

RESMED INC  
Form 10-Q  
May 08, 2007  
Table of Contents

**SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, DC 20549**

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**FORM 10-Q**

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QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2007.

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM \_\_\_\_\_ TO \_\_\_\_\_

001-15317

Commission file number

**ResMed Inc.**

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

98-0152841

(IRS Employer Identification No.)

14040 Danielson St

Poway, CA 92064-6857

United States Of America

(Address of principal executive offices)

(858) 746 2400

(Registrant's telephone number including area code)

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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, or a non accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non accelerated filer

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 April 27, 2007, 77,839,581 shares of Common Stock (\$0.004 par value) were outstanding. This number excludes 2,254,918 shares held by the registrant as treasury shares.

**Table of Contents****RESMED INC. AND SUBSIDIARIES****INDEX**

| <b>Part I</b>  | <b><u>Financial Information</u></b>   | <b>Page</b> |
|----------------|---|-------------|
| Item 1         | <u>Financial Statements</u>   |             |
|                | <u>Condensed Consolidated Balance Sheets (unaudited) as of March 31, 2007 and June 30, 2006</u>   | 3           |
|                | <u>Condensed Consolidated Statements of Income (unaudited) for the Three Months Ended March 31, 2007 and 2006 and the Nine Months ended March 31, 2007 and 2006</u> | 4           |
|                | <u>Condensed Consolidated Statements of Cash Flows (unaudited) for the Nine Months Ended March 31, 2007 and 2006</u>  | 5           |
|                | <u>Notes to Unaudited Condensed Consolidated Financial Statements</u>   | 6           |
| Item 2         | <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>  | 27          |
| Item 3         | <u>Quantitative and Qualitative Disclosures About Market Risk</u>   | 42          |
| Item 4         | <u>Controls and Procedures</u>  | 44          |
| <b>Part II</b> | <b><u>Other Information</u></b>   |             |
| Item 1         | <u>Legal Proceedings</u>  | 45          |
| Item 1A        | <u>Risk Factors</u>   | 45          |
| Item 2         | <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>  | 46          |
| Item 3         | <u>Defaults Upon Senior Securities</u>  | 46          |
| Item 4         | <u>Submission of Matters to a Vote of Security Holders</u>  | 46          |
| Item 5         | <u>Other Information</u>  | 46          |
| Item 6         | <u>Exhibits</u>   | 46          |
|                | <u>Signatures</u>   | 47          |

**Table of Contents**

PART I - FINANCIAL INFORMATION

Item 1

**RESMED INC. AND SUBSIDIARIES**

## Condensed Consolidated Balance Sheets

(in US\$ thousands, except share data)

(Unaudited)

|   | March 31,<br>2007  | June 30,<br>2006   |
|---|--------------------|--------------------|
| <b>ASSETS</b>   |                    |                    |
| <u>Current assets:</u>  |                    |                    |
| Cash and cash equivalents   | \$240,106          | \$219,544          |
| Marketable securities available-for-sale (note 3)   | 19,950             | -                  |
| Accounts receivable, net of allowance for doubtful accounts of \$4,823 at March 31, 2007 and \$3,199 at June 30, 2006 | 153,063            | 138,147            |
| Inventories, net (note 4)   | 156,915            | 116,194            |
| Deferred income taxes   | 52,148             | 26,636             |
| Prepaid expenses and other current assets   | 16,415             | 9,763              |
| <b>Total current assets</b>   | <b>638,597</b>     | <b>510,284</b>     |
| Property, plant and equipment, net (note 6)   | 292,706            | 245,376            |
| Goodwill, net (note 7)  | 204,421            | 195,612            |
| Other intangibles, net (note 8)   | 46,933             | 48,897             |
| Other assets  | 9,149              | 7,052              |
| <b>Total non current assets</b>   | <b>553,209</b>     | <b>496,937</b>     |
| <b>Total assets</b>   | <b>\$1,191,806</b> | <b>\$1,007,221</b> |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>  |                    |                    |
| <u>Current liabilities:</u>   |                    |                    |
| Accounts payable  | \$44,109           | \$45,045           |
| Accrued expenses  | 110,299            | 40,901             |
| Deferred revenue  | 18,141             | 15,344             |
| Income taxes payable  | 9,811              | 22,841             |
| Current portion of long-term debt (note 9)  | 18,683             | 4,869              |
| <b>Total current liabilities</b>  | <b>201,043</b>     | <b>129,000</b>     |
| <u>Non current liabilities:</u>   |                    |                    |
| Deferred income taxes   | 9,856              | 12,377             |
| Deferred revenue  | 12,515             | 11,484             |
| Long-term debt (note 9)   | 95,888             | 116,212            |
| <b>Total non current liabilities</b>  | <b>118,259</b>     | <b>140,073</b>     |

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|   |             |             |
|---|-------------|-------------|
| Total Liabilities   | 319,302     | 269,073     |
| Commitments and contingencies (notes 13 and 14)   |             |             |
| <u>Stockholders' Equity:</u>  |             |             |
| Preferred stock, \$0.01 par value, 2,000,000 shares authorized; none issued   | -           | -           |
| Series A Junior Participating preferred stock, \$0.01 par value, 250,000 shares authorized; none issued   | -           | -           |
| Common Stock, \$0.004 par value, 200,000,000 shares authorized; issued and outstanding 77,439,397 at March 31, 2007 and 75,670,316 at June 30, 2006 (excluding 2,254,918 and 2,254,918 shares held as Treasury Stock, respectively) | \$310       | \$303       |
| Additional paid-in capital  | 410,298     | 353,464     |
| Retained earnings   | 409,281     | 370,652     |
| Treasury stock  | (41,405)    | (41,405)    |
| Accumulated other comprehensive income (note 5)   | 94,020      | 55,134      |
| Total stockholders' equity  | 872,504     | 738,148     |
| Total liabilities and stockholders' equity  | \$1,191,806 | \$1,007,221 |

See accompanying notes to unaudited condensed consolidated financial statements.

**Table of Contents**

## PART I - FINANCIAL INFORMATION

Item 1

**RESMED INC. AND SUBSIDIARIES**

## Condensed Consolidated Statements of Income (Unaudited)

(in US\$ thousands, except per share data)

|  | Three Months Ended March 31, |           | Nine Months Ended March 31, |           |
|--|------------------------------|-----------|-----------------------------|-----------|
|  | 2007                         | 2006      | 2007                        | 2006      |
| Net revenue  | \$182,990                    | \$162,280 | \$525,023                   | \$435,824 |
| Cost of sales <sup>(A)</sup>                                       | 69,058                       | 61,414    | 198,037                     | 163,113   |
| Voluntary product recall expenses (note 10)                        | 59,700                       | -         | 59,700                      | -         |
| Gross profit   | 54,232                       | 100,866   | 267,286                     | 272,711   |
| <b>Operating expenses:</b>   |                              |           |                             |           |
| Selling, general and administrative <sup>(A)</sup>                 | 61,335                       | 52,903    | 172,115                     | 146,478   |
| Research and development <sup>(A)</sup>                            | 13,059                       | 9,143     | 35,942                      | 26,155    |
| Donation to foundation   | -                            | 505       | -                           | 760       |
| Amortization of acquired intangible assets                         | 1,730                        | 1,570     | 5,114                       | 4,661     |
| Restructuring expenses (note 11)                                   | -                            | -         | -                           | 1,124     |
| Total operating expenses   | 76,124                       | 64,121    | 213,171                     | 179,178   |
| Income (loss) from operations                                      | (21,892)                     | 36,745    | 54,115                      | 93,533    |
| <b>Other income (expense), net:</b>                                |                              |           |                             |           |
| Interest income (expense), net                                     | 1,608                        | 1,220     | 4,592                       | (471)     |
| Other, net   | (669)                        | 153       | (1,176)                     | 1,471     |
| Total other income (expense), net                                  | 939                          | 1,373     | 3,416                       | 1,000     |
| Income (loss) before income taxes                                  | (20,953)                     | 38,118    | 57,531                      | 94,533    |
| Income taxes   | 5,588                        | (11,756)  | (18,902)                    | (29,415)  |
| Net (loss) income  | (\$15,365)                   | \$26,362  | \$38,629                    | \$65,118  |
| Basic (loss) earnings per share                                    | (\$0.20)                     | \$0.36    | \$0.51                      | \$0.91    |
| Diluted (loss) earnings per share (note 2-j)                       | (\$0.20)                     | \$0.34    | \$0.49                      | \$0.87    |
| Basic shares outstanding (in thousands)                            | 77,035                       | 72,549    | 76,428                      | 71,242    |
| Diluted shares outstanding (in thousands)                          | 77,035                       | 77,403    | 78,198                      | 76,922    |
| <sup>(A)</sup> Includes stock-based compensation costs as follows: |                              |           |                             |           |
| Cost of sales  | \$299                        | \$348     | \$890                       | \$560     |
| Selling, general and administrative                                | 3,936                        | 2,833     | 10,593                      | 9,285     |

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|                                      |         |         |          |          |
|--------------------------------------|---------|---------|----------|----------|
| Research and development             | 496     | 486     | 1,487    | 1,535    |
| Total stock-based compensation costs | \$4,731 | \$3,667 | \$12,970 | \$11,380 |

See accompanying notes to unaudited condensed consolidated financial statements.

- 4 -

**Table of Contents**

PART I - FINANCIAL INFORMATION

Item 1

**RESMED INC. AND SUBSIDIARIES**

Condensed Consolidated Statements of Cash Flows (Unaudited)

(in US\$ thousands)

|   | Nine Months Ended<br>March 31, |               |
|---|--------------------------------|---------------|
|   | 2007                           | 2006          |
| <b>Cash flows from operating activities:</b>  |                                |               |
| Net income  | \$38,629                       | \$65,118      |
| <b>Adjustment to reconcile net income to net cash provided by operating activities:</b> |                                |               |
| Depreciation and amortization   | 34,846                         | 29,899        |
| Stock-based compensation costs  | 12,970                         | 11,380        |
| Amortization of deferred borrowing costs  | 158                            | 629           |
| Write-down of cost-method investment  | -                              | 1,156         |
| Provision for product warranties  | 1,181                          | 1,189         |
| Voluntary product recall expenses   | 59,700                         | -             |
| Foreign currency options revaluation  | (751)                          | 4,002         |
| Tax benefit from stock option exercises   | (11,290)                       | (2,173)       |
| <b>Changes in operating assets and liabilities; net of effect of acquisitions:</b>      |                                |               |
| Accounts receivable, net  | (11,586)                       | (20,200)      |
| Inventories, net  | (33,247)                       | (17,743)      |
| Prepaid expenses, net deferred income taxes and other current assets                    | (32,280)                       | (11,176)      |
| Accounts payable, accrued expenses and other liabilities                                | 5,670                          | 1,637         |
| <b>Net cash provided by operating activities</b>  | <b>64,000</b>                  | <b>63,718</b> |

|  |                 |                 |
|--|-----------------|-----------------|
| <b>Cash flows from investing activities:</b>   |                 |                 |
| Purchases of property, plant and equipment   | (60,127)        | (79,135)        |
| Capitalized interest   | (351)           | (639)           |
| Patent registration costs  | (2,700)         | (2,413)         |
| Purchase of non trading investments  | (1,063)         | (2,527)         |
| Cash paid for business acquisitions, net of cash acquired of \$Nil in 2007 and \$262 in 2006 | (1,912)         | (10,368)        |
| Purchases of marketable securities available-for-sale  | (21,950)        | (2,000)         |
| Proceeds from sale or maturity of marketable securities available-for-sale                   | 2,000           | -               |
| <b>Net cash used in investing activities</b>   | <b>(86,103)</b> | <b>(97,082)</b> |

Cash flows from financing activities:



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|   |           |           |
|---|-----------|-----------|
| Proceeds from issuance of common stock, net             | 32,678    | 26,729    |
| Tax benefit from stock option exercises                 | 11,290    | 2,173     |
| Proceeds from borrowings, net of borrowing costs        | 9,589     | 35,000    |
| Repayment of assumed borrowings from acquisitions       | -         | (2,195)   |
| Repayment of borrowings                                 | (20,000)  | -         |
|   |           |           |
| Net cash provided by financing activities               | 33,557    | 61,707    |
|   |           |           |
| Effect of exchange rate changes on cash                 | 9,108     | (4,367)   |
|   |           |           |
| Net increase in cash and cash equivalents               | 20,562    | 23,976    |
| Cash and cash equivalents at beginning of period        | 219,544   | 142,185   |
|   |           |           |
| Cash and cash equivalents at end of period              | \$240,106 | \$166,161 |
|   |           |           |
| Supplemental disclosure of cash flow information:       |           |           |
| Income taxes paid                                       | \$48,914  | \$34,920  |
| Interest paid   | 4,482     | 4,082     |
|   |           |           |
| Fair value of assets acquired in acquisitions           | \$-       | \$10,342  |
| Liabilities assumed                                     | -         | (7,528)   |
| Goodwill on acquisition                                 | 1,588     | 6,961     |
| Net acquisition costs accrued                           | 324       | 855       |
|   |           |           |
| Cash paid for acquisitions, including acquisition costs | \$1,912   | \$10,630  |

See accompanying notes to condensed consolidated financial statements.

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**Table of Contents**

PART I - FINANCIAL INFORMATION

Item 1

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**RESMED INC. AND SUBSIDIARIES**

**Notes to Condensed Consolidated Financial Statements**

**(unaudited )**

**(1) Organization and Basis of Presentation**

ResMed Inc. (referred to herein as we , us , our or the Company ) is a Delaware corporation formed in March 1994 holding company for the ResMed Group. Through our subsidiaries, we design, manufacture and market equipment for the diagnosis and treatment of sleep-disordered breathing and other respiratory disorders, including obstructive sleep apnea. Our manufacturing operations are located in Australia, Germany, France and the United States of America (the U.S. ). Major distribution and sales sites are located in the U.S., Germany, France, the United Kingdom, Switzerland, Australia and Sweden.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the U.S. for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X of the Securities and Exchange Commission. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included. Operating results for the nine months ended March 31, 2007 are not necessarily indicative of the results that may be expected for the year ending June 30, 2007.

