at January 2, 2010	$ 24,634	$ 23
Unrealized holding gain on make-whole provision, included in interest income and other		(11)
Unrealized holding loss on auction rate securities, included in other comprehensive income	(688)	
Balance as of April 3, 2010	$ 23,946	$ 12
Unrealized holding loss on make-whole provision, included in interest income and other		3
Unrealized holding gain on auction rate securities, included in other comprehensive income	220	
Balance as of July 3, 2010	$ 24,166	$ 15

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

In addition, we are using significant unobservable Level 3 inputs for the fair value of our convertible debenture with Levitronix, LLC as of July 3, 2010 and January 2, 2010 of $2.4 million and $3.0 million, respectively. This convertible debenture is recorded at the carrying value of $2.8 million as of both July 3, 2010 and January 2, 2010, and is included in Other long-term assets on the condensed consolidated balance sheets. Levitronix repaid the receivable balance of approximately $2.8 million in full on August 3, 2010.

Senior subordinated convertible notes measured at fair value on a recurring basis using Level 2 inputs include quoted prices of identical or similar liabilities and are measured at a fair value of $316.8 million and $205.4 million, as of July 3, 2010 and January 2, 2010, respectively. The senior subordinated convertible notes have been reclassified to current liabilities during the second quarter of 2010 due to a redemption feature which may require us to repurchase all or a portion of the senior subordinated convertible notes as early as May 16, 2011. For a detailed discussion, see Note 10 Senior Subordinated Convertible Notes.

6. Foreign Exchange Instruments

We utilize foreign currency forward exchange contracts and options to mitigate against future movements in foreign exchange rates that affect certain existing and forecasted foreign currency denominated sales and purchase transactions (primarily assets and liabilities on our U.K. subsidiary s consolidated balance sheet). We do not use derivative financial instruments for speculative or trading purposes. We routinely hedge our exposure to certain foreign currencies with various financial institutions in an effort to minimize the impact of certain currency exchange rate fluctuations. If a financial counterparty to any of our hedging arrangements experiences financial difficulties or is otherwise unable to honor the terms of the foreign currency forward contract, we may experience material financial losses.

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The impacts of the current foreign currency contracts with a maximum maturity of three months, which do not qualify for hedge accounting, were as follows:

	Notional Amounts	
	July 3, 2010	July 4, 2009
	(in thousands)	
Purchases	$	$ 8,414
Sales	12,860	11,973

Effective January 3, 2010, we changed our functional currency for our U.K subsidiary from U.K pounds to euros. This change did not have a material impact on our condensed consolidated financial statements: however the change did impact our foreign currency hedging contracts. As of July 3, 2010, we owned forward contracts to sell euros to U.S. dollars with a notional value of 7.1 million, to sell U.S. dollars to euro with a notional value of $2.3 million and to sell U.K. pounds to euros with a notional value of £1.0 million, as compared to July 4, 2009, when we owned forward contracts to sell euros to U.S dollars with a notional value of 8.5 million and to purchase U.K. pounds from U.S. dollars with a notional value of £5.1 million. As of July 3, 2010, our forward contracts had an average exchange rate of one U.S. dollar to 1.2546 euros and one U.K. pound to 1.2094 euros. The fair value of these contracts is $3,000 and is included in Prepaid expenses and other assets in our condensed consolidated balance sheets.

The following represents our realized fair value of the foreign currency contracts and offsets to the foreign currency exchange gains and losses which were included in Interest income and other in the condensed consolidated statements of operations:

	Three Months Ended		Six Months Ended	
	July 3, 2010	July 4, 2009	July 3, 2010	July 4, 2009
	(in thousands)			
Foreign currency exchange gain on foreign currency contracts	$ 482	$ 487	$ 746	$ 935
Foreign currency exchange loss on foreign translation adjustments	(296)	(498)	(626)	(1,448)

7. Inventories

Inventories are stated at the lower of cost or market. Cost is based on the first in, first out method and consisted of the following:

	July 3, 2010	January 2, 2010
	(in thousands)	
Finished goods	$ 10,102	$ 12,920
Work in process	11,739	7,350
Raw materials	26,664	24,365
Total	$ 48,505	$ 44,635

8. Property, Plant and Equipment, net

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

	July 3, 2010	January 2, 2010
	(in thousands)	

Land, building and improvements	$ 18,305	$ 18,134
Equipment and capitalized software	39,316	38,281
Furniture and leasehold improvements	21,052	20,655
Subtotal	78,673	77,070
Less accumulated depreciation	(41,567)	(39,955)
Total	$ 37,106	$ 37,115

9. Goodwill and Purchased Intangible Assets

The carrying amount of goodwill was $95.0 million as of July 3, 2010 and January 2, 2010.

