UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark one)

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

For the quarterly period ended July 2, 2011

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 (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 x 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 x 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 x	Accelerated filer o
Non-accelerated filer o (Do not check if 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 x

As of July 22, 2011, the registrant had 59,741,591 shares of common stock outstanding.

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THORATEC CORPORATION

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CentriMag and PediMag are registered trademarks of Thoratec LLC and PediVAS is a registered trademark of Levitronix Medical GmbH, which is being renamed as Thoratec Switzerland GmbH.

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PART I. FINANCIAL INFORMATION

ITEM 1. UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

THORATEC CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

(unaudited)

(in thousands)

	July 2, 2011	January 1, 2011
ASSETS		
Current assets:		
Cash and cash equivalents	$ 96,164	$ 56,887
Short-term available-for-sale investments	182,458	391,256
Receivables, net of allowances of $1,715 and $1,334, respectively	60,719	57,213
Inventories	62,148	59,790
Deferred tax assets	10,091	9,677
Income tax receivable	5,090	9,538
Prepaid expenses and other assets	4,426	5,706
Total current assets	421,096	590,067
Property, plant and equipment, net	40,372	38,077
Goodwill	95,015	95,015
Purchased intangible assets, net	84,019	88,518
Long-term available-for-sale investments	19,841	21,379
Other long-term assets	4,539	4,687
Total Assets	$ 664,882	$ 837,743
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 10,767	$ 13,495
Accrued compensation	11,980	20,753
Other accrued liabilities	13,064	14,604
Senior subordinated convertible notes		138,165
Total current liabilities	35,811	187,017
Long-term deferred tax liability	17,241	20,109
Other long-term liabilities	9,939	9,257
Total Liabilities	62,991	216,383
Shareholders equity:		
Common shares: no par, authorized 100,000; issued and outstanding 59,739 and 58,571 as of July 2, 2011 and January 1, 2011, respectively		
Additional paid-in capital	582,199	606,782
Retained earnings	22,332	18,603
Accumulated other comprehensive loss:		

Unrealized loss on investments		(1,465)		(1,660)
Cumulative translation adjustments		(1,175)		(2,365)
Total accumulated other comprehensive loss		(2,640)		(4,025)
Total Shareholders Equity		601,891		621,360
Total Liabilities and Shareholders Equity	$	664,882	$	837,743

See notes to the unaudited condensed consolidated financial statements.

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THORATEC CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(unaudited)

(in thousands, except per share data)

	Three Months Ended		Six Months Ended	
	July 2, 2011	July 3, 2010	July 2, 2011	July 3, 2010
Product sales	$ 111,221	$ 95,098	$ 210,751	$ 194,370
Cost of product sales	32,410	30,579	62,145	62,150
Gross profit	78,811	64,519	148,606	132,220
Operating expenses:				
Selling, general and administrative	26,559	21,065	51,213	42,906
Research and development	15,799	11,812	31,553	31,803
Amortization of purchased intangible assets	2,197	2,468	4,499	4,880
Total operating expenses	44,555	35,345	87,265	79,589
Income from operations	34,256	29,174	61,341	52,631
Other income and (expense):				
Interest expense and other	(1,767)	(3,275)	(4,647)	(6,155)
Interest income and other	488	1,293	1,243	2,899
Impairment on investment		(46)		(2,046)
Income before income taxes	32,977	27,146	57,937	47,329
Income tax expense	(11,195)	(9,609)	(19,696)	(16,428)
Income from continuing operations	21,782	17,537	38,241	30,901
Loss from discontinued operations (net of tax)		(1,583)		(2,514)
Net income	$ 21,782	$ 15,954	$ 38,241	$ 28,387
Income (loss) per share Basic:				
Continuing operations	$ 0.37	$ 0.30	$ 0.66	$ 0.54
Discontinued operations		(0.02)		(0.05)
Net income	$ 0.37	$ 0.28	$ 0.66	$ 0.49
Income (loss) per share Diluted:				
Continuing operations	$ 0.36	$ 0.29	$ 0.63	$ 0.52
Discontinued operations		(0.02)		(0.04)
Net income	$ 0.36	$ 0.27	$ 0.63	$ 0.48
Shares used to compute income (loss) per share:				
Basic	58,186	57,635	58,060	57,139
Diluted	63,213	66,436	64,590	65,986