The condensed consolidated financial statements for the three months ended March 31, 2007 and 2006 and the nine months ended March 31, 2007 and 2006 are unaudited and should be read in conjunction with the condensed consolidated financial statements and notes thereto included in our Form 10-K for the year ended June 30, 2006.

**(2) Summary of Significant Accounting Policies**

**(a) Basis of Consolidation**

The condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant intercompany transactions and balances have been eliminated in consolidation.

The preparation of financial statements in conformity with accounting principles generally accepted in the U.S. requires management estimates and assumptions that affect amounts reported in the financial statements and accompanying notes. Actual results could differ from management s estimates.

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**Table of Contents**

PART I - FINANCIAL INFORMATION

Item 1

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**RESMED INC. AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements****(unaudited)**

## (2) Summary of Significant Accounting Policies, Continued

## (b) Revenue Recognition

Revenue on product sales is generally recorded upon shipment, at which time title transfers to the customer. Revenue on product sales that requires customer acceptance is not recorded until we receive evidence of acceptance. Royalty revenue from license agreements is recorded when earned. Service revenue received in advance from service contracts is initially deferred and recognized ratably over the life of the service contract. Revenue received in advance from rental unit contracts is initially deferred and recognized ratably over the life of the rental contract. Revenue from sale of marketing or distribution rights is initially deferred and recognized ratably as revenue over the life of the contract. Freight charges billed to customers are included in revenue. All freight-related expenses are charged to cost of sales.

We do not recognize revenues to the extent that we offer a right of return or other recourse with respect to the sale of our products, other than returns for product defects or other warranty claims, nor do we recognize revenues if we offer variable sale prices for subsequent events or activities. However, as part of our sales processes we may provide upfront discounts for large orders, one time special pricing to support new product introductions, sales rebates for centralized purchasing entities or price-breaks for regular order volumes. The costs of all such programs are recorded as an adjustment to revenue. In our U.S. sales activities we use a number of manufacturer representatives to sell our products. These representatives are paid a direct commission on sales and act as an integral component of our U.S. sales force. We do not sell our products to these representatives and do not recognize revenue on such shipments. Our products are predominantly therapy-based equipment and require no installation. As such, we have no significant installation obligations.

## (c) Cash and Cash Equivalents

Cash equivalents include certificates of deposit, commercial paper and other highly liquid investments and are stated at cost, which approximates market. Investments with original maturities of 90 days or less are considered to be cash equivalents for purposes of the condensed consolidated statements of cash flows.

## (d) Inventories

Inventories are stated at the lower of cost, determined principally by the first-in, first-out method, or net realizable value. We review and provide for any product obsolescence in our manufacturing and distribution operations with assessments of individual products and components (based on estimated future usage and sales) being performed

throughout the year.

- 7 -

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**Table of Contents**

PART I - FINANCIAL INFORMATION

Item 1

---

**ResMed Inc. and Subsidiaries**

**Notes to Condensed Consolidated Financial Statements**

**(unaudited )**

(2) Summary of Significant Accounting Policies, Continued

(e) Property, Plant and Equipment

Property, plant and equipment, including rental equipment, is recorded at cost. Depreciation expense is computed using the straight line method over the estimated useful lives of the assets, generally two to ten years except for buildings, which are depreciated over an estimated useful life of 40 years. Straight line and accelerated methods of depreciation are used for tax purposes. Maintenance and repairs are charged to expense as incurred.

We capitalize interest in connection with the construction of facilities. Actual construction costs incurred relating to facilities under active development qualify for interest capitalization. Interest capitalization ceases when the construction of a facility is complete and available for use. During the three months and nine months ended March 31, 2007, we capitalized \$Nil and \$0.4 million, respectively, of interest relating to such construction costs.

(f) Intangible Assets

The registration costs for new patents are capitalized and amortized over the estimated useful life of the patent, generally five years. In the event of a patent being superseded, the unamortized costs are written off immediately.

Other intangible assets are amortized on a straight-line basis over their estimated useful lives, which range from seven to nine years. We evaluate the recoverability of intangible assets periodically and take into account events or circumstances that warrant revised estimates of useful lives or that indicate that impairment exists. All of our intangible assets are subject to amortization. No impairment of intangible assets has been identified during any of the periods presented.

(g) Goodwill

We conducted our annual review for goodwill impairment at June 30, 2006. In conducting our review of goodwill impairment, we identified reporting units, being components of our operating segment, as each of the entities acquired and giving rise to the goodwill. The fair value for each reporting unit was determined based on discounted cash flows and involved a two step process as follows:

Step 1 - Compare the fair value for each reporting unit to its carrying value, including goodwill. For each reporting unit where the carrying value, including goodwill, exceeds the reporting unit's fair value, move on to step 2. If a reporting unit's fair value exceeds the carrying value, no further work is performed and no impairment charge is necessary.

- 8 -

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**Table of Contents**

PART I - FINANCIAL INFORMATION

Item 1

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**RESMED INC. AND SUBSIDIARIES**

**Notes to Condensed Consolidated Financial Statements**

**(unaudited)**

(2) Summary of Significant Accounting Policies, Continued

(g) Goodwill (continued)

Step 2 - Allocate the fair value of the reporting unit to its identifiable tangible and non-goodwill intangible assets and liabilities. This will derive an implied fair value for the goodwill. Then, compare the implied fair value of the reporting unit's goodwill with the carrying amount of the reporting unit's goodwill. If the carrying amount of the reporting unit's goodwill is greater than the implied fair value of its goodwill, an impairment loss must be recognized for the excess.

The results of the review indicated that no impaired goodwill existed at June 30, 2006.

(h) Foreign Currency

The condensed consolidated financial statements of our non-U.S. subsidiaries, whose functional currencies are other than U.S. dollars, are translated into U.S. dollars for financial reporting purposes. Assets and liabilities of non-U.S. subsidiaries whose functional currencies are other than the U.S. dollar are translated at period end exchange rates, and revenue and expense transactions are translated at average exchange rates for the period. Cumulative translation adjustments are recognized as part of comprehensive income, as described in Note 5, and are included in accumulated other comprehensive income in the condensed consolidated balance sheet until such time as the subsidiary is sold or substantially or completely liquidated. Gains and losses on transactions denominated in other than the functional currency of the entity are reflected in operations.

(i) Research and Development

All research and development costs are expensed in the period incurred.

(j) Earnings Per Share

We calculate earnings per share in accordance with Statement of Financial Accounting Standards (SFAS) No. 128, Earnings per Share (SFAS 128), as amended by SFAS No. 123(R), Share Based Payments (SFAS 123(R)). SFAS requires the presentation of basic earnings per share and diluted earnings per share. Basic earnings per share is

computed by dividing the net income available to common shareholders by the weighted average number of shares of common stock outstanding. For purposes of calculating diluted earnings per share, net income is adjusted for the after-tax amount of interest associated with convertible debt, and the denominator includes both the weighted average number of shares of common stock outstanding and the number of dilutive common stock equivalents such as stock options and convertible notes.



**Table of Contents**

PART I - FINANCIAL INFORMATION

Item 1

**RESMED INC. AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements****(unaudited)****(2) Summary of Significant Accounting Policies, Continued****(j) Earnings Per Share (continued)**

The weighted average shares used to calculate basic earnings per share were 77,035,000 and 72,549,000 for the three months ended March 31, 2007 and 2006, respectively, and were 76,428,000 and 71,242,000 for the nine months ended March 31, 2007 and 2006, respectively. The difference between basic earnings per share and diluted earnings per share is attributable to the impact of outstanding stock options during the periods presented and the assumed conversion of our convertible notes. Stock options had the effect of increasing the number of shares used in the calculation (by application of the treasury stock method) by Nil and 2,307,000 for the three months ended March 31, 2007 and 2006, respectively, and 1,770,000 and 2,339,000 for the nine months ended March 31, 2007 and 2006, respectively. The assumed conversion of our convertible notes had the effect of increasing the number of shares used in the calculation by Nil and 2,547,000 for the three months ended March 31, 2007 and 2006, respectively, and Nil and 3,341,000 for the nine months ended March 31, 2007 and 2006, respectively.

Stock options of 8,575,000 and 1,988,200 for the three month periods ended March 31, 2007 and 2006, respectively, and stock options of 2,920,000 and 867,200 for the nine month periods ended March 31, 2007 and 2006, respectively, were not included in the computation of diluted earnings per share as the effect of exercising these options would have been anti-dilutive.

Basic and diluted earnings per share for the periods ended March 31, 2007 and 2006 are calculated as follows (in thousands except per share data):

|  | Three Months Ended<br>March 31, |          | Nine Months Ended<br>March 31, |          |
|--|---------------------------------|----------|--------------------------------|----------|
|  | 2007                            | 2006     | 2007                           | 2006     |
| Numerator:   |                                 |          |                                |          |
| Net (loss) income  | (\$15,365)                      | \$26,362 | \$38,629                       | \$65,118 |
| Adjustment for interest and deferred borrowing costs, net of income tax effect | -                               | -        | -                              | 1,660    |
| Net (loss) income, used in calculating diluted earnings per share              | (\$15,365)                      | \$26,362 | \$38,629                       | \$66,778 |

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|  |          |        |        |        |
|--|----------|--------|--------|--------|
| Denominator:                                     |          |        |        |        |
| Basic weighted average common shares outstanding | 77,035   | 72,549 | 76,428 | 71,242 |
| Effect of dilutive securities:                   |          |        |        |        |
| Stock options                                    | -        | 2,307  | 1,770  | 2,339  |
| Convertible subordinated notes                   | -        | 2,547  | -      | 3,341  |
| Diluted potential common shares                  | -        | 4,854  | 1,770  | 5,680  |
| Diluted weighted average shares                  | 77,035   | 77,403 | 78,198 | 76,922 |
| Basic (loss) earnings per share                  | (\$0.20) | \$0.36 | \$0.51 | \$0.91 |
| Diluted (loss) earnings per share                | (\$0.20) | \$0.34 | \$0.49 | \$0.87 |

- 10 -

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**Table of Contents**

PART I - FINANCIAL INFORMATION

Item 1

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**RESMED INC. AND SUBSIDIARIES**

**Notes to Condensed Consolidated Financial Statements**

**(unaudited)**

(2) Summary of Significant Accounting Policies, Continued

(k) Financial Instruments

The carrying value of financial instruments, such as cash and cash equivalents, marketable securities available-for-sale, accounts receivable and accounts payable, approximate their fair value because of their short-term nature. Foreign currency option contracts are marked to market and therefore reflect their fair value. We do not hold or issue financial instruments for trading purposes. The fair value of financial instruments is defined as the amount at which the instrument could be exchanged in a current transaction between willing parties.

(l) Foreign Exchange Risk Management

We enter into various types of foreign exchange contracts in managing our foreign exchange risk, including derivative financial instruments encompassing forward exchange contracts and foreign currency options.

The purpose of our foreign currency hedging activities is to protect us from adverse exchange rate fluctuations with respect to net cash movements resulting from the sales of products to foreign customers and our Australian manufacturing activities. We enter into foreign currency option contracts to hedge anticipated sales and manufacturing costs, principally denominated in Australian dollars and Euros. The terms of such foreign currency option contracts generally do not exceed three years.

Our foreign currency derivatives portfolio represents a cash flow hedge program against the net cash flow of our international manufacturing operations. We have determined our hedge program to be a non effective hedge as defined under SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities ( SFAS 133 ). The foreign currency derivatives portfolio is recorded in the condensed consolidated balance sheet at fair value and included in other assets or other liabilities.

All movements in the fair value of the foreign currency derivatives are recorded within other income, net on our condensed consolidated statements of income.

We are exposed to credit-related losses, in the event of non performance by counter parties to financial instruments. The credit exposure from foreign exchange options at March 31, 2007 and June 30, 2006 was \$2.8 million and \$1.2 million, respectively, which represents the positive fair value of options held by us and are included in other assets on the condensed consolidated balance sheet.

We held foreign currency option contracts with notional amounts totaling \$118.0 million and \$193.4 million at March 31, 2007 and June 30, 2006, respectively, to hedge foreign currency items. These contracts mature at various dates on or prior to December 2008.

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**Table of Contents**

PART I - FINANCIAL INFORMATION

Item 1

---

**RESMED INC. AND SUBSIDIARIES**

**Notes to Condensed Consolidated Financial Statements**

**(unaudited)**

(2) Summary of Significant Accounting Policies, Continued

(m) Income Taxes

We account for income taxes under the asset and liability method. We recognize deferred tax assets and liabilities for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

(n) Marketable Securities

Management determines the appropriate classification of our investments in debt and equity securities at the time of purchase and reevaluates such determination at each balance sheet date. Debt securities for which we do not have the intent or ability to hold to maturity are classified as available-for-sale. Securities available-for-sale are carried at fair value, with the unrealized gains and losses, net of tax, reported in accumulated other comprehensive income.

At March 31, 2007, the investments in debt securities were classified on the accompanying condensed consolidated balance sheet as marketable securities available-for-sale. These investments are diversified among high-credit quality securities in accordance with our investment policy and are principally comprised of corporate obligations.

At March 31, 2007, contractual maturities of marketable securities available-for-sale were all due in less than one year.

(o) Warranty

Estimated future warranty costs related to certain products are charged to operations in the period in which the related revenue is recognized. The liability for warranty costs are included in accrued expenses in our condensed consolidated balance sheet. Changes in the liability for product warranty for the nine months ended March 31, 2007 are as follows (in thousands):

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|  |         |
|--|---------|
| Balance as at July 1, 2006                                       | \$4,653 |
| Warranty accruals for the nine months ended March 31, 2007       | 2,400   |
| Warranty costs incurred for the nine months ended March 31, 2007 | (1,219) |
| Foreign currency translation adjustments                         | 484     |
|  | \$6,318 |
| Balance as at March 31, 2007                                     |         |

- 12 -

---

**Table of Contents**

PART I - FINANCIAL INFORMATION

Item 1

---

**RESMED INC. AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements****(unaudited)****(2) Summary of Significant Accounting Policies, Continued****(p) Impairment of Long-Lived Assets**

We periodically evaluate the carrying value of long-lived assets to be held and used, including certain identifiable intangible assets, when events and circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets, exceed the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

**(q) Cost-Method Investments**

The aggregate carrying amount of our cost-method investments at March 31, 2007 and June 30, 2006, were \$4.6 million and \$4.1 million, respectively. These include investments in privately held service companies, research companies and publicly traded companies and are included in other assets in our condensed consolidated balance sheet. At March 31, 2007, we performed an analysis of the carrying value of these investments and an unrealized loss of \$1.6 million was identified in relation to an investment in a publicly listed company. The severity of the impairment (fair value is approximately 48% less than the cost) and the duration of the impairment (less than 12 months) correlate with a devaluation in both the currency of the listed shares against the U.S. dollar and the actual share price. Because we have the ability and intent to hold this investment until the fair value returns to the cost and the decline in fair value is partly attributable to exchange rate movements, we do not consider this investment to be other-than-temporarily impaired at March 31, 2007. Except for this unrealized loss, we have determined that the fair values of our other investments exceeded the carrying values.