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

During the first quarter of 2010, we purchased patents at a fair value of $1.4 million, which we capitalized under ASC 350, *Intangibles Goodwill and Other*. These patents have an estimated useful life of approximately ten years.

The purchased intangibles on the condensed consolidated balance sheets are summarized as follows:

	July 3, 2010		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
	(in thousands)		
Patents and trademarks	$ 40,832	$ (30,143)	$ 10,689
Core technology	37,180	(16,530)	20,650
Developed technology	121,805	(59,735)	62,070
Total purchased intangible assets	$ 199,817	$ (106,408)	$ 93,409

	January 2, 2010		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
	(in thousands)		
Patents and trademarks	$ 39,418	$ (29,625)	$ 9,793
Core technology	37,180	(15,558)	21,622
Developed technology	121,805	(56,344)	65,461
Total purchased intangible assets	$ 198,403	$ (101,527)	$ 96,876

Amortization expense related to purchased intangible assets for the three months ended July 3, 2010 and July 4, 2009 was $2.5 million and $2.4 million, respectively. Amortization expense related to purchased intangible assets for the six months ended July 3, 2010 and July 4, 2009 was $4.9 million and $5.1 million, respectively. Our amortization expense is expected to be approximately $9.7 million in 2010, declining to $8.7 million by 2014. This decline in amortization expense is due to certain intangibles being fully amortized. Patents and trademarks have useful lives ranging from eight to ten years, and core and developed technology assets have useful lives ranging from zero to eleven years.

10. Senior Subordinated Convertible Notes

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.

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 outstanding notes at maturity will be $243.4 million.

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Holders of the senior subordinated convertible notes may convert their convertible notes into shares of our common stock at a conversion rate of 29.4652 shares per $1,000 principal amount of senior subordinated convertible notes, which represents a conversion price of $19.72 per share, subject to adjustments upon the occurrence of certain events as set forth in the indenture. Holders have been and are able to convert their convertible notes at any point after the close of business on October 30, 2004 if, as of the last day of the preceding calendar quarter, the closing price of our common stock for at least 20 trading days in a period of 30 consecutive trading days ending on the last trading day of such preceding calendar quarter is more than 120% of the accreted conversion price per share of our common stock. Commencing October 1, 2008, this market price conversion feature was satisfied, such that holders of the senior subordinated convertible notes may convert their notes through the final maturity date of the notes into shares of our common stock at a conversion rate of 29.4652 shares per $1,000 principal amount of senior subordinated convertible notes, subject to adjustments as provided in the indenture. If holders elect conversion, we may, at our option, deliver shares of common stock, pay a holder in cash, or deliver a combination of shares and cash, as determined pursuant to the terms of the notes. As of July 3, 2010, 4,035 bonds of the 247,427 bonds originally issued had been submitted to be converted and we have elected to pay cash in lieu of shares for these bonds.

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. Based on this redemption feature, we reclassified the net carrying amount of the senior subordinated notes to current liabilities during the second quarter of 2010. In addition, if we experience a change in control or a termination of trading of our common stock each holder may require the Company to purchase all or a portion of such holder s notes at the same price, plus, in certain circumstances, to pay a make-whole premium. This premium is considered an embedded derivative and has been bifurcated from the senior subordinated convertible notes and recorded at its estimated fair value, $15,000 as of July 3, 2010. There are significant variables and assumptions used in valuing the make-whole provision including, but not limited to, our stock price, the volatility of our stock, the probability of the Company being acquired and the probability of the type of consideration used by a potential acquirer.

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 the Company 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.