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	Three Months Ended		Six Months Ended	
	July 2, 2011	July 3, 2010	July 2, 2011	July 3, 2010

		(in thousands)		
Net income	$ 21,782	$ 15,954	$ 38,241	$ 28,387
Unrealized gains (losses) on investments (net of taxes of $42 and $31 for the three months ended July 2, 2011 and July 3, 2010, respectively, and $137 and $471 for the six months ended July 2, 2011 and July 3, 2010, respectively)	54	(47)	195	(707)
Foreign currency translation adjustments	341	(940)	1,190	(1,746)
Total other comprehensive income (loss)	395	(987)	1,385	(2,453)
Comprehensive income	$ 22,177	$ 14,967	$ 39,626	$ 25,934

See notes to the unaudited condensed consolidated financial statements.

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THORATEC CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)

(in thousands)

	Six Months Ended July 2, 2011	Six Months Ended July 3, 2010
Cash flows from continuing operating activities:		
Income from continuing operations	$ 38,241	$ 30,901
Adjustments to reconcile net income from continuing operations to net cash provided by operating activities:		
Depreciation and amortization	8,196	8,219
Investment premium amortization, net	2,271	2,492
Loss on extinguishment of senior subordinated convertible notes		99
Non-cash interest income and other	913	591
Non-cash interest expense	2,815	4,133
Write-down on investment		2,046
Tax benefit related to stock options	902	10,013
Share-based compensation expense	7,803	6,653
Excess tax benefits from share-based compensation	(910)	(9,265)
Loss on disposal of assets	135	74
Change in deferred taxes, net	(2,888)	(3,577)
Changes in assets and liabilities:		
Receivables	(2,406)	(4,325)
Inventories	(3,210)	(6,032)
Prepaid expenses and other assets	160	272
Accrued compensation and other accrued liabilities	(8,178)	(1,931)
Accounts payable	(2,831)	10,259
Income taxes, net	3,156	(21,780)
Net cash provided by continuing operating activities	44,169	28,842
Cash flows from continuing investing activities:		
Purchases of available-for-sale investments	(196,448)	(300,576)
Sales and maturities of available-for-sale investments	404,855	261,953
Purchases of property, plant and equipment, net	(4,461)	(2,133)
Purchases of patents		(1,414)
Net cash provided by (used in) continuing investing activities	203,946	(42,170)
Cash flows from continuing financing activities:		
Excess tax benefits from share-based compensation	910	9,265
Proceeds from stock option exercises	6,949	21,779
Proceeds from stock issued under the employee stock purchase plan	1,886	1,884
Repurchase and retirement of common shares	(53,654)	(4,505)
Extinguishment of senior subordinated convertible notes	(164,429)	(5,345)
Net cash (used in) provided by continuing financing activities	(208,338)	23,078
Effect of exchange rate changes on cash and cash equivalents	(500)	(102)
Net cash provided by continuing operations	39,277	9,648

Cash flows from discontinued operations:				
Net cash provided by operating activities				1,746
Net cash used in investing activities				(1,746)
Net cash provided by discontinued operations				
Net increase in cash and cash equivalents		39,277		9,648
Net cash and cash equivalents at beginning of period		56,887		27,787
Net cash and cash equivalents at end of period	$	96,164	$	37,435
Supplemental disclosure of consolidated cash flow information:				
Cash paid for taxes	$	18,518	$	29,562
Cash paid for interest	$	1,679	$	1,707
Supplemental disclosure of consolidated non-cash investing and financing activities:				
Transfers of equipment from inventory	$	1,392	$	2,029
Purchases of property, plant and equipment through accounts payable and accrued liabilities	$	7	$	34
Issuance of shares for extinguishment of senior subordinated convertible notes	$	82,711	$	

See notes to the unaudited condensed consolidated financial statements.