**(r) Stock-based Employee Compensation**

We have granted stock options to personnel, including officers and directors, under our 1995 Option Plan (the 1995 Plan), our 1997 Equity Participation Plan (the 1997 Plan) and our 2006 Incentive Award Plan, as amended (the 2006 Plan) and together with the 1995 Plan and the 1997 Plan, the Plans). These options have expiration dates of seven or ten years from the date of grant and vest over three or four years. We granted these options with the exercise price equal to the market value as determined at the date of grant. We have also offered to our personnel, including officers and directors, the right to purchase shares of our common stock at a discount pursuant to our employee stock purchase plan (ESPP).





**Table of Contents**

PART I - FINANCIAL INFORMATION

Item 1

**RESMED INC. AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements****(unaudited)****(2) Summary of Significant Accounting Policies, Continued****(r) Stock-based Employee Compensation, Continued**

As of July 1, 2006, we adopted SFAS 123(R) using the modified prospective method, which requires measurement of compensation expense of all stock-based awards at fair value on the date of grant and recognition of compensation expense over the service period for awards expected to vest. Under this method, the provisions of SFAS 123(R) apply to all awards granted or modified after the date of adoption. In addition, the unrecognized expense of awards not yet vested at the date of adoption, determined under the original provisions of SFAS 123, Accounting for Stock Based Compensation ( SFAS 123 ), shall be recognized in net income in the periods after adoption. The fair value of stock options is determined using the Black-Scholes valuation model. Such value is recognized as expense over the service period, using the graded-attribution method for stock-based awards granted prior to July 1, 2005 and the straight-line method for stock-based awards granted after July 1, 2005.

The fair value of stock options granted under the Plans and purchase rights granted under our ESPP is estimated on the date of the grant using the Black-Scholes option-pricing model, assuming no dividends and the following assumptions:

|  | Three months ended |           | Nine months ended |            |
|--|--------------------|-----------|-------------------|------------|
|  | March 31,          |           | March 31,         |            |
|  | 2007               | 2006      | 2007              | 2006       |
| <b>Stock options:</b>                    |                    |           |                   |            |
| Weighted average grant date fair value   | \$15.53            | \$12.94   | \$14.53           | \$12.74    |
| Weighted average risk-free interest rate | 4.5 - 4.8%         | 4.4%      | 4.5 - 4.8%        | 3.9 - 4.4% |
| Expected option life in years            | 4.0 - 4.7          | 4.3 - 5.2 | 4.0 - 5.2         | 3.9 - 5.2  |
| Expected volatility                      | 26%                | 29% - 30% | 26 - 27%          | 29% - 33%  |
| <b>ESPP purchase rights:</b>             |                    |           |                   |            |
| Weighted average risk-free interest rate | 5.1%               | 4.2%      | 4.9 - 5.1%        | 3.2 - 4.2% |
| Expected option life                     | 6 months           | 6 months  | 6 months          | 6 months   |
| Expected volatility                      | 32%                | 29%       | 32%               | 29 - 31%   |

Expected volatilities are based on a combination of historical volatilities of our stock and implied volatilities from traded options of our stock. The expected life represents the weighted average period of time that options granted are

expected to be outstanding giving consideration to vesting schedules and our historical exercise patterns. The risk-free rate is based on the U.S. Treasury yield curve in effect at the time of grant for periods corresponding with the expected life of the option.

**Table of Contents**

PART I - FINANCIAL INFORMATION

Item 1

**RESMED INC. AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements****(unaudited)****(3) Marketable Securities**

The estimated fair value of marketable securities available for sale as of March 31, 2007 and June 30, 2006 are \$20.0 million and \$Nil, respectively. Expected maturities may differ from contractual maturities because the issuers of the securities may have the right to prepay obligations without prepayment penalties.

**(4) Inventories**

Inventories were comprised of the following at March 31, 2007 and June 30, 2006 (in thousands):

|                  | March 31, 2007 | June 30, 2006 |
|------------------|----------------|---------------|
| Raw materials    | \$60,196       | \$41,979      |
| Work in progress | 2,878          | 3,520         |
| Finished goods   | 93,841         | 70,695        |
| Total Inventory  | \$156,915      | \$116,194     |

**(5) Comprehensive Income**

The components of comprehensive income, net of tax, were as follows (in thousands):

|  | Three months ended<br>March 31, |          | Nine months ended<br>March 31, |          |
|--|---------------------------------|----------|--------------------------------|----------|
|  | 2007                            | 2006     | 2007                           | 2006     |
| Net (loss) income                                  | (\$15,365)                      | \$26,362 | \$38,629                       | \$65,118 |
| Foreign currency translation gains/(losses)        | 13,364                          | (4,186)  | 38,886                         | (19,812) |
| Unrealized gains/(losses) on marketable securities | -                               | 2        | -                              | 6        |
| Comprehensive (loss) income                        | (\$2,001)                       | \$22,178 | \$77,515                       | \$45,312 |



**Table of Contents**

PART I - FINANCIAL INFORMATION

Item 1

**RESMED INC. AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements****(unaudited)****(6) Property, Plant and Equipment**

Property, plant and equipment is comprised of the following as of March 31, 2007 and June 30, 2006 (in thousands):

|   | March 31, 2007 | June 30, 2006 |
|---|----------------|---------------|
| Machinery and equipment   | \$62,492       | \$51,854      |
| Computer equipment  | 67,380         | 52,277        |
| Furniture and fixtures  | 27,029         | 21,572        |
| Vehicles  | 2,917          | 2,795         |
| Clinical, demonstration and rental equipment  | 50,637         | 40,615        |
| Leasehold improvements  | 16,417         | 11,604        |
| Land  | 59,684         | 55,946        |
| Buildings   | 148,602        | 77,474        |
| Construction in Progress  | 3,062          | 46,710        |
|   | 438,220        | 360,847       |
| Accumulated depreciation and amortization   | (145,514)      | (115,471)     |
| Total property, plant and equipment, net of accumulated depreciation and amortization | \$292,706      | \$245,376     |

**(7) Goodwill**

Changes in the carrying amount of goodwill for the nine months ended March 31, 2007 were as follows (in thousands):

|  |           |
|--|-----------|
| Balance at July 1, 2006                            | \$195,612 |
| Payment of earn-out relating to Hoefner            | 331       |
| Payment of earn-out relating to PolarMed           | 1,000     |
| Acquisition of Western Medical Marketing (Note 14) | 257       |
| Foreign currency translation adjustments           | 7,221     |
| Balance at March 31, 2007                          | \$204,421 |



**Table of Contents**

PART I - FINANCIAL INFORMATION

Item 1

**RESMED INC. AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements****(unaudited)****(8) Other Intangible Assets**

Other intangible assets are comprised of the following as of March 31, 2007 and June 30, 2006 (in thousands):

|  | March 31, 2007 | June 30, 2006 |
|--|----------------|---------------|
| Developed/core product technology                                  | \$32,749       | \$31,336      |
| Accumulated amortization   | (8,726)        | (4,992)       |
| Developed/core product technology, net of accumulated amortization | 24,023         | 26,344        |
| Trade names  | 1,738          | 1,663         |
| Accumulated amortization   | (462)          | (265)         |
| Trade names, net of accumulated amortization                       | 1,276          | 1,398         |
| Customer relationships   | 17,418         | 16,362        |
| Accumulated amortization   | (4,014)        | (2,094)       |
| Customer relationships, net of accumulated amortization            | 13,404         | 14,268        |
| Patents  | 20,401         | 16,151        |
| Accumulated amortization   | (12,171)       | (9,264)       |
| Patents, net of accumulated amortization                           | 8,230          | 6,887         |
| Other intangibles, net of accumulated amortization                 | \$46,933       | \$48,897      |

Intangible assets consist of patents, customer relationships, trade names, developed/core product technology and are amortized over the estimated useful life of the assets, generally between five and nine years. There are no expected residual values related to these intangible assets.

In fiscal year 2005, as part of the acquisition of Saime SAS ( Saime ), we recognized an intangible asset with respect to developed/core product technology. Specifically, this technology related to the design and architecture of the hardware and algorithms that formed part of Saime's ventilation products and is the subject of patents and other intellectual property protections. This technology is separable from goodwill as it is capable of being sold, transferred or licensed. This represents proprietary know-how predominantly associated with the following portfolio of products that were technologically feasible at the date of acquisition:

(i) Elisee Series: Combines all conventional ventilation modes and monitoring functions; and

(iii) VS Series (including Serena, Ultra and Integra): A new generation of ventilators using new blower technology.

Both of these series of products continue to generate revenue, which is consistent with our original expectations. Although no assurance can be given that the underlying assumptions used to value the acquired developed/core product technology will transpire as estimated, we remain confident in the assumptions used and, as a result, the net return of the Saime acquisition.





**Table of Contents**

PART I - FINANCIAL INFORMATION

Item 1

**RESMED INC. AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements****(unaudited)****(9) Long-Term Debt**

Long-term debt at March 31, 2007 and June 30, 2006 consists of the following (in thousands):

|                                       | March 31, 2007 | June 30, 2006 |
|---------------------------------------|----------------|---------------|
| Long-term loan and revolving facility | \$18,606       | \$4,796       |
| Capital lease                         | 77             | 73            |
| Current portion of long-term debt     | \$18,683       | \$4,869       |
| Long-term loan and revolving facility | \$95,389       | \$115,644     |
| Capital lease                         | 499            | 568           |
| Non-current portion of long-term debt | \$95,888       | \$116,212     |

**Revolving Facility**

On March 13, 2006, our wholly-owned subsidiaries ResMed Corp., Servo Magnetics Inc. and ResMed EAP Holdings Inc. entered into a Second Amended and Restated Revolving Loan Agreement with Union Bank of California, N.A. as administrative agent for the lenders (the Loan Agreement), which provides for a revolving loan of up to \$75 million. Draws under the revolving loan must be made before March 1, 2011, at which time all unpaid principal and interest must be repaid. The outstanding principal amount due under the loan will bear interest at a rate equal to LIBOR plus 0.75% to 1.00% (depending on the applicable leverage ratio). At June 30, 2006 and March 31, 2007, there were no amounts outstanding under the Loan Agreement.

The obligations of ResMed Corp., Servo Magnetics Inc. and ResMed EAP Holdings Inc. under the Loan Agreement are secured by substantially all of the personal property of each of ResMed Corp., Servo Magnetics Inc. and ResMed EAP Holdings Inc., and are guaranteed by ResMed Inc. under an Amended and Restated Continuing Guaranty and Pledge Agreement, which guaranty is secured by a pledge of the equity interests in ResMed Corp., Servo Magnetics Inc. and ResMed EAP Holdings Inc. held by ResMed Inc. The Loan Agreement also contains customary covenants, including certain financial covenants and an obligation that ResMed Inc. maintain certain financial ratios, including a maximum ratio of total debt to EBITDA (as defined in the Loan Agreement), a fixed charge coverage ratio, a minimum tangible net worth, and a minimum EBITDA and liquidity requirements for ResMed Corp., Servo Magnetics Inc. and ResMed EAP Holdings Inc.

The aggregate principal amount of the revolving loan and any accrued but unpaid interest may be declared immediately due and payable in the event of the occurrence of an event of default (as defined in the Loan Agreement). Events of default include, among other events, failure to make payments when due, the occurrence of a material default in the performance of any covenants in the Loan Agreement or related documents or a 35% or more change in control of ResMed Inc., ResMed Corp., Servo Magnetics Inc. or ResMed EAP Holdings Inc. At the most recent reporting date we were in compliance with our debt covenants.



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**Table of Contents**

PART I - FINANCIAL INFORMATION

Item 1

---

**RESMED INC. AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements****(unaudited)****(9) Long-Term Debt, Continued**  
**Syndicated Facility**

On June 8, 2006, our wholly-owned Australian subsidiary, ResMed Limited, entered into a Syndicated Facility Agreement with HSBC Bank Australia Limited as original financier, facility agent and security trustee, that provides for a loan in three tranches (the "Syndicated Facility Agreement").

Tranche A is an EUR 50 million five-year term loan facility that refinances all amounts outstanding under a syndicated facility agreement dated May 16, 2005, between ResMed Limited and HSBC Bank Australia Limited, to fund the obligations of our wholly-owned French subsidiary ResMed SAS under its agreement to acquire Saime. Tranche A bears interest at a rate equal to LIBOR for deposits denominated in EUR plus a margin of 0.80% or 0.90%, depending on the ratio of the total debt to EBITDA of ResMed Inc. and its subsidiaries (the "ResMed Group") for the most recently completed fiscal year for the applicable interest period. Payments of principal must be made to reduce the total outstanding principal amount of Tranche A to EUR 44.5 million on June 30, 2007, EUR 37.75 million on June 30, 2008, EUR 27.5 million on June 30, 2009, EUR 15 million on December 31, 2009, and the entire outstanding principal amount must be repaid in full on June 8, 2011. At March 31, 2007, the Tranche A facility loan had an amount outstanding of EUR 48.25 million, or USD 64.5 million.

Tranche B is a USD 15 million term loan facility that may only be used for the purpose of financing capital expenditures and other asset acquisitions by the ResMed Group. Tranche B bears interest at a rate equal to LIBOR for deposits denominated in EUR, Australian dollars, USD or Sterling plus a margin of 0.80% or 0.90%, depending on the ratio of the total debt to EBITDA of the ResMed Group for the most recently completed fiscal year for the applicable interest period. The entire principal amount must be repaid in full on June 8, 2011. At March 31, 2007, the Tranche B facility loan had an amount outstanding of USD 5.9 million.

