

SONOSITE INC
Form 10-Q
May 04, 2009

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

☒ Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.
For the quarterly period ended March 31, 2009

OR

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

Commission file number 0-23791

SONOSITE, INC.
(Exact name of registrant as specified in its charter)

Washington
(State or Other Jurisdiction
of Incorporation or Organization)

91-140502
(I.R.S. Employer
Identification Number)

21919 30th Drive SE, Bothell, WA
(Address of Principal Executive Offices)

98021-39
(Zip Code)

(425) 951-1200
(Registrant's Telephone Number, Including Area Code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Large accelerated filer ☐ Accelerated filer ☒ Non-accelerated filer ☐ Smaller reporting company ☐

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

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Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common Stock, \$0.01 par value
(Class)

17,131,656
(Outstanding as of April 20, 2009)

SonoSite, Inc.
Quarterly Report on Form 10-Q
For the Quarter Ended March 31, 2009
Table of Contents

| | Page No. |
|------------------|---|
| PART I | <u>FINANCIAL INFORMATION</u> |
| Item 1. | <u>Financial Statements (unaudited)</u> |
| | <u>Condensed Consolidated Balance Sheets – March 31, 2009 and 3 December 31, 2008</u> |
| | <u>Condensed Consolidated Statements of Income – Three Months 4 Ended March 31, 2009 and 2008</u> |
| | <u>Condensed Consolidated Statements of Cash Flows – Three 5 Months Ended March 31, 2009 and 2008</u> |
| | <u>Notes to Condensed Consolidated Financial Statements 6</u> |
| Item 2. | <u>Management’s Discussion and Analysis of Financial Condition 16 and Results of Operations</u> |
| Item 3. | <u>Quantitative and Qualitative Disclosures about Market Risk 20</u> |
| Item 4. | <u>Controls and Procedures 22</u> |
| PART II | <u>OTHER INFORMATION</u> |
| Item 1. | <u>Legal Proceedings 22</u> |
| Item 4. | <u>Submission of Matters to a Vote of Security Holders 23</u> |
| Item 6. | <u>Exhibits 24</u> |
| <u>SIGNATURE</u> | 25 |

Table of Contents

PART I: FINANCIAL INFORMATION

Item 1. Financial Statements

SonoSite, Inc.
Condensed Consolidated Balance Sheets
(unaudited)

(In thousands, except share data)

| | March 31, 2009 | December 31, 2008 As Adjusted |
|---|-------------------|-------------------------------------|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 198,119 | \$ 209,258 |
| Short-term investment securities | 58,945 | 69,882 |
| Accounts receivable, less allowances of \$1,962 and \$2,190 | 59,989 | 66,094 |
| Inventories | 29,386 | 29,115 |
| Deferred income taxes, current | 12,832 | 13,372 |
| Prepaid expenses and other current assets | 6,748 | 6,623 |
| Total current assets | 366,019 | 394,344 |
| Property and equipment, net | 9,029 | 8,955 |
| Investment securities | 1,050 | 578 |
| Goodwill | 3,821 | 3,767 |
| Deferred income taxes | 304 | 793 |
| Identifiable intangible assets, net | 13,002 | 13,062 |
| Other assets | 4,524 | 5,383 |
| Total assets | \$ 397,749 | \$ 426,882 |
| Liabilities and Shareholders' Equity | | |
| Current liabilities: | | |
| Accounts payable | \$ 7,474 | \$ 6,189 |
| Accrued expenses | 20,340 | 31,921 |
| Deferred revenue, current portion | 2,624 | 2,755 |
| Total current liabilities | 30,438 | 40,865 |
| Long-term debt, net | 93,212 | 111,336 |
| Deferred tax liability, net | 7,066 | 9,871 |
| Other non-current liabilities | 13,639 | 13,750 |
| Total liabilities | 144,355 | 175,822 |
| Commitments and contingencies | | |
| Shareholders' equity: | | |
| Preferred stock, \$1.00 par value | | |
| Authorized shares--6,000,000 | | |
| Issued and outstanding shares--none | -- | -- |
| Common stock, \$.01 par value | | |
| Authorized shares--50,000,000 | | |
| Issued and outstanding shares: | | |
| As of March 31, 2009—17,121,384 | 172 | |
| As of December 31, 2008—17,054,697 | | 171 |
| Additional paid-in-capital | 287,292 | 285,757 |

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| | | |
|--|-----------|------------|
| Accumulated deficit | (35,173) | (36,036) |
| Accumulated other comprehensive income | 1,103 | 1,168 |
| Total shareholders' equity | 253,394 | 251,060 |
| Total liabilities and shareholders' equity | \$397,749 | \$ 426,882 |

See accompanying notes to condensed consolidated financial statements.