In accordance with ASC 470-20, *Debt*, which applies to certain convertible debt instruments that may be settled in cash or other assets, or partially in cash, upon conversion, we recorded the debt and equity components on the senior subordinated convertible notes separately. This accounting pronouncement increased interest expense associated with our senior subordinated convertible notes by adding a non-cash component to amortize a debt discount calculated based on the difference between the cash coupon rate (2.375% per year) of the senior subordinated convertible notes and the effective interest rate on debt borrowing (9% per year). The discount, which represents the non-cash interest expense, classified as interest expense on the condensed consolidated statements of operations, is being amortized to interest expense over a seven-year period ending May 16, 2011 (the expected life of the liability component) using the effective interest method. Additionally, we allocated transaction costs on the same percentage as the liability and equity component, such that a portion of the deferred debt issuance costs is allocated to the liability component to be amortized using the effective interest method until May 16, 2011, and the equity component to be included in additional paid-in capital.

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Interest expense primarily includes interest and amortization of discount related to senior subordinated convertible notes as follows:

	Three Months Ended July 3, 2010	Three Months Ended July 4, 2009	Six Months Ended July 3, 2010	Six Months Ended July 4, 2009
	(in thousands)			
Interest expense cash component	$ 847	$ 853	$ 1,701	$ 1,706
Interest expense non-cash component	2,052	1,910	4,139	3,820

The debt and equity component (recorded in additional paid-in-capital, net of income tax benefit) consisted of the following:

	July 3, 2010	January 2, 2010
	(in thousands)	
Senior subordinated convertible notes		
Principal amount	$ 141,406	$ 143,750
Unamortized discount	(7,524)	(11,821)
Net carrying amount	$ 133,882	$ 131,929
Equity component, net of income tax benefit	$ 25,325	$ 28,462

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, at a redemption price equal to the sum of the issue price and the accrued original issue discount. If the holders converted the senior subordinated convertible notes into shares of our stock as of July 3, 2010, the if-converted value would be $309.8 million, based on our stock price of $43.20 per share on July 2, 2010, which amount exceeds the original value of the bonds outstanding, or $141.4 million, by $168.4 million. This if-converted value is $66.4 million more than the $243.4 million face amount of the outstanding bonds at maturity in 2034.

The aggregate fair value of the senior subordinated convertible notes at July 3, 2010 was $316.8 million.

11. Comprehensive Income

Comprehensive income refers to revenues, expenses, gains and losses that under generally accepted accounting principles are included in accumulated other comprehensive income or loss, a component of shareholders equity within the condensed consolidated balance sheets, rather than the condensed consolidated statements of operations. Under our existing accounting standards, comprehensive income includes unrecognized gains and losses on investments and currency translation adjustments.

	Three Months Ended July 3, 2010	Three Months Ended July 4, 2009	Six Months Ended July 3, 2010	Six Months Ended July 4, 2009
	(in thousands)			
Net income from continuing operations	$ 17,537	$ 2,886	$ 30,901	$ 9,055
Unrealized gains (losses) on investments (net of taxes of $31 and $1,595 for the three months ended July 3, 2010 and July 4, 2009, respectively, and $471 and $1,531 for the six months ended July 3, 2010 and July 4, 2009, respectively)	(47)	2,393	(707)	2,297
Foreign currency translation adjustments	(940)	1,229	(1,746)	1,276

Comprehensive income from continuing operations	16,550	6,508	28,448	12,628
Comprehensive loss from discontinued operations	(1,583)	(1,054)	(2,514)	(1,596)
Comprehensive income	$ 14,967	$ 5,454	$ 25,934	$ 11,032

There are no reconciling items between net loss from discontinued operations and comprehensive loss from discontinued operations.

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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 is 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. The estimated forfeiture rate is re-assessed periodically throughout the requisite service period. Such estimates are revised if they differ materially from actual forfeitures. As required, the forfeiture estimates will be adjusted to reflect actual forfeitures when an award vests.

Share-based compensation expense and related stock option and restricted stock award activity is presented on a consolidated basis, unless otherwise presented as continuing operations and discontinued operations.