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THORATEC CORPORATION

NOTES TO UNAUDITED 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 as of and for the periods presented. Certain information and footnote disclosures normally included in our annual financial statements, prepared in accordance with GAAP, have been condensed or omitted. The accompanying financial statements should be read in conjunction with our fiscal 2010 consolidated financial statements, and the accompanying notes thereto, filed with the SEC in our Annual Report on Form 10-K (the 2010 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 our 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.

On April 25, 2010, our Board Of Directors made a decision to sell our wholly-owned subsidiary, International Technidyne Corporation (ITC) and on November 4, 2010, we sold ITC to ITC Nexus Holding Company, Inc. (Nexus) for $55 million in cash pursuant to a Stock Purchase Agreement, dated as of November 4, 2010, with Nexus. As such, certain financial statement items have been reclassified to be presented as discontinued operations.

Revenue Recognition and Product Warranty

We recognize revenue from product sales to customers and distributors when evidence of an arrangement exists, and title has passed (generally upon shipment) or services have been rendered, the selling price (including pricing discounts) has been fixed or has become determinable, collectability is reasonably assured and there are no further obligations to customers or distributors.

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 from continuing operations is summarized in the following table:

	Three Months Ended		Six Months Ended	
	July 2, 2011	July 3, 2010	July 2, 2011	July 3, 2010
	(in thousands)			
Balance at beginning of period	$ 2,806	$ 1,777	$ 3,057	$ 1,706
Accruals for warranties issued	815	1,182	1,455	1,931
Settlements made	(628)	(1,212)	(1,519)	(1,890)
Balance at end of period	$ 2,993	$ 1,747	$ 2,993	$ 1,747

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Recently Issued Accounting Pronouncements

In May 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs.* This ASU is the result of joint efforts by the FASB and International Accounting Standards Board to develop a single, converged fair value framework. While this ASU is largely consistent with existing fair value measurement principles in U.S. GAAP, it expands Accounting Standards Codification (ASC) Topic 820, *Fair Value Measurement* existing disclosure requirements for fair value measurements and makes other amendments. Many of these amendments were made to eliminate unnecessary wording differences between U.S. GAAP and International Financial Reporting Standards, which could change how fair value measurement guidance in ASC 820 is applied. ASU No. 2011-04 is effective on a prospective basis for us for reporting periods after January 1, 2012. We are currently evaluating how this new guidance will impact our unaudited condensed consolidated financial statements.

In June 2011, the FASB issued ASU No. 2011-05, *Presentation of Comprehensive Income*. This ASU, gives an entity the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In both choices, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. In a single continuous statement, the entity is required to present the components of net income and total net income, the components of other comprehensive income and a total for other comprehensive income, along with the total of comprehensive income in that statement. In the two-statement approach, an entity is required to present components of net income and total net income in the statement of net income. The statement of other comprehensive income should immediately follow the statement of net income and include the components of other comprehensive income and a total for other comprehensive income, along with a total for comprehensive income. ASU No. 2011-05 is effective for us on or after December 31, 2011, but early adoption is permitted for public companies. We adopted this new guidance in our unaudited condensed consolidated financial statements for the period ended July 2, 2011.

2. Investments

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 and variable demand notes. Investments classified as long-term available-for-sale consist 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 loss.

As of July 2, 2011, we had gross unrealized gains before tax of $0.3 million from our investment in municipal bonds, corporate bonds and variable demand notes and gross unrealized losses before tax of $2.8 million on our auction rate securities. As of January 1, 2011, we had gross unrealized gains before tax of $0.6 million, net of gross unrealized losses of $0.1 million, from our investment in municipal bonds, corporate bonds and variable demand notes and gross unrealized losses before tax of $3.3 million on our auction rate securities.