Table of Contents

SonoSite, Inc.
Condensed Consolidated Statements of Income
(unaudited)

(In thousands, except per share amounts)

| | Three Months Ended March 31, 2008 | |
|--|---|-------------|
| | 2009 | As Adjusted |
| Revenue | \$ 51,805 | \$ 52,499 |
| Cost of revenue | 16,713 | 14,659 |
| Gross margin | 35,092 | 37,840 |
| Operating expenses: | | |
| Research and development | 7,697 | 6,197 |
| Sales, general and administrative | 25,803 | 29,249 |
| Total operating expenses | 33,500 | 35,446 |
| Other income (loss) | | |
| Interest income | 949 | 2,826 |
| Interest expense | (2,594) | (4,262) |
| Other | 1,441 | (615) |
| Total other loss, net | (204) | (2,051) |
| Income before income taxes | 1,388 | 343 |
| Income tax provision | 525 | 153 |
| Net income | \$ 863 | \$ 190 |
| Net income per share: | | |
| Basic | \$ 0.05 | \$ 0.01 |
| Diluted | \$ 0.05 | \$ 0.01 |
| Weighted average common and potential common shares outstanding: | | |
| Basic | 17,080 | 16,770 |
| Diluted | 17,532 | 17,406 |

See accompanying notes to condensed consolidated financial statements

Table of Contents

SonoSite, Inc.
Condensed Consolidated Statements of Cash Flows
(unaudited)

| | Three Months Ended March 31, | |
|---|---------------------------------|---------------------|
| (In thousands) | 2009 | 2008 As Adjusted |
| Operating activities: | | |
| Net income | \$ 863 | \$ 190 |
| Adjustments to reconcile net income to net cash (used in) provided by operating activities: | | |
| Depreciation and amortization | 1,046 | 1,064 |
| Stock-based compensation | 2,493 | 1,879 |
| Deferred income tax provision | 1,459 | 343 |
| Amortization of net discounts on investment securities | (145) | (598) |
| Amortization of debt discount and debt issuance costs | 1,340 | 2,170 |
| Accretion of contingent purchase consideration | 240 | 225 |
| Excess tax benefit from exercise of stock based awards | -- | (234) |
| Net (gain) loss on investments | (2) | 5 |
| Gain on convertible note repurchase | (1,339) | -- |
| Investment other-than-temporary impairment | 4 | 148 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | 4,736 | 9,047 |
| Inventories | (628) | (2,870) |
| Prepaid expenses and other assets | (319) | 3,435 |
| Accounts payable | 1,305 | (3,048) |
| Accrued expenses | (11,633) | (4,508) |
| Deferred liabilities | (294) | 86 |
| Net cash (used in) provided by operating activities | (874) | 7,334 |
| Investing activities: | | |
| Purchases of investment securities | (35,449) | (124,913) |
| Proceeds from sales/maturities of investment securities | 45,881 | 102,592 |
| Purchases of property and equipment | (1,092) | (355) |
| Earn-out consideration associated with SonoMetric acquisition | (387) | (921) |
| Net cash provided by (used in) investing activities | 8,953 | (23,597) |
| Financing activities: | | |
| Excess tax benefit from stock-based awards | -- | 234 |
| Minimum tax withholdings on stock-based awards | (562) | -- |
| Proceeds from exercise of stock-based awards | 53 | 451 |
| Repurchase of convertible senior notes | (20,500) | -- |
| Proceeds from sale of call options | 1,409 | -- |
| Repurchase of warrants | (1,325) | -- |
| Net cash (used in) provided by financing activities | (20,925) | 685 |
| Effect of exchange rate changes on cash and cash equivalents | 1,707 | (1,266) |
| Net change in cash and cash equivalents | (11,139) | (16,844) |
| Cash and cash equivalents at beginning of period | 209,258 | 188,701 |

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| | | |
|---|------------|------------|
| Cash and cash equivalents at end of period | \$ 198,119 | \$ 171,857 |
| Supplemental disclosure of cash flow information: | | |
| Cash paid for income taxes | \$ 1,643 | \$ 403 |
| Cash paid for interest | \$ 2,805 | \$ 4,195 |

See accompanying notes to condensed consolidated financial statements.

Table of Contents

SonoSite, Inc.
Notes to Condensed Consolidated Financial Statements
(unaudited)

Interim Financial Information

Basis of Presentation

The information contained herein has been prepared in accordance with instructions for Form 10-Q and Article 10 of Regulation S-X. The information reflects, in the opinion of SonoSite, Inc. management, all adjustments necessary (which are of a normal and recurring nature) for a fair presentation of the results for the interim periods presented. The results of operations for the three months ended March 31, 2009 are not necessarily indicative of expected results for the entire year ending December 31, 2009 or for any other fiscal period. These financial statements do not include all disclosures required by generally accepted accounting principles. For a presentation including all disclosures required by generally accepted accounting principles, these financial statements should be read in conjunction with the audited financial statements for the year ended December 31, 2008, included in our Annual Report on Form 10-K.

