

RESMED INC  
Form 10-Q  
November 09, 2007

**SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C. 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 SEPTEMBER 30, 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)

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

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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

At November 1, 2007 there were 77,302,180 shares of Common Stock (\$0.004 par value) outstanding. This number excludes 2,917,518 shares held by the registrant as treasury shares.

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**RESMED INC. AND SUBSIDIARIES****INDEX**

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**RESMED INC. AND SUBSIDIARIES**

Condensed Consolidated Balance Sheets (Unaudited)

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

|   | September 30, | June 30,    |
|---|---------------|-------------|
|   | 2007          | 2007        |
| <b>ASSETS</b>   |               |             |
| <u>Current assets:</u>  |               |             |
| Cash and cash equivalents   | \$251,314     | \$257,792   |
| Marketable securities available-for-sale (note 3)   | 26,450        | 19,950      |
| Accounts receivable, net of allowance for doubtful accounts of \$5,149 at September 30, 2007 and \$4,704 at June 30, 2007 | 166,416       | 167,821     |
| Inventories, net (note 4)   | 167,072       | 157,204     |
| Deferred income taxes   | 46,608        | 42,109      |
| Income taxes receivable   | -             | 7,952       |
| Prepaid expenses and other current assets   | 14,842        | 15,971      |
| <u>Total current assets</u>   | 672,702       | 668,799     |
| Property, plant and equipment, net (note 6)   | 328,079       | 310,580     |
| Goodwill (note 7)   | 216,252       | 206,778     |
| Other intangibles (note 8)  | 47,648        | 46,575      |
| Deferred income taxes   | 12,308        | 9,206       |
| Other assets  | 10,854        | 10,104      |
| Total non-current assets  | 615,141       | 583,243     |
| Total assets  | 1,287,843     | \$1,252,042 |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>  |               |             |
| <u>Current liabilities:</u>   |               |             |
| Accounts payable  | \$48,150      | \$53,039    |
| Accrued expenses  | 78,913        | 98,324      |
| Deferred revenue  | 20,949        | 18,865      |
| Income taxes payable (note 14)  | 7,318         | 3,410       |
| Deferred income taxes   | 436           | 415         |
| Current portion of long-term debt (note 9)  | 25,375        | 28,350      |
| Total current liabilities   | 181,141       | 202,403     |
| <u>Non-current liabilities:</u>   |               |             |
| Income taxes payable (note 14)  | 3,951         | -           |
| Deferred income taxes   | 16,682        | 18,297      |
| Deferred revenue  | 13,544        | 12,472      |
| Long-term debt (note 9)   | 90,540        | 87,648      |

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|   |                    |                    |
|---|--------------------|--------------------|
| Total non-current liabilities   | 124,717            | 118,417            |
| <b>Total liabilities</b>  | <b>305,858</b>     | <b>320,820</b>     |
| Commitments and contingencies (notes 12 and 13)   |                    | -                  |
| <u>Stockholders' equity:</u>  |                    |                    |
| Preferred stock, \$0.01 par value, 2,000,000 shares authorized; none issued   |                    | -                  |
| Common stock, \$0.004 par value, 200,000,000 shares authorized; issued and outstanding 77,485,735 at September 30, 2007 and 77,617,450 at June 30, 2007 (excluding 2,717,518 and 2,304,918 shares held as Treasury Stock, respectively) | 310                | 311                |
| Additional paid-in capital  | 432,875            | 421,701            |
| Retained earnings   | 462,165            | 436,954            |
| Treasury stock, at cost   | (59,998)           | (43,497)           |
| Accumulated other comprehensive income (note 5)   | 146,633            | 115,753            |
| <b>Total stockholders' equity</b>   | <b>981,985</b>     | <b>931,222</b>     |
| <b>Total liabilities and stockholders' equity</b>   | <b>\$1,287,843</b> | <b>\$1,252,042</b> |

See the accompanying notes to the unaudited condensed consolidated financial statements.

**RESMED INC. AND SUBSIDIARIES**

## Condensed Consolidated Statements of Income (Unaudited)

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

|  | Three Months Ended September 30, |           |
|--|----------------------------------|-----------|
|  | 2007                             | 2006      |
| Net revenues   | \$185,740                        | \$163,605 |
| Cost of sales <sup>(A)</sup>                                       | 73,963                           | 62,309    |
| Gross profit   | 111,777                          | 101,296   |
| Operating expenses:  |                                  |           |
| Selling, general and administrative <sup>(A)</sup>                 | 62,882                           | 53,444    |
| Research and development <sup>(A)</sup>                            | 13,013                           | 10,855    |
| Amortization of acquired intangible assets                         | 1,821                            | 1,681     |
| Restructuring expenses (note 10)                                   | 2,297                            | -         |
| Total operating expenses   | 80,013                           | 65,980    |
| Income from operations   | 31,764                           | 35,316    |
| Other income (expense), net:                                       |                                  |           |
| Interest income (expense), net                                     | 2,314                            | 1,497     |
| Other, net   | (266)                            | (574)     |
| Total other income (expense), net                                  | 2,048                            | 923       |
| Income before income taxes   | 33,812                           | 36,239    |
| Income taxes   | 9,687                            | 11,240    |
| Net income   | \$24,125                         | \$24,999  |
| Basic earnings per share   | \$0.31                           | \$0.33    |
| Diluted earnings per share (note 2-j)                              | \$0.31                           | \$0.32    |
| Basic shares outstanding (000 s)                                   | 77,569                           | 75,897    |
| Diluted shares outstanding (000 s)                                 | 78,941                           | 78,056    |
| <sup>(A)</sup> Includes stock-based compensation costs as follows: |                                  |           |
| Cost of sales  | \$257                            | \$306     |
| Selling, general and administrative                                | 3,842                            | 2,870     |
| Research and development   | 447                              | 448       |
| Total stock-based compensation costs                               | \$4,546                          | \$3,624   |

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See the accompanying notes to the unaudited condensed consolidated financial statements.