Tranche C is a USD 60 million term loan facility that may only be used for the purpose of the payment by ResMed Limited of a dividend to ResMed Holdings Limited, which will ultimately be paid to ResMed Inc. Tranche C bears interest at a rate equal to LIBOR for deposits denominated in EUR, Australian dollars or USD plus a margin of 0.70% or 0.80%, depending on the ratio of the total debt to EBITDA of the ResMed Group for the most recently completed fiscal year for the applicable interest period. Payments of principal must be made to reduce the total outstanding principal amount of Tranche C to USD 30 million on December 31, 2007 and the entire outstanding principal amount must be repaid in full by June 8, 2009. At March 31, 2007, the Tranche C facility loan had an amount outstanding of USD 39.7 million.

Simultaneous with the Syndicated Facility Agreement, ResMed Limited entered into a working capital agreement with HSBC Bank Australia Limited for revolving, letter of credit and overdraft facilities up to a total commitment of

6.5 million Australian dollars for one year, and ResMed (UK) Limited entered into a working capital agreement with HSBC Bank plc for a revolving cash advance facility up to a total commitment of 3 million Sterling for one year. At March 31, 2007, there was an aggregate of USD 3.9 million outstanding under these working capital agreements.

**Table of Contents**

PART I - FINANCIAL INFORMATION

Item 1

**RESMED INC. AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements****(unaudited)****(9) Long-Term Debt, Continued  
Syndicated Facility, Continued**

The loan is secured by a pledge of 100% of the shares of ResMed Inc.'s subsidiary, Saime, pursuant to a Pledge Agreement. The Syndicated Facility Agreement also contains customary covenants, including certain financial covenants and an obligation that ResMed Limited maintain certain financial ratios, including a minimum debt service cover ratio, a maximum ratio of total debt to EBITDA and a minimum tangible net worth. The entire principal amount of the loan and any accrued, but unpaid, interest may be declared immediately due and payable in the event of the occurrence of an event of default as defined in the Syndicated Facility Agreement. Events of default include, among other items, failure to make payments when due, breaches of representations, warranties or covenants, the occurrence of certain insolvency events, the occurrence of an event or change which could have a material adverse effect on ResMed Limited and its subsidiaries, and if ResMed Inc. ceases to control ResMed Limited, ResMed Corp., ResMed SAS, ResMed GmbH & Co. KG, ResMed (UK) Limited, Take Air Medical Handels-GmbH or Saime.

The obligations of ResMed Limited under the loan are subject to two guarantee and indemnity agreements, one on behalf of ResMed Inc. and its U.S. subsidiary, ResMed Corp., and another on behalf of ResMed's international subsidiaries, ResMed SAS (other than Tranche C), ResMed GmbH & Co. KG, ResMed (UK) Limited and Take Air Medical Handels-GmbH. At the most recent reporting date we were in compliance with our debt covenants.

**Capital Lease**

As part of the acquisition of Saime we assumed a capital lease over land and buildings. This lease contains an option to purchase the property, for nominal consideration, at the end of the lease term in September 2014.

Details of contractual debt maturities at March 31, 2007 are as follows (in thousands):

|                | Total     | 1 year   | 2 years | Payments Due by Period |          |          | Thereafter |
|----------------|-----------|----------|---------|------------------------|----------|----------|------------|
|                |           |          |         | 3 years                | 4 years  | 5 years  |            |
| Long-Term Debt | \$113,995 | \$18,606 | \$9,023 | \$13,701               | \$36,759 | \$35,906 | \$         |
| Capital Leases | 576       | 77       | 77      | 77                     | 77       | 77       | 191        |
| Total          | \$114,571 | \$18,683 | \$9,100 | \$13,778               | \$36,836 | \$35,983 | \$191      |

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**Table of Contents**

PART I - FINANCIAL INFORMATION

Item 1

---

**RESMED INC. AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements****(unaudited)****(10) Voluntary Product Recall Expenses**

On April 23, 2007 we initiated a worldwide voluntary recall of approximately 300,000 of our early production S8 flow generators used for the treatment of obstructive sleep apnea. In S8 devices manufactured between July 2004 and May 15, 2006, there is a remote potential for a short circuit in the power supply connector. Furthermore in seven cases worldwide, device failures have led to thermal damage to the device, with a remote potential to ignite material external to the device. We plan to work with our distribution partners globally to provide a replacement device to patients who have an affected S8 flow generator. We have advised the U.S. Food and Drug Administration and other regulatory authorities of this action and will be continuing to discuss this action with those authorities and finalize our proposed course of action after those discussions are concluded.

The estimated cost of this action is \$59.7 million which has been recognized as a charge to cost of sales in the condensed consolidated statement of income and accrued in the condensed consolidated balance sheet as of March 31, 2007 as the liability was probable and the related expenses could be reasonably estimated. These direct and incremental costs represent our best estimate of probable costs based on current available data and take into account factors such as expected return rates for the affected units, unit replacement costs, legal, consulting, logistical and administrative expenses directly associated with the recall. These costs are still subject to finalization and clearance of our recall plan by regulatory authorities. Accordingly, should we receive additional feedback from our ongoing discussions with regulatory bodies or should actual product recall costs differ from our estimated costs, material revisions to our estimated product recall accrual may be required.

**(11) Restructuring Expenses**

There were no restructuring expenses incurred during the three and nine months ended March 31, 2007 compared to \$Nil and \$1.1 million incurred during the three and nine months ended March 31, 2006, respectively. The prior year restructuring expenses (predominantly one-time termination benefits) were associated with the integration of the separate operations of ResMed Germany and MAP Medizin-Technologie GmbH ( MAP ) into a single operating unit. We have completed the relocation of our ResMed Germany operation (previously located in Moenchengladbach) to Munich and integration of the back office functions including customer service, logistics and administration. We will continue to monitor the progress of this restructure and adjust our business strategies and personnel accordingly in order to achieve maximum efficiencies and cost savings.

The following is a summary of the restructuring liabilities related to the restructure and integration of the separate operations of ResMed Germany and MAP into a single operating unit, which were recorded during the nine months ended March 31, 2007 (in thousands):

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|                              | Accrued employee costs | Other accrued costs | Total accrued costs |
|------------------------------|------------------------|---------------------|---------------------|
| Balance at July 1, 2006      | \$38                   | \$100               | \$138               |
| Cash payments                | (9)                    | (64)                | (73)                |
| Foreign currency translation | 2                      | 2                   | 4                   |
| Balance at March 31, 2007    | \$31                   | \$38                | \$69                |

- 21 -

**Table of Contents**

PART I - FINANCIAL INFORMATION

Item 1

**RESMED INC. AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements****(unaudited)****(12) Stockholders Equity**

**Stock Options.** We have granted stock options to personnel, including officers and directors, in accordance with the Plans. These options have expiration dates of seven or ten years from the date of grant and vest over three or four years. We have granted these options with an exercise price equal to the market value as determined at the date of grant.

At our Annual Meeting of Shareholders that was held on November 9, 2006, our shareholders approved the 2006 Plan. The 2006 Plan succeeds and replaces the 1997 Plan, which authorized a maximum of 16,000,000 shares (as adjusted for stock splits) of our common stock and was adopted by the board of directors and then approved by the shareholders in November 1997. In connection with the adoption of the 2006 Plan, we have terminated the 1997 Plan as to any and all future awards. Options granted under the 1997 Plan, which remain outstanding, will continue to be governed by the 1997 Plan.

The maximum number of shares of our common stock authorized for issuance under the 2006 Plan is 7,800,000 shares. The number of shares of our common stock available for issuance under the 2006 Plan will be reduced by (i) two and one tenth (2.1) shares for each one share of common stock delivered in settlement of any full-value award, which is any award other than a stock option, stock appreciation right or other award for which the holder pays the intrinsic value and (ii) one share for each share of common stock delivered in settlement of all other awards. The maximum number of shares, which may be subject to awards granted under the 2006 Plan to any individual during any calendar year, may not exceed 1,000,000 shares of our common stock.

At March 31, 2007, there was \$45.2 million in unrecognized compensation costs, related to unvested stock-based compensation arrangements. This is expected to be recognized over a weighted average period of 3.1 years. The aggregate intrinsic value of the options outstanding and the options exercisable at March 31, 2007 was \$164.6 million and \$119.0 million, respectively. The aggregate intrinsic value of the options exercised during the three months and nine months ended March 31, 2007 was \$18.9 million and \$44.4 million, respectively. The aggregate fair market value of options that vested during the three months and nine months ended March 31, 2007 was \$11.0 million and \$12.9 million, respectively.

The following table summarizes option activity during the nine months ended March 31, 2007:

| Options | Weighted<br>Average<br>Exercise | Weighted<br>Average<br>Remaining<br>Term |
|---------|---------------------------------|--|
|---------|---------------------------------|--|



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|   |             | Price              |           |
|---|-------------|--------------------|-----------|
| Outstanding at beginning of period      | 8,102,892   | \$24.26            |           |
| Granted                                 | 2,326,648   | 46.44              |           |
| Exercised                               | (1,598,487) | 18.25              |           |
| Forfeited                               | (255,558)   | 32.05              |           |
| Outstanding at end of period            | 8,575,495   | \$31.17            | 6.8 years |
| Exercise price range of granted options |             | \$40.25 - \$ 52.58 |           |
| Options exercisable at end of period    | 4,112,543   | \$21.41            | 5.8 years |

- 22 -

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**Table of Contents**

PART I - FINANCIAL INFORMATION

Item 1

---

**RESMED INC. AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements****(unaudited)**

(12) Stockholders' Equity, continued

**Employee Stock Purchase Plan ( ESPP ).** The ESPP was approved by our shareholders at the Annual Shareholder Meeting in November 2003. Under the ESPP, participants are offered the right to purchase shares of our common stock at a discount during successive offering periods. Each offering period under the ESPP will be for a period of time determined by the Compensation Committee of our board of directors of no less than 3 months and no more than 27 months. The purchase price for our common stock under the ESPP will be the lower of 85% of the fair market value of our common stock on the date of grant or 85% of the fair market value of our common stock on the date of purchase. An individual participant cannot subscribe to more than \$25,000 in value of our common stock during any calendar year. There is a maximum of 7,500,000 shares of our common stock authorized for sale under the ESPP.

During the nine months ended March 31, 2007, we recognized \$1.2 million of stock-based compensation expense associated with the ESPP and issued 69,262 shares at an average weighted share price of \$36.62.

**Convertible Subordinated Notes.** During the year ended June 30, 2006, and pursuant to the Indenture dated June 20, 2001 between us and American Stock Transfer & Trust Company, as trustee, holders of all of the 4% Convertible Subordinated Notes due 2006 converted the Notes into an aggregate of 3,737,593 shares of our common stock. The Notes were converted into 33 shares of our common stock for each \$1,000 principal amount of the Notes, at a conversion price of \$30.30 per share. The dilutive impact of these conversions has been reflected in the reported diluted earnings per share.

**Stock Split.** On August 10, 2005, our board of directors declared a two-for-one split of our common stock to be payable in the form of a 100% stock dividend distributed on September 30, 2005. Shareholders received one additional share of our common stock for every share held of record on September 15, 2005. All share and per share information has been adjusted for this stock split.

**Preferred Stock.** In April 1997, the Board of Directors authorized 2,000,000 shares of \$0.01 par value preferred stock. No such shares were issued or outstanding at March 31, 2007.

**Stock Purchase Rights.** In April 1997, the Company implemented a plan to protect stockholders' rights in the event of a proposed takeover of the Company. Under the plan, each share of the Company's outstanding common stock carries one right to purchase Series A Junior Participating Preferred Stock (the Right). The Right enables the holder, under certain circumstances, to purchase common stock of the Company or of the acquiring person at a substantially discounted price ten days after a person or group publicly announces it has acquired or has tendered an offer for 20% or more of the Company's outstanding common stock. The plan and its accompanying Rights expired pursuant to their terms in April 2007 and the Rights are no longer outstanding.



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**Table of Contents**

PART I - FINANCIAL INFORMATION

Item 1

---

**RESMED INC. AND SUBSIDIARIES**

**Notes to Condensed Consolidated Financial Statements**

**(unaudited)**

(13) Legal Actions and Contingencies

In the normal course of business, we are subject to routine litigation incidental to our business. While the results of this litigation cannot be predicted with certainty, we believe that their final outcome will not have a material adverse effect on our condensed consolidated financial statements taken as a whole.

During September and October 2004, the Company began receiving tax assessment notices for the audit of one of its German subsidiaries by the German tax authorities for the years 1996 through 1998. Certain of these adjustments are being contested and appealed to the German tax authority office. We believe no additional provision is necessary for any tax adjustment that may result from the tax audit. However, the outcome of the audit cannot be predicted with certainty. Should any tax audit issues be resolved in a manner not consistent with management's expectations, the Company could be required to adjust its provision for income tax in the period such matter is resolved.

On December 23, 2002, three former contractors of our subsidiary MAP initiated proceedings in Munich 1 Regional Court (Proceedings No. 7 O 23286/02), petitioning the Court for a declaration of inventorship with respect to MAP German Patent Applications identified as No. 100 31 079 and 101 92 802.5 and European Patent Application No. EP 01 967 819.7. On March 10, 2005, the Court entered judgment in favor of the plaintiffs, finding that they should be identified as co-inventors in place of certain individual defendants. In April 2005, MAP filed an appeal of that decision. We do not expect the outcome of this litigation to have an adverse material effect on our condensed consolidated financial statements.

In March 2006, an Australian university made a demand that we pay additional royalties pursuant to a current patent license agreement. We rejected the demand and have informed the university that we do not consider the claim to have merit. On February 13, 2007 the university commenced legal action in the Federal Court of Australia to pursue its claim. We are vigorously defending our position and we do not expect the outcome of this claim to have an adverse material effect on our condensed consolidated financial statements.