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

	Three Months Ended		Six Months Ended	
	July 3, 2010	July 4, 2009	July 3, 2010	July 4, 2009
	(in thousands)			
Cost of product sales	$ 359	$ 261	$ 626	$ 555
Selling, general and administrative	1,895	1,665	4,216	3,544
Research and development	809	585	1,811	1,398
Total share-based compensation expense before taxes	3,063	2,511	6,653	5,497
Tax benefit for share-based compensation expense	1,405	956	2,800	1,959
Total share-based compensation continuing operations (net of taxes)	$ 1,658	$ 1,555	$ 3,853	$ 3,538
Total share-based compensation discontinued operations (net of taxes)	$ 718	$ 852	$ 1,656	$ 1,784

As of July 3, 2010 and July 4, 2009, share-based compensation expense of $0.3 million and $0.2 million, respectively, was capitalized to inventory.

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. Our unaudited condensed consolidated statements of cash flows presentation reports the excess tax benefits (i.e., windfall only for tax deductions in excess of the share-based compensation expense recognized) as financing cash flows of $9.3 million and $1.6 million for the six months ended July 3, 2010 and July 4, 2009, respectively.

Cash proceeds from the exercise of stock options were $21.8 million and $2.9 million for the six months ended July 3, 2010 and July 4, 2009, respectively. Cash proceeds from our employee stock purchase plan were $1.9 million and $1.6 million for the six months ended July 3, 2010 and July 4, 2009, respectively. The Company purchased $4.5 million and $3.1 million of restricted stock for payment of income tax withholding due upon vesting for the six months ended July 3, 2010 and July 4, 2009, respectively.

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, in May 2008 the 2006 Plan was further amended by the Board of Directors and approved by our shareholders and in May 2010 the 2006 Plan was further amended by the Board of Directors and approved by our shareholders. The 2006 Plan allows us to grant to our employees, directors and consultants up to a total of 8.6 million shares of stock awards. Each share issued from May 20, 2008 through May 18, 2010 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 reduced the shares available for issuance under the 2006 Plan on a share-for-share basis. Each share issued from and after May 19, 2010 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 seven-tenths (1.7) 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 July 3, 2010, approximately 443,000 options were granted under the 2006 Plan at an exercise price equal to the fair market value on the date of grant, and approximately 580,000 shares of restricted stock and restricted stock units were granted under the 2006 Plan. As of July 3, 2010, approximately 3.9 million shares remained available for grant under the 2006 Plan.

Stock Options

Upon approval in May 2006, the 2006 Plan replaced our previous common stock option plans and equity incentive plans. As of July 3, 2010, we had 2.9 million options issued and 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 some options granted to officers may 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**	
	July 3, 2010	**July 4, 2009**	**July 3, 2010**	**July 4, 2009**
Risk-free interest rate (weighted average)	2.87%	2.97%	3.05%	2.32%
Expected volatility	40%	53%	40%	53%
Expected option term (years)	4.82	4.91 to 6.02	4.88 to 6.04	4.90 to 6.04
Dividends	None	None	None	None

The risk-free interest rate is based on the U.S. 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. We base the expected volatility on a combination of historical volatility trends and market-based implied volatility because we have determined that this combination of historical volatility trends and market-based implied trends are reflective of market conditions.

At July 3, 2010, there was $5.0 million of unrecognized compensation expense from continuing operations, net of estimated forfeitures, related to stock options, which expense we expect to recognize over a weighted average period of 1.63 years. At July 3, 2010, there was $1.1 million of unrecognized compensation expense from discontinued operations, net of estimated forfeitures, related to stock options, which expense we expect to recognize over a weighted average period of 1.63 years. The aggregate intrinsic value of in-the-money options outstanding was $67.9 million, based on the closing price of our common stock on July 2, 2010, the last trading day in the six months ended July 3, 2010, of $43.20. As of July 3, 2010, the aggregate intrinsic value of options currently exercisable was

$48.8 million and the intrinsic value of options vested and expected to vest was $66.7 million.

The total intrinsic value of options exercised for the three months ended July 3, 2010 and July 4, 2009 was $27.3 million and $1.7 million, respectively. The total intrinsic value of options exercised for the six months ended July 3, 2010 and July 4, 2009 was $32.0 million and $2.6 million, respectively.