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**RESMED INC. AND SUBSIDIARIES**

## Condensed Consolidated Statements of Cash Flows (Unaudited)

(in US\$ thousands)

|  | Three Months Ended |                 |
|--|--------------------|-----------------|
|  | September 30,      |                 |
|  | 2007               | 2006            |
| <b>Cash flows from operating activities:</b>   |                    |                 |
| Net income   | \$24,125           | \$24,999        |
| <b>Adjustments to reconcile net income to net cash provided by operating activities:</b> |                    |                 |
| Depreciation and amortization  | 14,291             | 10,626          |
| Stock-based compensation costs   | 4,546              | 3,624           |
| Amortization of deferred borrowing costs   | 99                 | 81              |
| Provision for warranties   | 430                | 577             |
| Foreign currency options revaluation   | (776)              | 653             |
| Tax benefit from stock option exercises  | (1,057)            | (1,546)         |
| <b>Changes in operating assets and liabilities, net of effect of acquisitions:</b>       |                    |                 |
| Accounts receivable, net   | 3,872              | 7,218           |
| Inventories, net   | (4,243)            | (5,188)         |
| Prepaid expenses, deferred income taxes and other current assets                         | (896)              | (6,396)         |
| Accounts payable, accrued expenses and other liabilities                                 | (12,263)           | (8,516)         |
| <b>Net cash provided by operating activities</b>   | <b>28,128</b>      | <b>26,132</b>   |
| <b>Cash flows from investing activities:</b>   |                    |                 |
| Purchases of property, plant and equipment   | (18,367)           | (28,146)        |
| Capitalized interest   | (194)              | (351)           |
| Patent registration costs  | (1,284)            | (761)           |
| Purchases of non-trading investments   | (432)              | (631)           |
| Cash paid for acquisitions, including acquisition costs                                  | -                  | (323)           |
| Purchases of marketable securities available-for-sale                                    | (6,500)            | (20,000)        |
| <b>Net cash used in investing activities</b>   | <b>(26,777)</b>    | <b>(50,212)</b> |
| <b>Cash flows provided by financing activities:</b>                                      |                    |                 |
| Proceeds from issuance of common stock, net  | 5,617              | 4,354           |
| Tax benefit from stock option exercises  | 1,057              | 1,546           |
| Purchases of treasury stock  | (16,501)           | -               |
| Repayment of borrowings  | (5,108)            | -               |
| <b>Net cash provided by financing activities</b>   | <b>(14,935)</b>    | <b>5,900</b>    |



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|  |           |           |
|--|-----------|-----------|
| Effect of exchange rate changes on cash                | 7,106     | (209)     |
| Net decrease in cash and cash equivalents              | (6,478)   | (18,389)  |
| Cash and cash equivalents at beginning of period       | 257,792   | 219,544   |
| Cash and cash equivalents at end of period             | \$251,314 | \$201,155 |
| Supplemental disclosure of cash flow information:      |           |           |
| Income taxes paid                                      | \$1,198   | \$13,007  |
| Interest paid  | 1,523     | 1,429     |
| Fair value of assets acquired in acquisition           | \$        | \$-       |
| Liabilities assumed                                    | -         | -         |
| Goodwill on acquisition                                | -         | -         |
| Net acquisition costs paid                             | -         | 323       |
| Cash paid for acquisition, including acquisition costs | \$-       | \$323     |

See the accompanying notes to the unaudited condensed consolidated financial statements.

**RESMED INC. AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements****(unaudited)****(1) Organization and Basis of Presentation**

ResMed Inc. is a Delaware corporation formed in March 1994 as a holding company for the ResMed Group. Unless otherwise stated in this 10-Q, the terms we, us, our and the Company refer to ResMed Inc. and its subsidiaries, consolidated basis. 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, France and the United States of America. Major distribution and sales sites are located in the United States of America, 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 United States of America 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 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 three months ended September 30, 2007 are not necessarily indicative of the results that may be expected for the year ending June 30, 2008.

The condensed consolidated financial statements for the three months ended September 30, 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, 2007.

**(2) Summary of Significant Accounting Policies****(a) Basis of Consolidation**

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

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

**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 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 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. 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.

**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 ended September 30, 2007 and 2006, we capitalized \$0.2 million 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 during the final quarter of fiscal 2007. 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.

**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, 2007.

**(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 No. 128, Earnings per Share (SFAS 128), as amended by SFAS No. 123(R). SFAS 128 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 stockholders 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.

## 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 77,569,000 and 75,897,000 for the three months ended September 30, 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. Stock options had the effect of increasing the number of shares used in the calculation (by application of the treasury stock method) by 1,372,000 and 2,159,000 for the three months ended September 30, 2007 and 2006, respectively.

Stock options of 492,000 and 250,000 for the three months ended September 30, 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 three months ended September 30, 2007 and 2006 are calculated as follows (in thousands except per share data):

|  | Three Months Ended<br>September 30, |          |
|--|-------------------------------------|----------|
|  | 2007                                | 2006     |
| <b>Numerator:</b>  |                                     |          |
| Net Income, used in calculating diluted earnings per share | \$24,125                            | \$24,999 |
| <b>Denominator:</b>  |                                     |          |
| Basic weighted-average common shares outstanding           | 77,569                              | 75,897   |
| <b>Effect of dilutive securities:</b>                      |                                     |          |



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|                                 |        |        |
|---------------------------------|--------|--------|
| Stock options                   | 1,372  | 2,159  |
| Diluted potential common shares | 1,372  | 2,159  |
| Diluted weighted average shares | 78,941 | 78,056 |
| Basic earnings per share        | \$0.31 | \$0.33 |
| Diluted earnings per share      | \$0.31 | \$0.32 |

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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 Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities*. The foreign currency derivatives portfolio is recorded in the condensed consolidated balance sheets 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 of foreign exchange options at September 30, 2007 and June 30, 2007 was \$4.5 million and \$3.8 million, respectively, which represents the positive fair value of options held by us and are included in other assets on the condensed consolidated balance sheets.

We held foreign currency option contracts with notional amounts totaling \$147.9 million and \$139.3 million at September 30, 2007 and June 30, 2007, respectively, to hedge foreign currency items. These contracts mature at

various dates prior to June 2009.

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**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 re-evaluates 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 September 30, 2007 and June 30, 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 September 30, 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 is included in accrued expenses in our condensed consolidated balance sheets. Changes in the liability for product warranty for the three months ended September 30, 2007 are as follows (in thousands):

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|   |         |
|---|---------|
| Balance at July 1, 2007   | \$7,040 |
| Warranty accruals for the three months ended September 30, 2007       | 1,226   |
| Warranty costs incurred for the three months ended September 30, 2007 | (796)   |
| Foreign currency translation adjustments                              | 330     |
| Balance at September 30, 2007   | \$7,800 |

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**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 which the carrying amount of the assets exceeds 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 September 30, 2007 and June 30, 2007 was \$4.8 million and \$4.6 million, respectively. We review the carrying value of these investments at each balance sheet date. At September 30, 2007, we performed an analysis of the carrying value of these investments and an unrealized loss of \$1.9 million was identified in relation to an investment in a publicly listed company. The severity of the impairment (fair value is approximately 56% less than the cost) and the duration of the impairment (less than 21 months) correlate with a devaluation in the actual share price. We performed an analysis in accordance with EITF 03-01, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*, and do not consider this investment to be other-than-temporarily impaired at September 30, 2007 as we have the intent and ability to hold the investment for a period of time sufficient for a forecasted recovery of fair value up to the cost of the investment. Except for this unrealized loss, we have determined that the fair values of our other investments exceeded their carrying values.