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**Table of Contents**

PART I - FINANCIAL INFORMATION

Item 1

---

**RESMED INC. AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements****(Unaudited)****(14) Business Acquisitions****Fiscal Year Ended June 30, 2007**

**Western Medical Marketing ( WMM ).** On October 4, 2006 we acquired the business assets of WMM, a distribution business operating in the Pacific Northwest region of the U.S. for a total cash consideration of \$0.3 million. The acquisition has been accounted for using purchase accounting and accordingly the results of operations of WMM have been included in our consolidated financial statements since October 4, 2006. An amount of \$0.3 million, representing the excess of the purchase price over the fair value of preliminary identifiable net assets acquired, has been recorded as goodwill. We have not yet completed the purchase price allocation as the valuation of certain assets are not yet complete. We do not believe that the valuations will materially modify the preliminary purchase price allocation. We expect to complete our purchase price allocation by June 30, 2007.

**Fiscal Year Ended June 30, 2006**

**PolarMed Holding AS ( PolarMed ).** As disclosed in our consolidated financial statements and Form 10-K for the year ended June 30, 2006, we acquired 100% of the outstanding stock of PolarMed, the holding company for PolarMed AS and its affiliates, on December 1, 2005, for net cash consideration of \$6.5 million. This was comprised of \$6.8 million in consideration less \$0.3 million of cash acquired. Additionally, as part of the acquisition, we assumed debt of \$1.5 million. Under the purchase agreement, we may also be required to make additional future payments of up to \$3.0 million based on the achievement of certain performance milestones following the acquisition through December 31, 2008. Of the \$0.3 million in potential future payments included within the purchase agreement, \$1.0 million was paid during the quarter ended March 31, 2007 as a result of the successful achievement of a performance milestone. This additional payment was accrued at December 31, 2006, which increased the total acquisition consideration to \$7.8 million from \$6.8 million and increased the amount recorded as goodwill to \$5.4 million from \$4.4 million.

**Pulmomed Medizinisch-Technische Geräte GmbH ( Pulmomed ).** As disclosed in our consolidated financial statements and Form 10-K for the year ended June 30, 2006, we acquired 100% of the outstanding stock of Pulmomed on July 1, 2005 for net cash consideration of \$2.5 million, including acquisition costs. Additionally, as part of the acquisition, we assumed debt of \$1.0 million. Under the purchase agreement, we may also be required to make additional future payments of up to \$0.9 million based on the achievement of certain performance milestones following the acquisition through June 30, 2007. Of the \$0.9 million in potential future payments included within the purchase agreement, \$0.3 million was paid during the quarter ended September 30, 2006 as a result of the successful achievement of a performance milestone. This additional payment was accrued at June 30, 2006, which increased the total acquisition consideration to \$2.8 million from \$2.5 million and increased the amount recorded as goodwill by \$0.3 million to \$2.1 million.



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**Table of Contents**

PART I - FINANCIAL INFORMATION

Item 1

---

**RESMED INC. AND SUBSIDIARIES**

**Notes to Condensed Consolidated Financial Statements**

**(Unaudited)**

(14) Business Acquisitions, Continued  
**Fiscal Year Ended June 30, 2005**

**Hoefner Medizintechnik GmbH ( Hoefner )**. As disclosed in our financial statements and Form 10-K for the year ended June 30, 2006, we acquired 100% of the outstanding stock of Hoefner Medizintechnik GmbH ( Hoefner ) on February 14, 2005 for net cash consideration of \$8.2 million. This was comprised of the \$10.7 million in total consideration, including acquisition costs, less \$2.5 million of cash acquired. Under the purchase agreement, additional future payments of up to \$0.9 million are possible based on the achievement of certain performance milestones following the acquisition through March 31, 2007. Of the \$0.9 million in potential additional payments, \$0.6 million was paid during fiscal 2006. The impact of this was to increase the total acquisition consideration to \$11.3 million from \$10.7 million and to increase the amount recorded as goodwill by \$0.6 million to \$8.8 million. The remaining \$0.3 million of the \$0.9 million was paid during the quarter ended March 31, 2007 as a result of the successful achievement of a performance milestone. This additional payment was accrued at December 31, 2006, which increased the total acquisition consideration to \$11.6 million and goodwill to \$9.1 million.

- 26 -

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**Table of Contents**

PART I - FINANCIAL INFORMATION

Item 2

---

**RESMED INC. AND SUBSIDIARIES****Management Discussion and Analysis of Financial Condition and Results of Operations****Special Note Regarding Forward-Looking Statements**

This report contains or may contain certain forward-looking statements and information that are based on the beliefs of our management as well as estimates and assumptions made by, and information currently available to, our management. The words believe, expect, anticipate, estimate, plan, future and other similar expressions, and statements of such expressions, generally identify forward-looking statements, including, in particular, statements regarding the development and approval of new products and product applications, market expansion, pending litigation, the development of new markets for our products, such as cardiovascular and stroke markets, and the impact of future developments related to the recently announced product recall. These forward-looking statements are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. You are cautioned not to place undue reliance on these forward-looking statements. Such forward-looking statements reflect the views of our management at the time such statements are made and are subject to a number of risks, uncertainties, estimates and assumptions, including, without limitation, and in addition to those identified in the text surrounding such statements, those identified in our Annual Report on Form 10-K for the fiscal year ended June 30, 2006 and elsewhere in this report, which could cause actual results to materially differ from those projected or implied in the forward-looking statements.

In addition, important factors to consider in evaluating such forward-looking statements include changes or developments in social, economic, market, legal or regulatory circumstances, changes in our business or growth strategy or an inability to execute our strategy due to changes in our industry or the economy generally, the emergence of new or growing competitors, the actions or omissions of third parties, including suppliers, customers, competitors and governmental authorities, the predicted costs of the product recall, which could change in response to additional feedback from ongoing discussions with regulatory bodies or other unforeseen circumstances, and various other factors. Should any one or more of these risks or uncertainties materialize, or the underlying estimates or assumptions prove incorrect, actual results may vary significantly from those expressed in such forward-looking statements, and there can be no assurance that the forward-looking statements contained in this report will in fact occur.

Before deciding to purchase, hold or sell our common stock, you should carefully consider the risks described in our annual report on Form 10-K, in addition to the other cautionary statements and risks described elsewhere in this report and in our other filings with the SEC, including our subsequent reports on Forms 10-Q and 8-K. These risks and uncertainties are not the only ones we face. Additional risks and uncertainties not presently known to us or that we currently deem immaterial may also affect our business. If any of these known or unknown risks or uncertainties actually occurs with material adverse effects on us, our business, reputation, financial condition and results of operations could be materially harmed. In that event, the market price for our common stock will likely decline, and you may lose all or part of your investment.



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**Table of Contents**

PART I - FINANCIAL INFORMATION

Item 2

---

**RESMED INC. AND SUBSIDIARIES****Management Discussion and Analysis of Financial Condition and Results of Operations****Overview**

The following is an overview of the results of operations for the nine months ended March 31, 2007. It should be read together with the detail provided in the individual sections below. In this report, all share numbers and per share amounts have been retroactively adjusted to reflect the two-for-one stock split effected in the form of a 100% stock dividend that was declared on August 10, 2005 and distributed on September 30, 2005.

We are a leading developer, manufacturer and distributor of medical equipment for treating, diagnosing, and managing sleep-disordered breathing and other respiratory disorders. Sleep-disordered breathing, or SDB, includes obstructive sleep apnea, or OSA, and other respiratory disorders that occur during sleep. When we were formed in 1989, our primary purpose was to commercialize a treatment for OSA developed by Professor Colin Sullivan. This treatment, nasal Continuous Positive Airway Pressure, or CPAP, was the first successful noninvasive treatment for OSA. CPAP systems deliver pressurized air, typically through a nasal mask, to prevent collapse of the upper airway during sleep.

Since the development of CPAP, we have developed a number of innovative products for SDB and other respiratory disorders including airflow generators, diagnostic products, mask systems, headgear and other accessories. Our growth has been fuelled by geographic expansion, increased awareness of respiratory conditions as a significant health concern among physicians and patients, and our research and product development efforts. Our net revenues are generated from the sale and rental of our various flow generator devices, nasal mask systems, accessories and other products, and, to a lesser extent from royalties and sales of custom motors.

During the quarter ended March 31, 2007 our net revenue increased by 13% when compared to the quarter ended March 31, 2006. These results were primarily driven by increasing unit sales of our products. Gross margin was 30% for the quarter ended March 31, 2007. The gross margin includes a provision of \$59.7 million for our voluntary product recall of approximately 300,000 of our S8 flow generators. Excluding this voluntary product recall our gross margin was 62%, which is consistent with the quarter ended March 31, 2006. Diluted (loss) earnings per share for the quarter ended March 31, 2007 decreased to (\$0.20) per share, down from \$0.34 per share in the quarter ended March 31, 2006. This result was significantly impacted by the \$59.7 million (\$41.8 million net of tax) charge for voluntary product recall expenses. For the quarter ended March 31, 2007, we recognized acquisition related amortization expenses and stock-based compensation costs of \$1.7 million and \$4.7 million, respectively.

**Net Revenue**

Net revenue increased for the three months ended March 31, 2007 to \$183.0 million as compared to \$162.3 million for the three months ended March 31, 2006, an increase of \$20.7 million or 13%. The increase in net revenue is primarily attributable to an increase in unit sales of our flow generators, masks and accessories. Movements in international currencies against the U.S. dollar positively impacted revenues by approximately \$6.5 million during the three months ended March 31, 2007.



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**Table of Contents**

PART I - FINANCIAL INFORMATION

Item 2

---

**RESMED INC. AND SUBSIDIARIES****Management Discussion and Analysis of Financial Condition and Results of Operations****Net Revenue, continued**

Net revenue in North and Latin America increased for the quarter ended March 31, 2007 to \$94.6 million from \$86.2 million for the three months ended March 31, 2006, an increase of \$8.4 million or 10%. Excluding sales from our motor division, our net revenue in North and Latin America for sleep-disordered breathing products increased by 13% compared to the three months ended March 31, 2006. The motor division has been reducing low margin non-core sales to concentrate on supply of motors for our products. The revenue growth has been generated by increased public and physician awareness of sleep-disordered breathing together with our continued investment in our sales force and marketing initiatives. Recent product releases such as the Adapt SV also contributed to our sales growth.

Net revenue in international markets for the quarter ended March 31, 2007 increased to \$88.4 million from \$76.1 million in the quarter ended March 31, 2006, an increase of \$12.3 million or 16%. International sales growth in the quarter ended March 31, 2007 predominantly reflects growth in the overall sleep-disordered breathing market and the positive impact from movements in international currencies against the U.S. dollar. Excluding the impact of movements in international currencies, international sales grew by 8%.

Revenue from sales of flow generators for the quarter ended March 31, 2007 totaled \$94.6 million, an increase of 12% compared to the quarter ended March 31, 2006, including increases of 12% in North and Latin America and 12% elsewhere. Revenue from sales of mask systems, motors and other accessories totaled \$88.4 million, an increase of 14%, including increases of 8% in North and Latin America and 24% elsewhere, for the quarter ended March 31, 2007, compared to the quarter ended March 31, 2006. We believe these increases primarily reflect growth in the overall sleep-disordered breathing market and contributions from new products.

For the nine months ended March 31, 2007, revenue from sales of flow generators increased by 20% compared to the nine months ended March 31, 2006, 21% in North and Latin America and 19% internationally. Revenue from sales of mask systems, motors and other accessories increased by 21%; 20% in North and Latin America and 24% internationally, for the nine months ended March 31, 2007 compared to the nine months ended March 31, 2006. We believe these increases primarily reflect growth in the overall sleep-disordered breathing market, contributions from acquisitions and contributions from new products.

**Gross Profit**

Gross profit decreased for the quarter ended March 31, 2007 to \$54.2 million from \$100.9 million for the quarter ended March 31, 2006, a decrease of \$46.7 million or 46%. Gross profit as a percentage of net revenue for the quarter ended March 31, 2007 was 30% and is lower than the quarter ended March 31, 2006 of 62%. The decrease in gross margin is primarily due to \$59.7 million of voluntary product recall expenses that we recognized during the quarter. Excluding voluntary product recall expenses, gross profit as a percentage of revenue was 62% for the quarter ended March 31, 2007, which is consistent with the same period in 2006.



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**Table of Contents**

PART I - FINANCIAL INFORMATION

Item 2

---

**RESMED INC. AND SUBSIDIARIES****Management Discussion and Analysis of Financial Condition and Results of Operations****Gross Profit, continued**

Gross profit for the nine months ended March 31, 2007 decreased to \$267.2 million from \$272.7 million for the nine months ended March 31, 2006. Gross profit as a percentage of revenue was 51% for the nine months ended March 31, 2007 which is lower than the nine months ended March 31, 2006 of 63%. This is due to voluntary product recall expenses of \$59.7 million. Excluding voluntary product recall expenses gross profit as a percentage of net revenue was 63% for the nine months ended March 31, 2007.

**Voluntary Product Recall Expenses**

On April 23, 2007 we initiated a worldwide voluntary product recall of approximately 300,000 of our early production S8 flow generators. In these particular units, which were manufactured between July 2004 and May 15, 2006, there is a remote potential for a short circuit in the power supply connector. Furthermore in seven cases worldwide, device failures have led to thermal damage to the device, with a remote potential to ignite material external to the device. We plan to work with our distribution partners globally to provide a replacement device to patients who have an affected S8 flow generator.

The estimated cost of this action is \$59.7 million which has been recognized as a charge to cost of sales in the condensed consolidated statement of income during the quarter ended March 31, 2007. We have advised the U.S. Food and Drug Administration and other regulatory authorities of this action, however, the estimated costs of this voluntary product recall are still subject to finalization and clearance of our recall plan by regulatory authorities. We cannot assure that the actual costs of the product recall will not exceed the amount we have estimated and recognized.

**Selling, General and Administrative Expenses**

Selling, general and administrative expenses increased for the three months ended March 31, 2007 to \$61.3 million from \$52.9 million for the three months ended March 31, 2006, an increase of \$8.4 million or 16%. Stock-based compensation expenses of \$3.9 million and \$2.8 million have been included within the selling, general and administrative expenses for the three months ended March 31, 2007 and 2006, respectively. Selling, general and administrative expenses, as a percentage of net revenue, were 34% for the three months ended March 31, 2007 compared to 33% for the three months ended March 31, 2006.