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 January 2, 2010	3,857	$	17.29	5.60
Granted	443		30.17	
Exercised	(1,361)		16.01	
Forfeited or expired	(31)		19.43	
Outstanding options at July 3, 2010	2,908	$	19.83	6.16
Outstanding options exercisable at July 3, 2010	1,897	$	17.49	4.84
Outstanding options vested at July 3, 2010 and expected to vest	2,724	$	19.42	5.97

The weighted average grant-date fair value of options granted during the six months ended July 3, 2010 and July 4, 2009 was $12.61 per share and $12.03 per share, respectively.

Restricted Stock Awards and Units

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.

Restricted Stock Awards

Share-based compensation expense from continuing operations related to restricted stock awards was $1.7 million for the six months ended July 3, 2010. As of July 3, 2010, we had $2.8 million of unrecognized compensation expense from continuing operations, net of estimated forfeitures, related to restricted stock awards, which amount we expect to recognize over 1.29 years. As of July 3, 2010, we had $0.9 million of unrecognized compensation expense from discontinued operations, net of estimated forfeitures, related to restricted stock awards, which amount we expect to recognize over 1.29 years. There were no restricted stock awards granted during the six months ended July 3, 2010.

Restricted stock activity is summarized as follows:

	Number of Shares (in thousands)		Weighted Average Grant Date Fair Value
Outstanding unvested restricted stock at January 2, 2010	609	$	16.63
Granted			
Vested	(264)		17.08
Forfeited or expired	(18)		16.03

Outstanding unvested restricted stock at July 3, 2010	327	$	16.31

Restricted Stock Units

Share-based compensation expense from continuing operations related to restricted stock units was $2.5 million for the six months ended July 3, 2010. As of July 3, 2010, we had $15.0 million of unrecognized compensation expense from continuing operations, net of estimated forfeitures, related to restricted stock units, which amount we expect to recognize over 3.30 years. As of July 3, 2010, we had $4.6 million of unrecognized compensation expense from discontinued operations, net of estimated forfeitures, related to restricted stock units, which amount we expect to recognize over 3.30 years. The aggregate intrinsic value of the units outstanding, based on our stock price on July 2, 2010, was $38.2 million.

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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 January 2, 2010	463	$	24.17	3.12
Granted	580		30.82	
Released	(136)		25.15	
Forfeited or expired	(22)		25.68	
Outstanding units at July 3, 2010	885	$	28.34	3.30

Employee Stock Purchase Plan

In May 2002, our shareholders approved our Employee Stock Purchase Plan (ESPP) under which 500,000 shares of common stock were reserved for issuance. In addition, the ESPP provides for an annual, automatic increase of up to 250,000 shares in the total number of shares available for issuance thereunder on March 1 of each year, unless our Board of Directors specifies a smaller increase or no increase. Under this provision, an additional 250,000 shares were reserved for issuance under the ESPP on each of March 1, 2006, March 1, 2008 and March 1, 2009; our Board of Directors specified no increase as of each other year. Eligible employees may purchase a limited number of shares, over a six month period, of our common stock at 85% of the lower of the market value on the offering date or the market value on the purchase date. During the six months ended July 3, 2010, 83,791 shares of common stock were issued under the ESPP. As of July 3, 2010, approximately 215,909 shares remained available for issuance under this plan.

The estimated subscription date fair value of the current offering under the ESPP is approximately $0.6 million using the Black-Scholes option pricing model and the following assumptions:

Risk-free interest rate	0.25%
Expected volatility	43%
Expected option life	0.50 years
Dividends	None

As of July 3, 2010, there was approximately $0.2 million of unrecognized compensation expense from continuing operations and $0.2 million of unrecognized expense from discontinued operations related to ESPP subscriptions that began on May 1, 2010, which amount we expect to recognize during the second half of 2010.

13. Income Taxes

Our effective income tax rates for the three months ended July 3, 2010 and July 4, 2009, were 35.4% and 30.7%, respectively. Our effective income tax rates for the six months ended July 3, 2010 and July 4, 2009 were 34.7% and 28.2%, respectively. The increase in our reported income tax rates are primarily due to the reduced impact that tax exempt income has on our tax rate due to our pretax increase in earnings. In addition, federal resear