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

We have granted stock options to personnel, including officers and directors, under our 2006 Incentive Award Plan, as amended (the 2006 Plan ). These options have expiration dates of seven years from the date of grant and vest over 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 under our employee stock purchase plan ( ESPP ).

## 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, 2005, we adopted SFAS No.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 No.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 No.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 our stock option 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<br>September 30, |            |
|--|-------------------------------------|------------|
|  | 2007                                | 2006       |
| Stock options:                           |                                     |            |
| Weighted average grant date fair value   | \$13.60                             | \$16.92    |
| Weighted average risk-free interest rate | 4.2 - 4.6%                          | 4.7 - 5.1% |
| Expected option life in years            | 4.03 - 4.68                         | 4.3 - 5.2  |
| Expected volatility                      | 27%                                 | 27 - 30%   |
| ESPP purchase rights:                    |                                     |            |
| Weighted average risk-free interest rate | 5.0%                                | 4.9%       |
| Expected option life in years            | 6 months                            | 6 months   |
| Expected volatility                      | 30%                                 | 41%        |

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.





## 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 September 30, 2007 and June 30, 2007 are \$26.5 million and \$20.0 million, 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 September 30, 2007 and June 30, 2007 (in thousands):

|                  | September 30, 2007 | June 30, 2007 |
|------------------|--------------------|---------------|
| Raw materials    | \$67,911           | \$68,911      |
| Work in progress | 2,480              | 1,965         |
| Finished goods   | 96,681             | 86,328        |
|                  | \$167,072          | \$157,204     |

## (5) Comprehensive Income

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

|  | Three months ended    |                       |
|--|-----------------------|-----------------------|
|  | September 30,<br>2007 | September 30,<br>2006 |
| Net income                                   | \$24,125              | \$24,999              |
| Foreign currency translation gains/( losses) | 30,833                | (1,074)               |
| Comprehensive income                         | \$54,958              | \$23,925              |

We do not provide for U.S. income taxes on foreign currency translation adjustments since we do not provide for such taxes on undistributed earnings of foreign subsidiaries.

**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 September 30, 2007 and June 30, 2007 (in thousands):

|  | September 30, 2007 | June 30, 2007 |
|--|--------------------|---------------|
| Machinery and equipment                      | \$69,878           | \$66,093      |
| Computer equipment                           | 79,502             | 73,114        |
| Furniture and fixtures                       | 30,031             | 27,865        |
| Vehicles                                     | 3,230              | 2,985         |
| Clinical, demonstration and rental equipment | 54,502             | 52,128        |
| Leasehold improvements                       | 19,598             | 17,635        |
| Land   | 63,165             | 61,503        |
| Buildings                                    | 159,155            | 152,691       |
| Construction in progress                     | 19,925             | 11,125        |
|  | 498,986            | 465,139       |
| Accumulated depreciation and amortization    | (170,907)          | (154,559)     |
|  | \$328,079          | \$310,580     |

**(7) Goodwill**

Changes in the carrying amount of goodwill for the three months ended September 30, 2007, were as follows (in thousands):

|  |           |
|--|-----------|
| Balance at July 1, 2007                  | \$206,778 |
| Foreign currency translation adjustments | 9,474     |
| Balance at September 30, 2007            | \$216,252 |

**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 September 30, 2007 (in thousands):

|  | September 30, 2007 |
|--|--------------------|
| Developed/core product technology                                  | \$34,986           |
| Accumulated amortization   | (11,821)           |
| Developed/core product technology, net of accumulated amortization | 23,165             |
| Trade names  | 1,856              |
| Accumulated amortization   | (626)              |
| Trade names, net of accumulated amortization                       | 1,230              |
| Customer relationships   | 18,716             |
| Accumulated amortization   | (5,482)            |
| Customer relationships, net of accumulated amortization            | 13,234             |
| Patents  | 25,034             |
| Accumulated amortization   | (15,015)           |
| Patents, net of accumulated amortization                           | 10,019             |
| Other intangibles, net of accumulated amortization                 | \$47,648           |

Intangible assets consist of patents, customer relationships, trade names and 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.

## RESMED INC. AND SUBSIDIARIES

## Notes to Condensed Consolidated Financial Statements

(unaudited)

## (9) Long-term Debt

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

|                                      | September 30, 2007 | June 30, 2007 |
|--------------------------------------|--------------------|---------------|
| Long-term loan                       | \$25,293           | \$28,272      |
| Capital lease                        | 82                 | 78            |
| Current portion of long-term debt    | \$25,375           | \$28,350      |
| Long-term loan                       | \$90,048           | \$87,162      |
| Capital lease                        | 492                | 486           |
| Noncurrent portion of long-term debt | \$90,540           | \$87,648      |

**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, as amended, 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 \$70 million. Payments of principal must be made to reduce the total outstanding principal to \$65 million on March 1, 2008; to \$55 million on March 1, 2009; and the entire outstanding principal amount must be repaid in full before March 1, 2011. 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 September 30, 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 that ResMed Corp., Servo Magnetics Inc. and ResMed EAP Holdings Inc. maintain certain minimum EBITDA and liquidity.

The entire 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 items, failure to make payments when due, the occurrence of a material default in the performance of any covenants in the Loan Agreement or related document or a 35% or more change in control of ResMed Inc., ResMed Corp., Servo Magnetics Inc. or ResMed EAP Holdings Inc. At September 30, 2007, we were in compliance with our debt covenants.



**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 a EUR 50 million five-year term loan facility that refinances all amounts outstanding under a previous 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 SA. 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 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 September 30, 2007, the Tranche A facility loan had an amount outstanding of USD 63.5 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 September 30, 2007, the Tranche B facility loan had an amount outstanding of USD 6.1 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 September 30, 2007, the Tranche C facility loan had an amount outstanding of USD 41.6 million.

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

The loan is secured by a pledge of one hundred percent of the shares of ResMed Inc.'s subsidiary, Saime SAS, 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 SAS.

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.

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, 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. At September 30, 2007, the working capital agreement had an amount outstanding of USD 4.1 million.