Selling, general and administrative expenses increased for the nine months ended March 31, 2007 to \$172.1 million from \$146.5 million for the nine months ended March 31, 2006, an increase of \$25.6 million or 17%. Stock-based compensation expenses of \$10.6 million and \$9.3 million have been included within the selling, general and administrative expenses for the nine months ended March 31, 2007 and 2006, respectively. Selling, general and administrative expenses, as a percentage of net revenue, were 33% for the nine months ended March 31, 2007 compared to 34% for the nine months ended March 31, 2006.



---

**Table of Contents**

PART I - FINANCIAL INFORMATION

Item 2

---

**RESMED INC. AND SUBSIDIARIES****Management Discussion and Analysis of Financial Condition and Results of Operations****Selling, General and Administrative Expenses, continued**

The increase in selling, general and administrative expenses was primarily due to an increase in the number of sales and administrative personnel to support our growth, continued infrastructure investment, particularly in our European businesses, and other expenses related to the increase in our sales. The increase in selling, general and administrative expenses was also attributable to net appreciation of international currencies against the U.S. dollar, which added approximately \$2.9 million and \$6.5 million to our expenses for the three months and nine months ended March 31, 2007, respectively, as reported in U.S. dollars. As a percentage of net revenue, we expect our future selling, general and administrative expense to continue in the range of 31% to 34%.

**Research and Development Expenses**

Research and development expenses increased for the three months ended March 31, 2007 to \$13.1 million from \$9.1 million for the three months ended March 31, 2006, an increase of \$3.9 million or 43%. Stock-based compensation expenses of \$0.5 million have been included within research and development expenses for both the three months ended March 31, 2007 and 2006. Research and development expenses, as a percentage of net revenue, were 7%, for the three months ended March 31, 2007 compared to 6% for the three months ended March 31, 2006.

Research and development expenses increased for the nine months ended March 31, 2007 to \$35.9 million from \$26.2 million for the nine months ended March 31, 2006, an increase of \$9.8 million or 37%. Stock-based compensation expenses of \$1.5 million have been included within research and development expenses for both the nine months ended March 31, 2007 and 2006. Research and development expenses, as a percentage of net revenue, were 7%, for the three months ended March 31, 2007, compared to 6% for the nine months ended March 31, 2006.

The increase in research and development expenses was primarily due to an increase in the number of research and development personnel, increased charges for consulting fees and an increase in technical assessments incurred to facilitate development of new products. The increase in research and development expenses was also attributable to net appreciation of international currencies against the US dollar, which added approximately \$0.7 million and \$1.2 million to our expenses for both the three months and nine months ended March 31, 2007, respectively, as reported in U.S. dollars. As a percentage of net revenue, we expect our future research and development expense to continue in the range of 6% to 7%.

---

**Table of Contents**

PART I - FINANCIAL INFORMATION

Item 2

---

**RESMED INC. AND SUBSIDIARIES****Management Discussion and Analysis of Financial Condition and Results of Operations****Amortization of Acquired Intangible Assets**

Amortization of acquired intangible assets for the three months ended March 31, 2007 totaled \$1.7 million (\$1.6 million for the three months ended March 31, 2006) and related to acquired intangible assets associated with the acquisitions of Pulmomed, Saime, Hoefner, Resprecare and Polarmed.

Amortization of acquired intangible assets for the nine months ended March 31, 2007 totaled \$5.1 million (\$4.7 million for the nine months ended March 31, 2006) and related to acquired intangible assets associated with the acquisitions of Pulmomed, Saime, Hoefner, Resprecare and Polarmed.

**Restructuring Expenses**

There were no restructuring expenses incurred during the three or nine months ended March 31, 2007 compared to \$Nil and \$1.1 million incurred during the three and nine months ended March 31, 2006, respectively. The prior year restructuring expenses were mainly associated with the integration of the separate operations of ResMed Germany and MAP into a single operating unit. This restructuring is now complete.

**Income Taxes**

For the three months ended March 31, 2007 we recognized an income tax benefit of \$5.6 million. This is primarily attributable to the tax benefit associated with the voluntary product recall expense that was recognized during the quarter. Excluding the impact of voluntary product recall expenses, the effective income tax rate was 32% for the three months ended March 31, 2007, which is broadly consistent with the three months ended March 31, 2006 of 31%.

Our effective income tax rate of approximately 33% for the nine months ended March 31, 2007 was higher than our effective tax rate of 31% for the nine months ended March 31, 2006. This is primarily due to the tax impact of the voluntary product recall expense. Excluding the voluntary product recall expenses, the effective income tax rate was 31% for the nine months ended March 31, 2007.

**Other Income (Expense), Net**

Other income (expense), net, for the three months ended March 31, 2007 decreased to net income of \$0.9 million compared to net income of \$1.4 million for the three months ended March 31, 2006. The decrease in other income was predominantly attributable to foreign exchange losses recognized during the quarter ended March 31, 2007.

Other income (expense), net, for the nine months ended March 31, 2007 increased to net income of \$3.4 million compared to net income of \$1.0 million for the nine months ended March 31, 2006. The increase in other income was predominantly attributable to higher interest income on additional cash balances and the lower interest expense due to the reduction in our convertible debt, which was converted into equity during the quarter ended March 31, 2006.





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**Table of Contents**

PART I - FINANCIAL INFORMATION

Item 2

---

**RESMED INC. AND SUBSIDIARIES****Management Discussion and Analysis of Financial Condition and Results of Operations****Net Income**

As a result of the factors discussed above and in particular the voluntary product recall expense, we recorded a net loss for the three months ended March 31, 2007 of (\$15.4) million or a loss of (\$0.20) per diluted share compared to net income of \$26.4 million or \$0.34 per diluted share for the three months ended March 31, 2006.

As a result of the factors discussed above, our net income for the nine months ended March 31, 2007 was \$38.6 million or \$0.49 per diluted share compared to net income of \$65.1 million or \$0.87 per diluted share for the nine months ended March 31, 2006.

**Business Acquisitions**

**Western Medical Marketing ( WMM ).** On October 4, 2006 we acquired the business assets of WMM, a distribution business operating in the Pacific Northwest region of the U.S. for a total cash consideration of \$0.3 million. The acquisition has been accounted for using purchase accounting and accordingly, the results of operations of WMM have been included in our consolidated financial statements from October 4, 2006. An amount of \$0.3 million, representing the excess of the purchase price over the fair value of preliminary identifiable net assets acquired, has been recorded as goodwill. We have not yet completed the purchase price allocation, as the valuation of certain assets are not yet complete. We do not believe that the valuations will materially modify the preliminary purchase price allocation. We expect to complete our purchase price allocation by June 30, 2007.

**PolarMed Holding AS ( PolarMed ).** As disclosed in our financial statements and Form 10-K for the year ended June 30, 2006, we acquired 100% of the outstanding stock of PolarMed, the holding company for PolarMed AS and its affiliates, on December 1, 2005, for net cash consideration of \$6.5 million. This was comprised of \$6.8 million in consideration less \$0.3 million of cash acquired. Additionally, as part of the acquisition, we assumed debt of \$1.5 million. Under the purchase agreement, we may also be required to make additional future payments of up to \$3.0 million based on the achievement of certain performance milestones following the acquisition through December 31, 2008. Of the \$0.3 million in potential future payments included within the purchase agreement, \$1.0 million was paid during the quarter ended March 31, 2007 as a result of the successful achievement of a performance milestone. This additional payment was accrued at December 31, 2006, which increased the total acquisition consideration to \$7.8 million from \$6.8 million and increased the amount recorded as goodwill to \$5.4 million from \$4.4 million.

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**Table of Contents**

PART I - FINANCIAL INFORMATION

Item 2

---

**RESMED INC. AND SUBSIDIARIES****Management Discussion and Analysis of Financial Condition and Results of Operations****Business Acquisitions, continued**

**Pulmomed Medizinisch-Technische Geräte GmbH ( Pulmomed )**. As disclosed in our financial statements and Form 10-K for the year ended June 30, 2006, we acquired 100% of the outstanding stock of Pulmomed on July 1, 2005, for net cash consideration of \$2.5 million, including acquisition costs. Additionally, as part of the acquisition, we assumed debt of \$1.0 million. Under the purchase agreement, we may also be required to make additional future payments of up to \$0.9 million based on the achievement of certain performance milestones following the acquisition through June 30, 2007. Of the \$0.9 million in potential future payments included within the purchase agreement, \$0.3 million was paid during the quarter ended September 30, 2006 as a result of the successful achievement of a performance milestone. This additional payment was accrued at June 30, 2006, which increased the total acquisition consideration to \$2.8 million from \$2.5 million and increased the amount recorded as goodwill by \$0.3 million to \$2.1 million.

**Hoefner Medizintechnik GmbH ( Hoefner )**. As disclosed in our financial statements and Form 10-K for the year ended June 30, 2006, we acquired 100% of the outstanding stock of Hoefner Medizintechnik GmbH ( Hoefner ) on February 14, 2005, for net cash consideration of \$8.2 million. This was comprised of the \$10.7 million in total consideration, including acquisition costs, less \$2.5 million of cash acquired. Under the purchase agreement, additional future payments of up to \$0.9 million are possible based on the achievement of certain performance milestones following the acquisition through March 31, 2006. Of the \$0.9 million in potential future payments, \$0.6 million was paid during fiscal 2006. The impact of this was to increase the total acquisition consideration to \$11.3 million from \$10.7 million and to increase the amount recorded as goodwill by \$0.6 million to \$8.8 million. The remaining \$0.3 million of the \$0.9 million was paid during the quarter ended March 31, 2007 as a result of the successful achievement of a performance milestone. This additional payment was accrued at December 31, 2006, which increased the total acquisition consideration to \$11.6 million and goodwill to \$9.1 million.

**Liquidity and Capital Resources**

As of March 31, 2007 and June 30, 2006, we had cash and cash equivalents and marketable securities available-for-sale of \$260.1 million and \$219.5 million, respectively. Working capital was \$437.6 million and \$381.3 million at March 31, 2007 and June 30, 2006, respectively.

Inventories at March 31, 2007 increased by \$48.2 million or 44% to \$156.9 million compared to March 31, 2006 inventories of \$108.7 million. The percentage increase in inventories was higher than the 20% increase in revenues in the nine month period ended March 31, 2007 compared to the nine month period ended March 31, 2006. The higher inventory growth reflects increased inventory levels to accommodate our increasing sales and additional inventory associated with the upcoming launch of several new products including the VPAP Malibu and Tango flow generators, and the Quattro and Liberty mask offerings.

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**Table of Contents**

PART I - FINANCIAL INFORMATION

Item 2

---

**RESMED INC. AND SUBSIDIARIES****Management Discussion and Analysis of Financial Condition and Results of Operations****Liquidity and Capital Resources, Continued**

Accounts receivable at March 31, 2007 were \$153.1 million, an increase of \$25.9 million or 20% over the March 31, 2006 accounts receivable balance of \$127.2 million. This increase was consistent with the 20% incremental increase in revenues for the nine months ended March 31, 2007 compared to the nine months ended March 31, 2006. Accounts receivable days outstanding were 73 days for the quarter ended March 31, 2007. Our allowance for doubtful accounts as a percentage of total accounts receivable at March 31, 2007 and June 30, 2006 was 3.1% and 2.3%, respectively. The credit quality of our customers remains consistent with our past experience.

During the nine months ended March 31, 2007, we generated cash of \$64.0 million from operations compared to \$63.7 million for the nine months ended March 31, 2006. The cash generated from operations included a reduction of \$11.3 million (2006: \$2.2 million) due to the adoption of SFAS 123(R) as tax benefits associated with employee stock options exercised during the quarter are required to be included within cashflows from financing activities.

Capital expenditures for the nine months ended March 31, 2007, and for the nine months ended March 31, 2006, aggregated \$60.1 million and \$79.1 million, respectively. The capital expenditures for the nine months ended March 31, 2007 primarily reflected the construction of new facilities, computer hardware and software, rental and loan equipment and purchase of production tooling equipment and machinery. As a result of these capital expenditures, our balance sheet reflects net property, plant and equipment of approximately \$292.7 million at March 31, 2007 compared to \$245.4 million at June 30, 2006.

During the nine months ended March 31, 2007, we completed the construction of our new research and development and office facilities at our existing site in Sydney, Australia. We incurred construction costs of \$12.0 million to complete our new building during the nine months ended March 31, 2007. We also commenced an extension to our manufacturing facility in Sydney, Australia during the quarter ended March 31, 2007. We have incurred \$3.3 million during the quarter and estimate additional construction cost of approximately \$10.0 million to complete the project. We expect to complete this extension within the next calendar year and to fund the project through a combination of cash on hand and cash generated from operations.

**Table of Contents**

PART I - FINANCIAL INFORMATION

Item 2

**RESMED INC. AND SUBSIDIARIES****Management Discussion and Analysis of Financial Condition and Results of Operations****Liquidity and Capital Resources, Continued**

On July 7, 2005, we purchased a 9.78-acre parcel of land in Kearney Mesa, San Diego for \$21.0 million. The new location in San Diego will allow us to develop a new corporate headquarters. We are currently in the early stages of the development of these new corporate headquarters.