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The aggregate market value, cost basis and net unrealized gains and losses of available-for-sale investments as of July 2, 2011 and as of January 1, 2011 by major security type are as follows:

	Amortized cost	Net unrealized gains (losses) (in thousands)	Fair value
As of July 2, 2011:			
Short-term investments:			
Municipal bonds	$ 143,743	$ 262	$ 144,005
Variable demand notes	33,525	9	33,534
Corporate bonds	4,918	1	4,919
Total short-term investments	$ 182,186	$ 272	$ 182,458
Long-term investments:			
Auction rate securities	$ 22,600	$ (2,759)	$ 19,841
As of January 1, 2011:			
Short-term investments:			
Municipal bonds	$ 255,785	$ 336	$ 256,121
Variable demand notes	119,080		119,080
Corporate bonds	15,899	156	16,055
Total short-term investments	$ 390,764	$ 492	$ 391,256
Long-term investments:			
Auction rate securities	$ 24,700	$ (3,321)	$ 21,379

As of July 2, 2011, we owned approximately $22.6 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 BBB 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 of July 2, 2011, we had recorded an estimated cumulative unrealized loss of $2.8 million ($1.7 million, net of tax) related to the temporary impairment of the auction rate securities, which was included in accumulated other comprehensive income (loss) within shareholders equity. In addition, our management reviews impairments and credit loss associated with our investments, including auction rate securities, to determine the classification of the impairment as temporary or other-than-temporary and to bifurcate the credit and non-credit component of an other-than-temporary impairment event. We (i) do not intend to sell any of the auction rate securities prior to maturity at an amount below the original purchase value; (ii) intend to hold the investment to recovery and, based on a more-likely-than-not probability assessment, will not be required to sell the security before recovery; and (iii) deem that it is not probable that we will receive less than 100% of the principal and accrued interest from the issuer. Therefore, 100% of the impairment was charged to other comprehensive income (loss). Our auction rate securities are classified as long-term and are valued at $19.8 million using significant unobservable inputs. Further, we continue to liquidate investments in auction rate securities as opportunities arise. During the six months ended July 2, 2011, we liquidated $2.1 million of our auction rate securities as they were called at par. Subsequent to July 2, 2011, we liquidated $0.1 million of our auction rate securities as they were also called at par.

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.

Our deferred compensation plan includes our corporate owned life insurance policies and mutual fund investments. The aggregate value of our deferred compensation plan assets as of July 2, 2011 and January 1, 2011 was as follows:

	July 2, 2011	January 1, 2011
	(in thousands)	
Deferred compensation plan	$ 3,711	$ 3,188

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The investments associated with the deferred compensation plan are included in Other long-term assets on our unaudited condensed consolidated balance sheets at the cash surrender value of our corporate-owned life insurance policies and the fair value of the mutual fund investments. The realized gain before tax from the change in the value of the deferred compensation plan was $0.2 million and $0.1 million for the six months ended July 2, 2011 and July 3, 2010, respectively, and is included in Interest income and other.

3. Fair Value Measurements

ASC 820, *Fair Value Measurement*, 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.

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

	July 2, 2011				
	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	$ 144,005	$ 144,005	$	$ 144,005	$
Variable demand notes	33,534	33,534		33,534	
Corporate bonds	4,919	4,919		4,919	
Long-term investments auction rate securities	19,841	19,841			19,841

Other long-term assets carrying value of investments included in our deferred compensation plan	2,904	2,904	2,904
Liabilities			
Other accrued liabilities mark to market on foreign exchange instruments (Note 4)	58	58	58

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	January 1, 2011				
	Assets and liabilities at carrying value	Total fair value	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
			(in thousands)		
Assets					
Short-term investments:					
Municipal bonds	$ 256,121	$ 256,121	$	$ 256,121	$
Variable demand notes	119,080	119,080		119,080	
Corporate bonds	16,055	16,055		16,055	
Prepaid expenses and other assets mark to market on foreign exchange instruments (Note 4)	172	172		172	
Long-term investments auction rate securities	21,379	21,379			21,379
Other long-term assets carrying value of investments included in our deferred compensation plan	2,408	2,408		2,408	