**Capital Lease**

As part of the acquisition of Saime SAS, 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 September 30, 2007 are as follows (in thousands):

|                | Total     | Payments Due by Period |          |          |          |         | Thereafter |
|----------------|-----------|------------------------|----------|----------|----------|---------|------------|
|                |           | 2008                   | 2009     | 2010     | 2011     | 2012    |            |
| Long-term Debt | \$115,341 | \$25,293               | \$44,637 | \$17,850 | \$21,420 | \$6,141 | \$         |
| Capital Leases | 574       | 82                     | 82       | 82       | 82       | 82      | 164        |
| Total          | \$115,915 | \$25,375               | \$44,719 | \$17,932 | \$21,502 | \$6,223 | \$164      |



## RESMED INC. AND SUBSIDIARIES

## Notes to Condensed Consolidated Financial Statements

(unaudited)

## (10) Restructuring Expenses

Restructuring expenses incurred during the quarter ended September 30, 2007 were \$2.3 million (\$1.8 million net of tax). Restructuring expenses consisted predominantly of expenses associated with the Company's decision to streamline European management including the closure of part of the European headquarters in Basel, Switzerland and two regional offices in the Netherlands. Total restructuring expenses, including expenses recognized in the quarter ended September 30, 2007, are estimated to be \$2.5 million. This mainly comprises employee termination costs, leasehold improvement write-downs and property lease exit costs. We expect to incur the balance of restructuring expenses over the course of fiscal year 2008. We will continue to monitor the progress of this restructure and adjust our business strategies and personnel accordingly to achieve maximum efficiencies and cost savings.

Following is a summary of the restructuring liabilities related to the restructure of our European operations that were recorded during the quarter ended September 30, 2007 (in thousands):

|                                     | Accrued employee costs | Other accrued costs | Total accrued costs |
|-------------------------------------|------------------------|---------------------|---------------------|
| Balance at July 1, 2007             | \$-                    | \$-                 | \$-                 |
| Restructuring expenses              | 639                    | 1,658               | 2,297               |
| Cash payments and asset write-downs | (255)                  | (1,258)             | (1,513)             |
| Foreign currency translation        | 5                      | 6                   | 11                  |
| Balance at September 30, 2007       | 389                    | 406                 | 795                 |

## (11) Stockholders' Equity

**Stock Options.** We have granted stock options to personnel, including officers and directors, in accordance with the 2006 Plan. These options have expiration dates of seven years from the date of grant and vest over four years. We have granted these options with an exercise price equal to the market value as determined at the date of grant.

The maximum number of shares of our common stock authorized for issuance under the 2006 Plan is 7,800,000 shares. The number of securities remaining available for future issuance under the 2006 Plan at September 30, 2007 is 5,282,482. 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.



## RESMED INC. AND SUBSIDIARIES

## Notes to Condensed Consolidated Financial Statements

(unaudited)

## (11) Stockholders' Equity, Continued

**Stock Options, Continued.** At September 30, 2007, there was \$38.9 million in unrecognized compensation costs, related to unvested stock-based compensation arrangements. This is expected to be recognized over a weighted average period of 2.7 years. The aggregate intrinsic value of the options outstanding and the options exercisable at September 30, 2007 was \$89.1 million and \$79.5 million, respectively. The aggregate intrinsic value of the options exercised during the three months ended September 30, 2007, was \$3.2 million. The total fair value of options that vested during the three months ended September 30, 2007, was \$2.4 million. The following table summarizes option activity during the three months ended September 30, 2007:

|   | Options   | Weighted<br>Average<br>Exercise<br>Price | Weighted<br>Average<br>Remaining<br>Term |
|---|-----------|--|--|
| Outstanding at beginning of period      | 8,406,483 | \$31.43                                  |  |
| Granted                                 | 133,800   | 43.18                                    |  |
| Exercised                               | (277,120) | 20.09                                    |  |
| Forfeited                               | (118,158) | 37.55                                    |  |
| Outstanding at end of period            | 8,145,005 | \$31.92                                  | 6.2 years                                |
| Exercise price range of granted options |           | \$41.43 - 43.42                          |  |
| Options exercisable at end of period    | 3,905,747 | \$22.51                                  | 5.5 years                                |

**Employee Stock Purchase Plan (the ESPP).** The ESPP was approved by our stockholders at the Annual General 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 Board of Directors' Compensation Committee 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 for more than \$25,000 in common stock during any calendar year. On August 21, 2006, the Board of Directors approved a reduction in the number of shares available for grant under the ESPP to 500,000 shares, effective as of November 9, 2006, the date of the shareholder approval of the 2006

Plan. The number of securities remaining available for future issuance under the ESPP at September 30, 2007 is 420,624.

During the three months ended September 30, 2007, we recognized \$0.4 million of stock-based compensation expense associated with the ESPP.

**Common Stock.** On June 6, 2002, the Board of Directors authorized the Company to repurchase up to 8.0 million shares of outstanding common stock. During the three months ended September 30, 2007 and 2006, the Company repurchased 0.4 million and Nil shares, at a cost of \$16.5 million and \$Nil, respectively. At September 30, 2007 we have repurchased a total of 2.7 million shares at a cost of \$60.0 million. Shares that are repurchased are classified as treasury stock pending future use and reduce the number of shares outstanding used in calculating earnings per share.

**RESMED INC. AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements****(unaudited)****(12) 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 consolidated financial statements taken as a whole.

On December 23, 2002, three former contractors of our subsidiary MAP Medizin-Technologie GmbH 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 consolidated financial statements.

During September and October 2004, we began receiving tax assessment notices for the audit of one of our German subsidiaries by the German tax authorities for the years 1996 through 1998. Certain aspects of these assessment notices are being contested and appealed to the German tax authority office. As the outcome of the appeal cannot be predicted with certainty, any tax issues resolved in a manner not consistent with our expectations may require us to adjust our provision for income tax in the period of resolution.

In February 2007, an Australian university commenced legal action in the Federal Court of Australia against us, claiming breach of a license agreement and infringement of certain intellectual property. The university is seeking various types of relief, including an injunction against manufacturing, supplying, offering for sale, selling or exporting certain mask devices, payment of license fees, damages or an account of profits, interest, costs and assignment of certain intellectual property. In October 2007, we filed a defence denying the university's claim, as well as a cross-claim against the university seeking an order for rectification of the contract and alleging the university violated the Australian Trade Practices Act. We do not expect the outcome of this matter to have a material adverse effect on our condensed consolidated financial statements.

**(13) Voluntary Product Recall Expenses**

On April 23, 2007, we initiated a worldwide voluntary recall of approximately 300,000 units 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. We are working 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 was recognized as a charge to cost of sales in the consolidated statement of income during the three months ended March 31, 2007.



## RESMED INC. AND SUBSIDIARIES

## Notes to Condensed Consolidated Financial Statements

(unaudited)

## (13) Voluntary Product Recall Expenses, Continued

At September 30, 2007 we have a remaining liability of \$26.6 million which is accrued in the consolidated balance sheet. 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 temporary contractor expenses directly associated with the recall. Accordingly, should actual product recall costs differ from our estimated costs, material revisions to our estimated product recall accrual may be required. Following is a summary of the liabilities related to the voluntary product recall that were recorded during the quarter ended September 30, 2007 (in thousands):

|                               | Total accrued costs |
|-------------------------------|---------------------|
| Balance at July 1, 2007       | \$45,098            |
| Costs incurred                | (19,546)            |
| Foreign currency translation  | 1,052               |
| Balance at September 30, 2007 | \$26,604            |

## (14) Income Taxes

In June 2006, the FASB issued FIN No. 48, *Accounting for Uncertainty in Income Taxes* an interpretation of FASB Statement No. 109 and subsequently in May 2007 issued FSP FIN 48-1, *Definition of Settlement in FASB Interpretation No. 48 (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*. FIN 48 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 and also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition.