Details of contractual obligations at March 31, 2007 are as follows:

| In \$000 s                                | Total            | Payments Due by Period |                 |                 |                 |                 |              |
|---|------------------|------------------------|-----------------|-----------------|-----------------|-----------------|--------------|
|   |                  | Mar 2008               | Mar 2009        | Mar 2010        | Mar 2011        | Mar 2012        | Thereafter   |
| Long-Term Debt                            | \$113,995        | \$18,606               | \$9,023         | \$13,701        | \$36,759        | \$35,906        | \$-          |
| Operating Leases                          | 25,726           | 8,296                  | 7,064           | 4,931           | 3,061           | 1,852           | 522          |
| Capital Leases                            | 576              | 77                     | 77              | 77              | 77              | 77              | 191          |
| Unconditional Purchase Obligations        | 39,108           | 37,392                 | 834             | 834             | 21              | 21              | 6            |
| <b>Total Contractual Cash Obligations</b> | <b>\$179,405</b> | <b>\$64,371</b>        | <b>\$16,998</b> | <b>\$19,543</b> | <b>\$39,918</b> | <b>\$37,856</b> | <b>\$719</b> |

Details of other commercial commitments as at March 31, 2007 are as follows:

| In \$000 s                          | Total           | Amount of Commitment Expiration Per Period |            |                 |              |            |                |
|-------------------------------------|-----------------|--|------------|-----------------|--------------|------------|----------------|
|                                     |                 | Mar 2008                                   | Mar 2009   | Mar 2010        | Mar 2011     | Mar 2012   | Thereafter     |
| Available Lines of Credit           | \$1,280         | \$-  | \$-        | \$-             | \$-          | \$-        | \$1,280        |
| Standby Letters of Credit           | 35              | 35   | -          | -               | -            | -          | -              |
| Guarantees*                         | 56,314          | 1,667                                      | -          | 53,954          | 149          | -          | 544            |
| <b>Total Commercial Commitments</b> | <b>\$57,629</b> | <b>\$1,702</b>                             | <b>\$-</b> | <b>\$53,954</b> | <b>\$149</b> | <b>\$-</b> | <b>\$1,824</b> |

\* These guarantees mainly relate to requirements under contractual obligations with insurance companies transacting with our German subsidiaries and our loan agreements

On March 13, 2006, our wholly-owned subsidiaries ResMed Corp., Servo Magnetics Inc. and ResMed EAP Holdings Inc. entered into a Second Amended and Restated Revolving Loan Agreement with Union Bank of California, N.A. as administrative agent for the lenders (the Loan Agreement), that provides for a revolving loan of up to \$75 million. The Loan Agreement also contains customary covenants, including certain financial covenants and an obligation that we maintain certain financial ratios, including a maximum ratio of total debt to EBITDA (as defined in the Loan Agreement), a fixed charge coverage ratio, a minimum tangible net worth, and that certain of our subsidiaries maintain a minimum EBITDA and liquidity. We are currently in compliance with all of these covenants. Draws under the revolving loan must be made before March 1, 2011, at which time all unpaid principal and interest must be repaid. The outstanding principal amount due under the loan will bear interest at a rate equal to LIBOR plus 0.75% to 1.00% (depending on the applicable leverage ratio). At March 31, 2007 there were no amounts outstanding under the Loan Agreement.



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**Table of Contents**

PART I - FINANCIAL INFORMATION

Item 2

---

**RESMED INC. AND SUBSIDIARIES****Management Discussion and Analysis of Financial Condition and Results of Operations****Syndicated Facility**

On June 8, 2006, our wholly-owned Australian subsidiary, ResMed Limited, entered into a Syndicated Facility Agreement with HSBC Bank Australia Limited as original financier, facility agent and security trustee, that provides for a loan in three tranches.

Tranche A is an EUR 50 million five-year term loan facility that refinances all amounts outstanding under a syndicated facility agreement dated May 16, 2005, between ResMed Limited and HSBC Bank Australia Limited, to fund the obligations of our wholly-owned French subsidiary ResMed SAS under its agreement to acquire Saime. Tranche A bears interest at a rate equal to LIBOR for deposits denominated in EUR plus a margin of 0.80% or 0.90%, depending on the ratio of the total debt to EBITDA of ResMed Inc. and its subsidiaries (the ResMed Group) for the most recently completed fiscal year for the applicable interest period. Payments of principal must be made to reduce the total outstanding principal amount of Tranche A to EUR 44.5 million on June 30, 2007, EUR 37.75 million on June 30, 2008, EUR 27.5 million on June 30, 2009, EUR 15 million on December 31, 2009, and the entire outstanding principal amount must be repaid in full on June 8, 2011. At March 31, 2007, the Tranche A facility loan had an amount outstanding of EUR 48.25 million, or USD 64.5 million.

Tranche B is a USD 15 million term loan facility that may only be used for the purpose of financing capital expenditures and other asset acquisitions by the ResMed Group. Tranche B bears interest at a rate equal to LIBOR for deposits denominated in EUR, Australian dollars, USD or Sterling plus a margin of 0.80% or 0.90%, depending on the ratio of the total debt to EBITDA of the ResMed Group for the most recently completed fiscal year for the applicable interest period. The entire principal amount must be repaid in full on June 8, 2011. At March 31, 2007, the Tranche B facility loan agreement had an outstanding amount of USD 5.9 million.

Tranche C is a USD 60 million term loan facility that may only be used for the purpose of the payment by ResMed Limited of a dividend to ResMed Holdings Limited, which will ultimately be paid to ResMed Inc. Tranche C bears interest at a rate equal to LIBOR for deposits denominated in EUR, Australian dollars or USD plus a margin of 0.70% or 0.80%, depending on the ratio of the total debt to EBITDA of the ResMed Group for the most recently completed fiscal year for the applicable interest period. Payments of principal must be made to reduce the total outstanding principal amount of Tranche C to USD 30 million on December 31, 2007 and the entire outstanding principal amount must be repaid in full by June 8, 2009. At March 31, 2007, the Tranche C facility loan had an amount outstanding of USD 39.7 million.

Simultaneous with the Syndicated Facility Agreement, ResMed Limited entered into a working capital agreement with HSBC Bank Australia Limited for revolving letter of credit and overdraft facilities up to a total commitment of 6.5 million Australian dollars for one year, and ResMed (UK) Limited entered into a working capital agreement with HSBC Bank plc for a revolving cash advance facility up to a total commitment of 3 million Sterling for one year. At March 31, 2007, there was an amount of USD 3.9 million outstanding under these working capital agreements.





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**Table of Contents**

PART I - FINANCIAL INFORMATION

Item 2

---

**RESMED INC. AND SUBSIDIARIES****Management Discussion and Analysis of Financial Condition and Results of Operations****Syndicated Facility, continued**

The loan is secured by a pledge of one hundred percent of the shares of ResMed Inc.'s subsidiary, Saime, pursuant to a Pledge Agreement. The Syndicated Facility Agreement also contains customary covenants, including certain financial covenants and an obligation that ResMed Limited maintain certain financial ratios, including a minimum debt service cover ratio, a maximum ratio of total debt to EBITDA and a minimum tangible net worth. The entire principal amount of the loan and any accrued but unpaid interest may be declared immediately due and payable in the event of the occurrence of an event of default as defined in the Syndicated Facility Agreement. Events of default include, among other items, failure to make payments when due, breaches of representations, warranties or covenants, the occurrence of certain insolvency events, the occurrence of an event or change which could have a material adverse effect on ResMed Limited and its subsidiaries, and if ResMed Inc. ceases to control ResMed Limited, ResMed Corp., ResMed SAS, ResMed GmbH & Co. KG, ResMed (UK) Limited, Take Air Medical Handels-GmbH or Saime. At the most recent reporting date we were in compliance with our debt covenants.

We expect to satisfy all of our short-term liquidity requirements through a combination of cash on hand, cash generated from operations, our \$75 million undrawn revolving line of credit with Union Bank of California and our \$16.4 million undrawn facilities with HSBC.

The results of our international operations are affected by changes in exchange rates between currencies. Changes in exchange rates may negatively affect our consolidated net revenue and gross profit margins from international operations. We are exposed to the risk that the dollar value equivalent of anticipated cash flows would be adversely affected by changes in foreign currency exchange rates. We manage this risk through foreign currency option contracts.

**Stock Split**

On August 10, 2005, our Board of Directors declared a two-for-one split of our common stock which was effected in the form of a 100% stock dividend. Shareholders received one additional share of common stock for every share held of record on September 15, 2005. All share numbers and per share amounts contained in the condensed consolidated financial statements and accompanying notes have been retroactively adjusted to reflect this stock split.

**Critical Accounting Principles and Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the U.S. requires us to make estimates and judgments that affect our reported amounts of assets and liabilities, revenues and expenses and related disclosures of contingent assets and liabilities. On an ongoing basis we evaluate our estimates, including those related to allowance for doubtful accounts, inventory reserves, warranty obligations, goodwill, impaired assets, intangible assets, income taxes and contingencies.

We state these accounting policies in the notes to the financial statements and at relevant sections in this discussion and analysis. The estimates are based on the information that is currently available to us and on various other assumptions that we believe to be reasonable under the circumstances. Actual results could vary from those estimates under different assumptions or conditions.

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**Table of Contents**

PART I - FINANCIAL INFORMATION

Item 2

---

**RESMED INC. AND SUBSIDIARIES****Management Discussion and Analysis of Financial Condition and Results of Operations****Critical Accounting Principles and Estimates, continued**

We believe that the following critical accounting policies affect the more significant judgments and estimates used in the preparation of our financial statements:

- (1) Allowance for Doubtful Accounts. We maintain an allowance for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments, which results in bad debt expense. We determine the adequacy of this allowance by continually evaluating individual customer receivables, considering a customer's financial condition, credit history and current economic conditions. 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.
- (2) Inventory Adjustments. Inventories are stated at lower of cost or market and are determined by the first-in, first-out method. We review the components of inventory on a regular basis for excess, obsolete and impaired inventory based on estimated future usage and sales. The likelihood of any material inventory write-downs is dependent on changes in competitive conditions, new product introductions by us or our competitors, or rapid changes in customer demand.
- (3) Valuation of Goodwill, Intangible and Other Long-Lived Assets. We use assumptions in establishing the carrying value, fair value and estimated lives of our long-lived assets and goodwill. The criteria used for these evaluations include management's estimate of the asset's continuing ability to generate positive income from operations and positive cash flow in future periods compared to the carrying value of the asset, as well as the strategic significance of any identifiable intangible asset in our business objectives. If assets are considered to be impaired, the impairment recognized is the amount by which the carrying value of the assets exceeds the fair value of the assets. Useful lives and related amortization or depreciation expense are based on our estimate of the period that the assets will generate revenues or otherwise be used by us.

Factors that would influence the likelihood of a material change in our reported results include significant changes in the asset's ability to generate positive cash flow, loss of legal ownership or title to the asset, a significant decline in the economic and competitive environment on which the asset depends, significant changes in our strategic business objectives, utilization of the asset, and a significant change in the economic and/or political conditions in certain countries.

- (4) Valuation of Deferred Income Taxes. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount expected to be realized. The likelihood of a material change in our expected realization of these assets is dependent on future taxable income, the intrinsic value of stock options, our ability to deduct tax loss carry forwards against future taxable income, the effectiveness of our tax planning and strategies among the various tax jurisdictions that we operate in, and any significant changes in the tax treatment received on our business combinations.



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**Table of Contents**

PART I - FINANCIAL INFORMATION

Item 2

---

**RESMED INC. AND SUBSIDIARIES****Management Discussion and Analysis of Financial Condition and Results of Operations****Critical Accounting Principles and Estimates, continued**

(5) Provision for Warranty. We provide for the estimated cost of product warranties at the time the related revenue is recognized. The amount of this provision is determined by using a financial model, which takes into consideration actual, historical expenses and potential risks associated with our different products. This financial model is then used to calculate the future probable expenses related to warranty and the required level of the warranty provision. Although we engage in product improvement programs and processes, our warranty obligation is affected by product failure rates and costs incurred to correct those product failures. Should actual product failure rates or estimated costs to repair those product failures differ from our estimates, revisions to our estimated warranty provision would be required.

(6) Revenue Recognition. Revenue on product sales is recorded at the time of shipment, at which time title transfers to the customer. Revenue on product sales, which require customer acceptance, is not recorded until acceptance is received. Royalty revenue from license agreements is recorded when earned. Service revenue received in advance from service contracts is initially deferred and recognized ratably over the life of the service contract. Revenue received in advance from rental unit contracts is initially deferred and recognized ratably over the life of the rental contract. Revenue from sale of marketing and distribution rights is initially deferred and recognized ratably as revenue over the life of the contract. Freight charges billed to customers are included in revenue. All freight-related expenses are charged to cost of sales.

We do not recognize revenues to the extent that we offer a right of return or other recourse with respect to the sale of our products, other than returns for product defects or other warranty claims, nor do we recognize revenues if we offer variable sale prices for subsequent events or activities. As part of our sales processes we may provide upfront discounts for large orders, one time special pricing to support new product introductions, sales rebates for centralized purchasing entities or price-breaks for regular order volumes. The costs of all such programs are recorded as an adjustment to revenue. In our domestic sales activities we use a number of manufacturer representatives to sell our products. These representatives are paid a direct commission on sales and act as an integral component of our domestic sales force. We do not sell our products to these representatives, and do not recognize revenue on such shipments. Our products are predominantly therapy-based equipment and require no installation. As such, we have no significant installation obligations.

(7) Stock-Based Compensation. In accordance with the modified prospective method of SFAS 123(R), we measure the compensation of all stock-based awards at fair value on the date of grant. Such value is recognized as compensation expense over the service period, net of estimated forfeitures. The estimation of stock awards that will ultimately vest requires judgment, and to the extent actual results differ from our estimates, such amounts will be recorded as a cumulative adjustment in the period the estimates are revised. We consider many factors when estimating expected forfeitures, including the type of awards, employee class, and historical experience. Actual results may differ substantially from these estimates.



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**Table of Contents**

PART I - FINANCIAL INFORMATION

Item 2

---

**RESMED INC. AND SUBSIDIARIES****Management Discussion and Analysis of Financial Condition and Results of Operations****Critical Accounting Principles and Estimates, Continued**

(8) Voluntary Product Recall Expenses. We recognized an accrual for the estimated cost of the voluntary product recall at the time the liability was probable and the related expenses could be reasonably estimated. The amount of this accrual was determined taking into consideration the future probable expenses directly related to the product recall including expected return rates for the affected units, unit replacement costs, legal, consulting, logistical and administrative expenses. Should actual product recall costs differ from our estimated costs or should we receive additional feedback from our ongoing discussions with regulatory bodies, revisions to our estimated product recall accrual may be required.

**Recently Issued Accounting Pronouncements**

In June 2006, the FASB issued FIN No. 48, *Accounting for Uncertainty in Income Taxes* an interpretation of FASB Statement No. 109 ( FIN 48 ), which clarifies the accounting for uncertainty in income taxes recognized in the financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes* . The interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken, or expected to be taken in a tax return. FIN 48 requires recognition of tax benefits that satisfy a greater than 50% probability threshold. It also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. FIN 48 is effective for us beginning July 1, 2007. We are assessing the potential impact that the adoption of FIN 48 will have on our financial statements.

In September 2006, the FASB issued FASB No. 157, *Fair Value Measurements* ( FASB 157 ), which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. FASB 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. We are assessing the potential impact that the adoption of this standard will have on our financial statements.