Valuation Techniques

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

Financial assets and liabilities are considered Level 3 when their fair values are determined using pricing models, discounted cash flow methodologies, or similar techniques, and at least one significant model assumption or input is unobservable. Level 3 financial assets include the auction rate securities for which there is limited market activity such that the determination of fair value requires significant judgment or estimation. The auction rate securities were valued using a discounted cash-flow model over a five-year period based on estimated interest rates, the present value of future principal payments, and interest payments discounted at rates considered to reflect the current market conditions and the credit quality of auction rate securities.

We review the fair value hierarchy classification on a quarterly basis. Changes in the ability to observe valuation inputs may result in a reclassification of levels of certain securities within the fair value hierarchy. We recognize transfers into and out of levels within the fair value hierarchy in which the actual event or change in circumstances that caused the transfer occurs. There were no transfers between Level 1 and Level 2 during the three and six months ended July 2, 2011. When a determination is made to classify an asset or liability within Level 3, the determination is based upon the significance of the unobservable inputs to the overall fair value measurement. The following table provides a reconciliation of the beginning and ending balances for the assets measured at fair value using significant unobservable inputs (Level 3):

	Auction Rate Securities

		(in thousands)
Balance as of January 1, 2011	$	21,379
Settlements at par		(2,100)
Unrealized holding gain on auction rate securities, included in other comprehensive income (loss)		444
Balance as of April 2, 2011	$	19,723
Unrealized holding gain on auction rate securities, included in other comprehensive income (loss)		118
Balance as of July 2, 2011	$	19,841

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

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

Non-financial assets such as goodwill, intangible assets and property, plant, and equipment are evaluated for impairment and adjusted to fair value using Level 3 inputs, only when an impairment is recognized. Fair values are considered Level 3 when management makes significant assumptions in developing a discounted cash-flow model based upon a number of considerations including projections of revenues, earnings and a discount rate. In addition, in evaluating the fair value of goodwill impairment, further corroboration is obtained using our market capitalization. There was no impairment recorded in the six months ended July 2, 2011.

4. Foreign Exchange Instruments

We utilize foreign currency exchange forward contracts to mitigate volatility resulting from future movements in foreign exchange rates that affect certain existing and forecasted foreign currency denominated sales and purchase transactions. We do not use derivative financial instruments for speculative or trading purposes. We routinely hedge our exposure to certain foreign currencies over a four month period, 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 derivative arrangements experiences financial difficulties or is otherwise unable to honor the terms of the foreign currency forward exchange contract, we may experience material financial losses.

The notional amount of foreign currency exchange forward contracts with a maximum maturity of four months, and does not qualify for hedge accounting, were as follows:

	Notional Amounts			
	July 2, 2011		July 3, 2010	
	(in thousands)			
Sales	$	19,544	$	12,860

As of July 2, 2011, we had forward contracts to sell euros to U.S. dollars with a notional value of   9.5 million, to sell U.S. dollars to euros with a notional value of $3.6 million and to sell U.K. pounds to euros with a notional value of £1.4 million, as compared to July 3, 2010, when 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 euros 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 of July 2, 2011, our forward contracts had an average exchange rate of one U.S. dollar to 0.6938 euros and one U.K. pound to 1.1078 euros.

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

	Three Months Ended		Six Months Ended	
	July 2, 2011	July 3, 2010	July 2, 2011	July 3, 2010
	(in thousands)			
Foreign currency exchange gain on foreign currency contracts	$ 491	$ 482	$ 126	$ 746
Foreign currency exchange loss on foreign translation adjustments	(709)	(296)	(846)	(626)

5. Inventories

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

	July 2, 2011	January 1, 2011
	(in thousands)	
Finished goods	$ 20,151	$ 8,439
Work in process	11,827	14,971