We have adopted the provisions of FIN 48 on July 1, 2007. As a result of the implementation of FIN 48, we recognized an increase of \$1.1 million to the July 1, 2007 retained earnings balance. At the adoption date, our gross unrecognized tax benefits totaled \$3.5 million of which \$0.5 million, if recognized, would affect our effective tax rate. We recognize potential accrued interest and penalties related to unrecognized tax benefits in income tax expense. As of adoption date, we had a liability of \$0.6 million for accrued interest and penalties.

We file numerous consolidated and separate income tax returns in the United States Federal jurisdiction and in many state and foreign jurisdictions. We are no longer subject to US Federal income tax examination for tax years prior to fiscal year 2004, and no longer subject to state income tax examinations for the tax years prior to fiscal year 2003. With few exceptions, including the German tax assessment discussed in Note 12, we are no longer subject to foreign income tax examinations for fiscal years before 2001.

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Within the next 12 months, we anticipate a potential decrease of up to \$0.6 million in the unrecognized tax benefit relating to the timing of certain amortization deductions due to a statute of limitation expiration. This will not have an impact on the effective tax rate other than the potential reduction in accrued interest as any change will be offset by a similar adjustment to our deferred tax balances. We do not anticipate any other significant changes within the next 12 months.

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**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. All statements other than statements regarding historical facts are forward looking statements. The words believe, expect, anticipate, will continue, will, estimate, plan, future and other similar expressions in this report are forward-looking 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 and the development of new markets for our products, such as cardiovascular and stroke markets. 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, 2007 and elsewhere in this report.

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 and various other factors. Should any one or more of these risks or uncertainties materialize, or 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, financial condition and results of operations could be seriously harmed. In that event, the market price for our common stock will likely decline, and you may lose all or part of your investment.

**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 three months ended September 30, 2007. It should be read together with the detail provided in the individual sections below.

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.

We currently employ approximately 2,700 people and market our products in over 68 countries using a network of distributors and our direct sales force. We market our products primarily to home health care dealers and sleep clinics. We attempt to tailor our marketing approach to each national market, based on regional awareness of SDB as a health problem, physician referral patterns, consumer preferences and local reimbursement policies.

Our principal manufacturing facility is located in Sydney, Australia, and we have additional manufacturing facilities in Combs La Ville, France and Chatsworth, California. Our manufacturing operations consist primarily of assembly and testing of our flow generators, masks and accessories. Of the numerous raw materials, parts and components purchased for assembly of our therapeutic and diagnostic sleep disorder products, most are off-the-shelf items available from multiple vendors. We generally manufacture to our internal sales forecasts and fill orders as received.

During the quarter ended September 30, 2007, our net revenue increased by 14% and gross profit increased by 10%, when compared to the quarter ended September 30, 2006. These results were primarily driven by increasing unit sales of our flow generators, masks and accessories including a strong contribution from our new VPAP Adapt SV flow generator and our new Mirage Liberty and Mirage Quattro full-face masks. Diluted earnings per share for the quarter ended September 30, 2007 decreased to \$0.31 per share, down from \$0.32 per share in the quarter ended September 30, 2006. Gross margin was 60% for the quarter ended September 30, 2007 compared to 62% for the same period in fiscal 2006. For the quarter ended September 30, 2007, we recognized acquisition related amortization expenses and stock-based compensation costs of \$1.8 million and \$4.5 million, respectively.



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

Net revenue increased for the three months ended September 30, 2007 to \$185.7 million from \$163.6 million for the three months ended September 30, 2006, an increase of \$22.1 million or 14%. 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 \$6.1 million during the three months ended September 30, 2007.

Net revenue in North and Latin America increased for the quarter ended September 30, 2007 to \$97.7 million from \$89.6 million for the three months ended September 30, 2006, an increase of \$8.1 million or 9%. This growth has been generated by increased public and physician awareness of sleep-disordered breathing together with continued investment in our sales force and marketing initiatives. Recent product releases, in particular the new VPAP Adapt SV flow generator, and our new Mirage Liberty and Mirage Quattro masks have contributed strongly to our sales growth.

Net revenue in international markets for the quarter ended September 30, 2007 increased to \$88.0 million from \$74.0 million compared to quarter ended September 30, 2006, an increase of \$14.0 million or 19%. International sales growth in the quarter ended September 30, 2007 predominantly reflects organic 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 11%.

Revenue from sales of flow generators for the quarter ended September 30, 2007 totaled \$93.8 million, an increase of 14% compared to the quarter ended September 30, 2006, including increases of 12% in North and Latin America and 16% elsewhere. Revenue from sales of mask systems, motors and other accessories totaled \$91.9 million, an increase of 13%, including increases of 7% in North and Latin America and 25% elsewhere, for the quarter ended September 30, 2007, compared to the quarter ended September 30, 2006. We believe these increases primarily reflect growth in the overall sleep-disordered breathing market and contributions from new products.

**Gross Profit**

Gross profit increased for the quarter ended September 30, 2007 to \$111.8 million from \$101.3 million for the quarter ended September 30, 2006, an increase of \$10.5 million or 10%. Gross profit as a percentage of net revenue for the quarter ended September 30, 2007 was 60%, compared to 62% for the quarter ended September 30, 2006. The lower gross margin is primarily due to a reduction in average selling prices and to a lesser extent the impact of higher manufacturing costs in our Australian manufacturing facility resulting from a stronger Australian dollar against the U.S. dollar as the majority of manufacturing labor and overhead costs are incurred in Australia. These impacts were partially offset by a favorable change in product mix as sales of our premium products represented a higher proportion of our sales.

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

Selling, general and administrative expenses increased for the three months ended September 30, 2007 to \$62.9 million from \$53.4 million for the three months ended September 30, 2006, an increase of \$9.4 million or 18%. Stock-based compensation expenses of \$3.8 million and \$2.9 million, have been included within the selling, general and administrative expenses for the three months ended September 30, 2007 and 2006, respectively. Selling, general and administrative expenses, as a percentage of net revenue, were 34% for the three months ended September 30, 2007 compared to 33% for the three months ended September 30, 2006.

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. The increase in selling, general and administrative expenses was also attributable to the appreciation of international currencies against the U.S. dollar, which added approximately \$3.2 million to our expenses for the three months ended September 30, 2007, as reported in U.S. dollars. As a percentage of net revenue, we expect our future selling, general and administrative expenses to continue in the range of 32% to 34%.