In September 2006, the Securities and Exchange Commission ( the SEC ) issued Staff Accounting Bulletin ( SAB ) No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Current Year Misstatements* ( SAB 108 ), which requires analysis of misstatements using both an income statement (rollover) approach and a balance sheet (iron curtain) approach in assessing materiality and provides for a one-time cumulative effect transition adjustment. SAB 108 is effective for our fiscal year 2007 annual financial statements. We do not expect that the adoption of SAB 108 will have a material impact on our financial statements.

**Off-Balance Sheet Arrangements**

As of March 31, 2007, we are not involved in any off-balance sheet arrangements, as defined in Item 303(a)(4)(ii) of SEC Regulation S-K.





**Table of Contents**

PART I - FINANCIAL INFORMATION

Item 3

**RESMED INC. AND SUBSIDIARIES****Quantitative and Qualitative Disclosures About Market Risk****Foreign Currency Market Risk**

Our functional currency is the U.S. dollar, although we transact business in various foreign currencies, including a number of major European currencies as well as the Australian dollar. We have significant foreign currency exposure through both our Australian manufacturing activities and international sales operations.

We have established a foreign currency hedging program using purchased currency options to hedge foreign-currency-denominated financial assets, liabilities and manufacturing expenditures. The goal of this hedging program is to economically guarantee or lock in the exchange rates on our foreign currency exposures denominated in Euros and Australian dollars. Under this program, increases or decreases in our foreign-currency-denominated financial assets, liabilities, and firm commitments are partially offset by gains and losses on the hedging instruments. We do not enter into financial instruments for trading or speculative purposes.

The table below provides information in U.S. dollar equivalents on our foreign-currency-denominated financial assets by legal entity functional currency as at March 31, 2007 (in thousands):

|                                 | Foreign Currency Financial Assets |           |          |                     |                  |                    |               |             |                 |   |
|---------------------------------|-----------------------------------|-----------|----------|---------------------|------------------|--------------------|---------------|-------------|-----------------|---|
|                                 | Aust Dollar                       | US Dollar | Euro     | Great Britain Pound | Singapore Dollar | New Zealand Dollar | Swedish Krona | Swiss Franc | Norwegian Krone |   |
| <b>AUD Functional Currency</b>  |                                   |           |          |                     |                  |                    |               |             |                 |   |
| Entities:                       |                                   |           |          |                     |                  |                    |               |             |                 |   |
| Assets                          | -                                 | 77,745    | 105,558  | 14,706              | 632              | 984                | 1,398         | 4,274       | 1,135           |   |
| Liability                       | -                                 | (23,255)  | (93,501) | (6,368)             | (55)             | (54)               | (7)           | (6)         | -               |   |
| Net Total                       | -                                 | 54,490    | 12,057   | 8,338               | 577              | 930                | 1,391         | 4,268       | 1,135           |   |
| <b>USD Functional Currency</b>  |                                   |           |          |                     |                  |                    |               |             |                 |   |
| Entities:                       |                                   |           |          |                     |                  |                    |               |             |                 |   |
| Assets                          | 46,898                            | -         | -        | -                   | -                | -                  | -             | -           | -               | - |
| Liability                       | -                                 | -         | -        | -                   | -                | -                  | -             | -           | -               | - |
| Net Total                       | 46,898                            | -         | -        | -                   | -                | -                  | -             | -           | -               | - |
| <b>Euro Functional Currency</b> |                                   |           |          |                     |                  |                    |               |             |                 |   |
| Entities:                       |                                   |           |          |                     |                  |                    |               |             |                 |   |
| Assets                          | -                                 | 1         | 682      | -                   | -                | -                  | -             | -           | -               | - |
| Liability                       | -                                 | (381)     | (44)     | (1,998)             | -                | -                  | -             | -           | -               | - |
| Net Total                       | -                                 | (380)     | 638      | (1,998)             | -                | -                  | -             | -           | -               | - |
| <b>GBP Functional Currency</b>  |                                   |           |          |                     |                  |                    |               |             |                 |   |
| Entities:                       |                                   |           |          |                     |                  |                    |               |             |                 |   |
| Assets                          | -                                 | 429       | 8,089    | -                   | -                | -                  | -             | -           | -               | - |
| Liability                       | -                                 | 29        | (598)    | -                   | -                | -                  | -             | -           | -               | - |
| Net Total                       | -                                 | 458       | 7,491    | -                   | -                | -                  | -             | -           | -               | - |
| <b>CHF Functional Currency</b>  |                                   |           |          |                     |                  |                    |               |             |                 |   |
| Entities:                       |                                   |           |          |                     |                  |                    |               |             |                 |   |
| Assets                          | -                                 | 838       | 20       | 10                  | -                | -                  | -             | -           | -               | - |
| Liability                       | -                                 | (9)       | (814)    | (319)               | -                | -                  | -             | -           | -               | - |
| Net Total                       | -                                 | 829       | (794)    | (309)               | -                | -                  | -             | -           | -               | - |
| <b>NOK Functional Currency</b>  |                                   |           |          |                     |                  |                    |               |             |                 |   |
| Entities:                       |                                   |           |          |                     |                  |                    |               |             |                 |   |

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|                         |   |         |       |      |   |   |      |   |       |
|-------------------------|---|---------|-------|------|---|---|------|---|-------|
| Assets                  | - | -       | -     | -    | - | - | -    | - | -     |
| Liability               | - | (97)    | (139) | (81) | - | - | (83) | - | -     |
| Net Total               | - | (97)    | (139) | (81) | - | - | (83) | - | -     |
| SEK Functional Currency |   |         |       |      |   |   |      |   |       |
| Entities:               |   |         |       |      |   |   |      |   |       |
| Assets                  | - | 2       | -     | -    | - | - | -    | - | -     |
| Liability               | - | (1,240) | (64)  | (26) | - | - | -    | - | 1,136 |
| Net Total               | - | (1,238) | (64)  | (26) | - | - | -    | - | 1,136 |

- 42 -

**Table of Contents**

PART I - FINANCIAL INFORMATION

Item 3

**RESMED INC. AND SUBSIDIARIES****Quantitative and Qualitative Disclosures About Market and Business Risk****Foreign Currency Market Risk, Continued**

The table below provides information about our foreign currency derivative financial instruments and presents the information in U.S. dollar equivalents. The table summarizes information on instruments and transactions that are sensitive to foreign currency exchange rates, including foreign currency call options held at March 31, 2007. The table presents the notional amounts and weighted average exchange rates by contractual maturity dates for our foreign currency derivative financial instruments. These notional amounts generally are used to calculate payments to be exchanged under our option contracts.

| (In thousands except exchange rates) |                     |                     |                    |                     | Fair Value Assets /(Liabilities) |               |
|--------------------------------------|---------------------|---------------------|--------------------|---------------------|----------------------------------|---------------|
| Foreign Exchange Call Options        | FY 2007             | FY 2008             | FY 2009            | Total               | Mar 31, 2007                     | June 30, 2006 |
| <b>Receive AUD/Pay USD</b>           |                     |                     |                    |                     |                                  |               |
| Option amount                        | \$33,000            | \$45,000            | \$12,000           | \$90,000            | \$2,670                          | \$1,035       |
| Ave. contractual exchange rate       | AUD 1 = USD 0.7775  | AUD 1 = USD 0.7838  | AUD 1 = USD 0.7949 | AUD 1 = USD 0.7829  |                                  |               |
| <b>Receive AUD/Pay Euro</b>          |                     |                     |                    |                     |                                  |               |
| Option amount                        | \$14,035            | \$8,020             | -                  | \$22,056            | \$64                             | \$144         |
| Ave. contractual exchange rate       | AUD 1 = Euro 0.6399 | AUD 1 = Euro 0.6230 | -                  | AUD 1 = Euro 0.6336 |                                  |               |
| <b>Receive AUD/Pay GBP</b>           |                     |                     |                    |                     |                                  |               |
| Option Amount                        | -                   | \$5,905             | -                  | \$5,905             | \$50                             | \$-           |
| Ave. contractual exchange rate       | -                   | AUD 1 = GBP 0.4274  | -                  | AUD 1 = GBP 0.4274  |                                  |               |

**Interest Rate Risk**

We are exposed to risk associated with changes in interest rates affecting the return on our cash and cash equivalents, marketable securities and debt.

At March 31, 2007, we maintained a short-term investment portfolio containing financial instruments that have original maturities of less than twelve months. These financial instruments, principally comprised of corporate obligations, are subject to interest rate risk and will decline in value if interest rates increase.

At March 31, 2007, we had total long-term debt, including the current portion of those obligations, of \$114.6 million. Of this debt, \$114.0 million is at variable interest rates and \$0.6 million is subject to fixed interest rates.

A hypothetical 10% change in interest rates during the three months ended March 31, 2007, would not have had a material impact on pretax income. We have no interest rate hedging agreements.



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**Table of Contents**

PART I-FINANCIAL INFORMATION

Item 4

---

**RESMED INC. AND SUBSIDIARIES**

**Controls and Procedures**

We maintain disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended (the Exchange Act )) that are designed to provide reasonable assurance that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and in reaching a reasonable level of assurance management necessarily was required to apply its judgment in evaluating the cost benefit relationship of possible controls and procedures.

As required by Rule 13a-15(b) of the Exchange Act, we carried out an evaluation, 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 of March 31, 2007. Based on the foregoing, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective at the reasonable assurance level.

During the three months ended March 31, 2007, there has been no change in our internal controls over financial reporting that has materially affected, or is reasonably likely to materially affect, our internal controls over financial reporting.

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**Table of Contents**

PART II - OTHER INFORMATION

Items 1-6

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**RESMED INC. AND SUBSIDIARIES****Item 1 Legal Proceedings**

The information required by this Item is incorporated herein by reference to Note 13, *Legal Actions and Contingencies*, to the Condensed Consolidated Financial Statements (unaudited) under Item 1 of Part I of this report.

**Item 1A Risk Factors**

The discussion of our business and operations should be read together with the risk factors contained in our Annual Report on Form 10-K for the fiscal year ended June 30, 2006, which was filed with the SEC and describes the various risks and uncertainties to which we are or may become subject to. At March 31, 2007, there have been no material changes to the risk factors set forth in our Annual Report on Form 10-K for the year ended June 30, 2006, except as set forth below:

**Complying with Food and Drug Administration, or FDA, and other regulations is an expensive and time-consuming process, and any failure to comply could result in substantial penalties.**

We are subject to various federal, state, local and international regulations regarding our business activities. Failure to comply with these regulations could result in, among other things, recalls of our products, substantial fines and criminal charges against us or against our employees. Furthermore, our products could be subject to recall if the FDA or we determine, for any reason, that our products are not safe or effective. Any recall or other regulatory action could increase our costs, damage our reputation, affect our ability to supply customers with the quantity of products they require and materially affect our operating results. For example, in April 2007 we announced a worldwide voluntary product recall of approximately 300,000 of our S8 flow generators manufactured between July 2004 and May 2006. We have determined that there is a remote potential for a short circuit in the power connector. In only seven cases worldwide, device failures have led to thermal damage to the device, with a remote potential to ignite material external to the device. To date, no significant property damage or patient injury has been reported. We have advised the FDA and other regulatory authorities of this action and will be continuing to discuss this action with those authorities to finalize our proposed course of action. The estimated cost of this action is \$59.7 million, which we recognized as an expense in the quarter ended March 31, 2007. These costs are still subject to finalization and approval of our recall plan by regulatory authorities. We cannot assure you that this will be the total cost for the recall or that the total cost will not significantly exceed our estimates. Moreover, we cannot predict the effect this recall and the negative publicity associated with the recall will have on our reputation among physicians and customers. Our results of operations could be severely impacted if we have failed to accurately estimate the costs of this product recall or if physicians and customers cease to recommend and purchase our products as a result of this product recall.

**We are subject to potential product liability claims that may exceed the scope and amount of our insurance coverage, which would expose us to liability for uninsured claims.**



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**Table of Contents**

PART II - OTHER INFORMATION

Items 1-6

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**RESMED INC. AND SUBSIDIARIES****Item 1A Risk Factors, Continued**

We are subject to potential product liability claims as a result of the design, manufacture and marketing of medical devices. In April 2007 we announced a worldwide voluntary product recall of approximately 300,000 of our S8 flow generators manufactured between July 2004 and May 2006. We have determined that there is a remote potential for a short circuit in the power connector which can cause the device to fail. In only seven cases worldwide, device failures have led to thermal damage to the device, with a remote potential to ignite material external to the device. To date, no significant property damage or patient injury has been reported. However, we would likely be subject to product liability claims should any of these devices malfunction, resulting injury to a patient or damage to property. Any product liability claim brought against us, with or without merit, could result in the increase of our product liability insurance rates. In addition, we would have to pay any amount awarded by a court in excess of our policy limits. Our insurance policies have various exclusions, and thus we may be subject to a product liability claim for which we have no insurance coverage, in which case, we may have to pay the entire amount of any award. We cannot assure you that our insurance coverage will be adequate or that all claims brought against us will be covered by our insurance. Insurance varies in cost and can be difficult to obtain, and we cannot assure you that we will be able to obtain insurance in the future on terms acceptable to us or at all. A successful product liability claim brought against us in excess of our insurance coverage, if any, may require us to pay substantial amounts, which could harm our business.

**Item 2 Unregistered Sales of Equity Securities and Use of Proceeds**

None.

**Item 3 Defaults Upon Senior Securities**

None.

**Item 4 Submission of Matters to a Vote of Security Holders**

None.

**Item 5 Other Information**

None.

**Item 6 Exhibits**

3.1 Third Amended and Restated Bylaws of ResMed Inc. (1)

31.1 Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002



31.2 Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

32.1 Certification of Chief Executive Officer and Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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<sup>(1)</sup> Incorporated by reference to Exhibit 3.1 of the Registrants Current Report on Form 8-K filed on March 1, 2007.

**Table of Contents**

PART II - OTHER INFORMATION

SIGNATURES

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**RESMED INC. AND SUBSIDIARIES**

**Signatures**

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

May 4, 2007

ResMed Inc.

/s/ **PETER C. FARRELL**

Peter C. Farrell  
Chairman and Chief Executive Officer

/s/ **BRETT A. SANDERCOCK**

Brett A. Sandercock  
Chief Financial Officer