**Research and Development Expenses**

Research and development expenses increased for the three months ended September 30, 2007 to \$13.0 million from \$10.9 million for the three months ended September 30, 2006, an increase of \$2.1 million or 20%. Stock-based compensation expenses of \$0.4 million and \$0.4 million, have been included within research and development expenses for the three months ended September 30, 2007 and 2006, respectively. Research and development expenses, as a percentage of net revenue, were 7% for the three months ended September 30, 2007, which is consistent with the three months ended September 30, 2006.

The increase in research and development expenses was 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 the appreciation of international currencies against the US dollar, which added approximately \$1.3 million to our expenses as reported in US dollars. As a percentage of net revenue, we expect our future research and development expense to continue at approximately 7%.

**Amortization of Acquired Intangible Assets**

Amortization of acquired intangible assets for the three months ended September 30, 2007 totaled \$1.8 million as compared to \$1.7 million for the three months ended September 30, 2006 and is related to acquired intangible assets. The increase in amortization expense is mainly attributable to the appreciation of the Euro against the U.S. dollar as the majority of the acquired intangible assets are denominated in Euros.

**RESMED INC. AND SUBSIDIARIES****Management's Discussion and Analysis of Financial Condition and Results of Operations****Restructuring Expenses**

Restructuring expenses incurred during the quarter ended September 30, 2007 were \$2.3 million and \$Nil for the three months ended September 30, 2006. Restructuring expenses consisted of expenses associated with our decision to streamline European management, including the closure of part of the European headquarters in Basel, Switzerland and two regional offices in the Netherlands. Total restructuring expenses, including expenses recognized in the quarter ending September 30, 2007, are estimated to be \$2.5 million. We expect to incur the balance of restructuring expenses over the course of fiscal year 2008.

**Income Taxes**

Our effective income tax rate decreased to approximately 28.6% for the three months ended September 30, 2007 from approximately 31.0% for the three months ended September 30, 2006. The lower tax rate was primarily due to a one-time tax benefit of approximately \$0.7 million relating to a decrease in the German tax rate of approximately 10% and the associated reduction in deferred tax liability. Excluding the impact of this one-time German tax benefit, the effective income tax rate was 30.7% for the three months ended September 30, 2007. We also continue to benefit from the relatively low Australian corporate tax rate of 30% and certain Australian research and development tax benefits because we generate a majority of our taxable income in Australia.

**Other Income (Expense), Net**

Other income (expense), net for the three months ended September 30, 2007 increased to net income of \$2.0 million compared to net income of \$0.9 million for the three months ended September 30, 2006. This was predominantly due to higher interest income on additional cash balances and lower interest expense due to reduction of our long-term debt.

**Net Income**

As a result of the factors above, our net income for the three months ended September 30, 2007 was \$24.1 million or \$0.31 per diluted share compared to net income of \$25.0 million or \$0.32 per diluted share for the three months ended September 30, 2006. The restructure expenses of \$2.3 million (\$1.8 million net of tax) constituted a reduction of \$0.02 per diluted share on an after-tax basis for the three months ended September 30, 2007.

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

As of September 30, 2007 and June 30, 2007, we had cash and cash equivalents and marketable securities available-for-sale of \$277.8 million and \$277.7 million, respectively. Working capital was \$491.6 million and \$466.4 million at September 30, 2007 and June 30, 2007, respectively.

Inventories at September 30, 2007 increased by \$44.1 million or 36% to \$167.1 million compared to September 30, 2006 inventories of \$123.0 million. The percentage increase in inventories was higher than the 14% increase in revenues in the three-month period ended September 30, 2007 as compared to the three-month period ended September 30, 2006, which reflects a build up of inventory necessary to facilitate our recall replacement as well as a general inventory expansion to support the sales growth of our new products including; the VPAP Malibu and Tango flow generators, and the Mirage Liberty and Mirage Quattro masks.

Accounts receivable at September 30, 2007 were \$166.4 million, an increase of \$36.5 million or 28% over the September 30, 2006 accounts receivable balance of \$129.9 million. This increase was higher than the 14% incremental increase in revenues for the three months ended September 30, 2007 and predominantly reflects increased credit terms in response to competitor actions. Accounts receivable days outstanding were 79 days for the quarter ended September 30, 2007, compared to 70 days for the quarter ended September 30, 2006. Our allowance for doubtful accounts as a percentage of total accounts receivable at September 30, 2007 and June 30, 2007 was 3.0% and 2.7%, respectively. The credit quality of our customers remains consistent with our past experience.

During the three months ended September 30, 2007, we generated cash of \$28.1 million from operations. The cash generated from operations included a reduction of \$1.1 million and \$1.5 million for the quarters ended September 30, 2007 and 2006, respectively since tax benefits associated with employee stock options exercised during the quarter are required to be included within cashflows from financing activities in accordance with SFAS 123(R).

Capital expenditures for the three months ended September 30, 2007, and 2006 aggregated \$18.4 million and \$28.1 million, respectively. The capital expenditures for the three months ended September 30, 2007 primarily reflected the construction costs related to the extension of our manufacturing facility in Sydney Australia, construction of our new corporate headquarters in Kearney Mesa, San Diego, computer hardware and software, rental and loan equipment and the 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 \$328.1 million at September 30, 2007 compared to \$310.6 million at June 30, 2007.

During the quarter ended September 30, 2007, we incurred \$4.1 million in construction costs in relation to the extension of our manufacturing facility in Sydney, Australia. To date we have incurred a total of \$11.1 million and estimate we will incur additional construction costs of approximately \$3.5 million to complete the project. We expect to complete this extension during fiscal 2008 and to fund the remaining project through a combination of cash on hand and cash generated from operations.





## 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 San Diego for \$21.0 million. The new location at Kearney Mesa, San Diego will allow us to develop a new corporate headquarters. We commenced construction of our new corporate headquarters during fiscal 2007 and to date have incurred expenditures of \$8.0 million. We estimate additional construction costs of \$88.1 million to complete the project. We expect to complete the project in March 2009 and to fund the project through a combination of cash on hand and our undrawn revolving loan facility of \$70 million.

Details of contractual obligations at September 30, 2007 are as follows:

| In \$000 s  | Total            | Sep 2008        | Sep 2009        | Payments Due by Period |                 |                |              |
|---|------------------|-----------------|-----------------|------------------------|-----------------|----------------|--------------|
|   |                  |                 |                 | Sep 2010               | Sep 2011        | Sep 2012       | Thereafter   |
| Long-Term Debt  | \$115,341        | \$25,293        | \$44,637        | \$17,850               | \$21,420        | \$6,141        | \$-          |
| Operating Leases  | 35,176           | 11,321          | 9,778           | 6,944                  | 4,623           | 2,274          | 236          |
| Capital Leases  | 574              | 82              | 82              | 82                     | 82              | 82             | 164          |
| Unconditional Purchase Obligations                      | 30,530           | 27,468          | 835             | 1,106                  | 1,106           | 15             | -            |
| <b>Total Contractual Cash Obligations<sup>(A)</sup></b> | <b>\$181,621</b> | <b>\$64,164</b> | <b>\$55,332</b> | <b>\$25,982</b>        | <b>\$27,231</b> | <b>\$8,512</b> | <b>\$400</b> |

<sup>(A)</sup> The liabilities related to unrecognized tax benefits of \$3.5 million, as disclosed within Note 14 of the financial statements, are not included in the above contractual obligations because the timing cannot be reliably estimated.

Details of other commercial commitments as at September 30, 2007 are as follows:

| In \$000 s                          | Total           | Sep 2008       | Sep 2009     | Amount of Commitment Expiration Per Period |                 |             |                |
|-------------------------------------|-----------------|----------------|--------------|--|-----------------|-------------|----------------|
|                                     |                 |                |              | Sep 2010                                   | Sep 2011        | Sep 2012    | Thereafter     |
| Standby Letters of Credit           | \$38            | \$38           | \$-          | \$-  | \$-             | \$-         | \$-            |
| Guarantees*                         | 61,441          | 1,064          | 131          | 332  | 57,310          | 23          | 2,581          |
| <b>Total Commercial Commitments</b> | <b>\$61,479</b> | <b>\$1,102</b> | <b>\$131</b> | <b>\$332</b>                               | <b>\$57,310</b> | <b>\$23</b> | <b>\$2,581</b> |

\* The above guarantees relate to guarantees required by statutory authorities as a pre-requisite to developing our site at Norwest and requirements under contractual obligations with insurance companies transacting with our German subsidiaries.

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, as amended, 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 \$70 million. Payments of principal must be made to reduce the total outstanding principal to \$65 million on March 1, 2008; to \$55 million on March 1, 2009; and the entire outstanding principal amount must be repaid in full before March 1, 2011. The Loan Agreement 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 September 30, 2007 there were no amounts outstanding under the Loan Agreement.

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

Tranche A is a EUR 50 million term loan facility that refinances all amounts outstanding under a previous 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 SA). 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 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 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 September 30, 2007, the Tranche A facility loan had an amount outstanding of USD 63.5 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 September 30, 2007, the Tranche B facility loan had an amount outstanding of USD 6.1 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 September 30, 2007, the Tranche C facility loan had an amount outstanding of USD 41.6 million.

**RESMED INC. AND SUBSIDIARIES****Management Discussion and Analysis of Financial Condition and Results of Operations****Long-Term Debt, Continued**

The loan is secured by a pledge of one hundred percent of the shares of ResMed Inc.'s subsidiary, Saime SAS, 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 SAS.

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.

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, 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. At September 30, 2007, the working capital agreement had an amount outstanding of USD 4.1 million.

We expect to satisfy all of our short-term liquidity requirements through a combination of cash on hand, cash generated from operations, our \$70 million undrawn revolving line of credit with Union Bank of California and our \$25.5 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.

**Common Stock.** On June 6, 2002, the Board of Directors authorized the Company to repurchase up to 8.0 million shares of outstanding common stock. During the three months ended September 30 2007, we repurchased 0.4 million shares at a cost of \$16.5 million and since the commencement of our share repurchase program, we have repurchased a total of 2.7 million shares at a cost of \$60.0 million. Shares that are repurchased are classified as treasury stock pending future use and reduce the number of shares outstanding used in calculating earnings per share.



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

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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.

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.



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

(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.

(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. Our products are predominantly therapy-based equipment and require no installation. As such, we have no significant installation obligations.



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

(7) Stock-Based Compensation. In accordance with the modified prospective method of SFAS No. 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 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.

(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, revisions to our estimated product recall accrual may be required.

(9) Income Tax. We have adopted the provisions of Financial Accounting Standards Board (FASB) Interpretation No. 48 Accounting for Uncertainty in Income Taxes An Interpretation of FASB Statement No. 109 ( FIN 48 ) on July 1, 2007. In accordance with FIN 48 we assess our income tax positions and record tax benefits for all years subject to examination based upon management's evaluation of the facts, circumstances, and information available at the reporting date. For those tax positions where it is more likely than not that a tax benefit will be sustained, we have recorded the largest amount of tax benefit with a greater than 50 percent likelihood of being realized upon ultimate settlement with a taxing authority that has full knowledge of all relevant information. For those income tax positions where it is not more likely than not that a tax benefit will be sustained, no tax benefit has been recognized in the financial statements.

**Recently Issued Accounting Pronouncements**

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 February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities ( SFAS No. 159 ). SFAS No. 159 gives us the irrevocable option to carry many financial assets and liabilities at fair values, with changes in fair value recognized in earnings. SFAS No. 159 is effective for us beginning July 1, 2008, although early adoption is permitted. We are currently assessing the potential impact, if any, should we elect the fair value option, that adoption of SFAS No. 159 will have on our financial statements.

**Off-Balance Sheet Arrangements**

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As of September 30, 2007, we are not involved in any off-balance sheet arrangements, as defined in Item 3(a)(4)(ii) of Securities and Exchange Commission ( SEC ) Regulation S-K.

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## RESMED INC. AND SUBSIDIARIES

## Quantitative and Qualitative Disclosures About Market and Business Risk

## Foreign Currency Market Risk

Our reporting currency is the U.S. dollar, although the financial statements of our non-U.S. subsidiaries are maintained in their respective local currencies. 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. The table below provides information in U.S. dollar equivalents on our foreign-currency-denominated financial assets by legal entity functional currency at September 30, 2007 (in thousands):

|   | Foreign Currency Financial Assets |           |           |                        |                    |                     |                       |                  |                |           |
|---|-----------------------------------|-----------|-----------|------------------------|--------------------|---------------------|-----------------------|------------------|----------------|-----------|
|   | Australian                        |           | Euro      | Great Britain<br>Pound | Canadian<br>Dollar | Singapore<br>Dollar | New Zealand<br>Dollar | Swedish<br>Krona | Swiss<br>Franc | Norwegian |
|   | Dollar                            | US Dollar |           |                        |                    |                     |                       |                  |                | Krone     |
| (AUD)                                     | (USD)                             | (EUR)     | (GBP)     | (CAD)                  | (SGD)              | (NZD)               | (SEK)                 | (CHF)            | (NOK)          |           |
| <b>AUD Functional Currency Entities:</b>  |                                   |           |           |                        |                    |                     |                       |                  |                |           |
| Assets                                    | \$ -                              | \$ 90,678 | \$ 99,147 | \$ 17,419              | -                  | \$ 798              | \$ 991                | \$ 621           | \$ 5,352       | \$ 821    |
| Liability                                 | -                                 | (37,670)  | (102,349) | (6,370)                | -                  | (41)                | (113)                 | (4)              | (2,386)        | (355)     |
| Net Total                                 | -                                 | 53,008    | (3,202)   | 11,049                 | -                  | 757                 | 878                   | 617              | 2,966          | 466       |
| <b>USD Functional Currency Entities:</b>  |                                   |           |           |                        |                    |                     |                       |                  |                |           |
| Assets                                    | 62,287                            | -         | -         | -                      | 1,106              | -                   | -                     | -                | -              | -         |
| Liability                                 | -                                 | -         | -         | -                      | -                  | -                   | -                     | -                | -              | -         |
| Net Total                                 | 62,287                            | -         | -         | -                      | 1,106              | -                   | -                     | -                | -              | -         |
| <b>EURO Functional Currency Entities:</b> |                                   |           |           |                        |                    |                     |                       |                  |                |           |
| Assets                                    | -                                 | 1         | -         | -                      | -                  | -                   | -                     | -                | -              | -         |
| Liability                                 | -                                 | (46)      | -         | (974)                  | -                  | -                   | -                     | -                | (14)           | -         |
| Net Total                                 | -                                 | (45)      | -         | (974)                  | -                  | -                   | -                     | -                | (14)           | -         |
| <b>GBP Functional Currency Entities:</b>  |                                   |           |           |                        |                    |                     |                       |                  |                |           |
| Assets                                    | -                                 | 609       | 9,181     | -                      | -                  | -                   | -                     | -                | -              | -         |
| Liability                                 | -                                 | (3)       | (968)     | -                      | -                  | -                   | -                     | -                | (128)          | -         |
| Net Total                                 | -                                 | 606       | 8,213     | -                      | -                  | -                   | -                     | -                | (128)          | -         |
| <b>CHF Functional Currency Entities:</b>  |                                   |           |           |                        |                    |                     |                       |                  |                |           |
| Assets                                    | -                                 | 253       | 14        | 1                      | -                  | -                   | -                     | -                | -              | -         |
| Liability                                 | -                                 | (67)      | (408)     | (71)                   | -                  | -                   | -                     | -                | -              | -         |
| Net Total                                 | -                                 | 186       | (394)     | (70)                   | -                  | -                   | -                     | -                | -              | -         |
| <b>SEK Functional Currency Entities:</b>  |                                   |           |           |                        |                    |                     |                       |                  |                |           |
| Assets                                    | -                                 | -         | -         | -                      | -                  | -                   | -                     | -                | -              | -         |
| Liability                                 | -                                 | (1,269)   | (81)      | (12)                   | -                  | -                   | -                     | -                | -              | (1,352)   |
| Net Total                                 | -                                 | (1,269)   | (81)      | (12)                   | -                  | -                   | -                     | -                | -              | (1,352)   |

## 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 September 30, 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)<br>Foreign Exchange Call Options | FY 2008               | FY 2009              | Total                | Fair Value Assets /(Liabilities) |               |
|---|-----------------------|----------------------|----------------------|----------------------------------|---------------|
|   |                       |                      |                      | Sept 30, 2007                    | June 30, 2007 |
| <b>Receive AUD/Pay USD</b>  |                       |                      |                      |                                  |               |
| Option amount   | \$70,500              | \$60,000             | \$130,500            | \$4,297                          | \$3,558       |
| Ave. contractual exchange rate  | AUD\$1 = USD 0.8255   | AUD\$1 = USD 0.8570  | AUD\$1 = USD 0.8387  |                                  |               |
| <b>Receive AUD/Pay Euro</b>   |                       |                      |                      |                                  |               |
| Option amount   | \$8,568               | \$4,284              | \$12,852             | \$103                            | \$209         |
| Ave. contractual exchange rate  | AUD \$1 = Euro 0.6418 | AUD\$1 = Euro 0.6629 | AUD\$1 = Euro 0.6487 |                                  |               |
| <b>Receive AUD/Pay GBP</b>  |                       |                      |                      |                                  |               |
| Option amount   | \$4,606               | -                    | \$4,606              | \$137                            | \$82          |
| Ave. contractual exchange rate  | AUD \$1 = GBP 0.4270  | -                    | AUD \$1 = GBP 0.4270 |                                  |               |

**RESMED INC. AND SUBSIDIARIES**

**Quantitative and Qualitative Disclosures About Market and Business Risk**

**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 September 30, 2007, we maintain 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 September 30, 2007, we had total long-term debt, including the current portion of those obligations, of \$115.9 million. Of this debt, \$115.3 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 September 30, 2007, would not have had a material impact on pretax income. We have no interest rate hedging agreements.

**RESMED INC. AND SUBSIDIARIES****Controls and Procedures**

We maintain disclosure controls and procedures 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 SEC Rule 13a-15(b), 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 the end of the period covered by this report. 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.

There has been no change in our internal controls over financial reporting during our most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal controls over financial reporting.

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

Refer to Note 12 to the Condensed Consolidated Financial Statements

**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, 2007, which was filed with the Securities and Exchange Commission and describes the various risks and uncertainties to which we are or may become subject. At September 30, 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, 2007.

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

Purchases of equity securities. The following table summarizes purchases by us of our common stock during the three months ended September 30, 2007:

| Period                                   | Total Number<br>of Shares | Average Price<br>Paid per Share | Total Number of<br>Shares Purchased as<br>Part of Publicly<br>Announced Plans or<br>Programs <sup>(1)</sup> | Maximum Number<br>of Shares that May<br>Yet Be Purchased<br>Under the Plans or<br>Programs <sup>(1)</sup> |
|--|---------------------------|---------------------------------|---|---|
| Opening balance at July 1, 2007          | 2,304,918                 | \$18.87                         | 2,304,918   | 5,695,082   |
| July 2007                                | Nil                       | -                               | -   | -   |
| August 2007                              | Nil                       | -                               | -   | -   |
| September 2007                           | 412,600                   | \$40.01                         | 412,600   | (412,600)   |
| Closing balance at<br>September 30, 2007 | 2,717,518                 | \$22.08                         | 2,717,518   | 5,282,482   |

<sup>(1)</sup> On June 6, 2002, the Board of Directors authorized us to repurchase up to 8.0 million shares of our outstanding common stock. For the three months ended September 30, 2007 and 2006, we repurchased 412,600 and Nil shares at a cost of \$15.6 million and \$Nil, respectively. Since the inception of the share buyback program, we have repurchased 2,717,518 shares at a cost of \$60.0 million.

**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**

- 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



**RESMED INC. AND SUBSIDIARIES**

**Signatures**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

November 6, 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