Adjustment of prior period balances

Certain amounts reported in comparable prior periods have been adjusted due to the adoption of Financial Accounting Standards Board Staff Position (FSP) No. APB 14-1, "Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)" ("APB 14-1") on January 1, 2009. For additional detail on the adjusted balances, refer to the Change in Accounting Principle footnote.

Inventories

Inventories are stated at the lower of cost or market, on a first-in, first-out method. Included in our inventories balance are demonstration products used by our sales representatives and marketing department. Adjustments to reduce carrying costs are recorded for obsolete material, shrinkage, earlier generation products and used or refurbished products held either as saleable inventory or as demonstration product. If market conditions change or if the introduction of new products by us impacts the market for our previously released products, we may be required to further write down the carrying cost of our inventories.

Inventories consisted of the following (in thousands):

| | March 31, 2009 | As of December 31, 2008 |
|-------------------------|-------------------|----------------------------------|
| Raw material | \$ 10,578 | \$ 10,007 |
| Demonstration inventory | 8,534 | 8,198 |
| Finished goods | 10,274 | 10,910 |
| Total | \$ 29,386 | \$ 29,115 |

Warranty expense

We accrue estimated warranty expense at the time of sale for costs expected to be incurred under our product warranties. This provision for warranty expense is made based upon our historical product failure rates and service repair costs using management's judgment.

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The warranty liability is summarized as follows (in thousands):

| | Beginning of Period | Charged to Cost of Revenue | Applied to Liability | End of Period |
|-----------------------------------|------------------------|----------------------------------|-------------------------|------------------|
| Three months ended March 31, 2009 | \$ 7,094 | \$ 997 | \$ (605) | \$ 7,486 |
| Three months ended March 31, 2008 | \$ 4,045 | \$ 642 | \$ (321) | \$ 4,366 |

Table of Contents

Income taxes

The income tax provision for the three months ended March 31, 2009 is based on projections of total year pre-tax income and the projected total year tax provision. Deferred income taxes are provided based on the estimated future tax effects of temporary differences between financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates that are expected to apply to taxable income in the years in which those temporary differences and carryforwards are expected to be recovered or settled. The decrease in our consolidated effective tax rate for the three months ended March 31, 2009, as compared to 2008, results primarily from the reinstatement of the U.S. research and development tax credit in late 2008 and our qualification for the domestic production activities tax deduction.

Net income per share

Basic net income per share is based on the weighted average number of common shares outstanding during the period. Diluted net income per share is based on the weighted average number of common and dilutive common equivalent shares outstanding during the period. Potentially dilutive common equivalent shares consist of common stock issuable upon exercise of stock options and warrants, or upon vesting of restricted stock units using the treasury stock method. Diluted net income per share would also be impacted to reflect shares issuable upon conversion of our convertible senior notes if our share price exceeds \$38.20 per share. Our call option on our shares is anti-dilutive and, therefore, excluded from the calculation of diluted net income per share.

The following is a reconciliation of the numerator and denominator of the basic and diluted net income per share calculations (in thousands, except per share amounts):

| | Three Months Ended March 31, | |
|---|---------------------------------|---------|
| | 2009 | 2008 |
| Net income | \$ 863 | \$ 190 |
| Weighted average common shares outstanding used in computing basic net income per share | 17,080 | 16,770 |
| Effect of dilutive stock options and restricted stock units | 452 | 636 |
| Weighted average common shares outstanding used in computing diluted net income per share | 17,532 | 17,406 |
| Net income per share: | | |
| Basic | \$ 0.05 | \$ 0.01 |
| Diluted | \$ 0.05 | \$ 0.01 |

The following common shares were excluded from the computation of diluted net income per share as their effect would have been anti-dilutive (in thousands):

| | Three Months Ended March 31, | |
|--|---------------------------------|-------|
| | 2009 | 2008 |
| Stock options and restricted stock units | 1,475 | 434 |
| Warrants outstanding | 1,184 | 2,500 |
| Total common shares excluded from diluted net income per share | 2,659 | 2,934 |

Table of Contents

The computation of diluted net income per share does not include any potential dilutive common shares associated with our convertible senior notes. The convertible senior notes would become dilutive and included in the calculation of diluted net income per share, for the number of shares that would be required to satisfy the conversion spread, if the average market price of our common stock exceeds \$38.20 per share.

Accumulated other comprehensive income

Unrealized gains or losses on our available-for-sale securities that are considered temporary and foreign currency translation adjustments are included in accumulated other comprehensive income.

The following presents the components of comprehensive income (in thousands):

| | Three Months Ended March 31, | |
|---|---------------------------------|--------|
| | 2009 | 2008 |
| Net income | \$ 863 | \$ 190 |
| Other comprehensive income: | | |
| Foreign currency translation adjustment | 102 | 326 |
| Unrealized holding (loss) gain, net | (167) | 111 |
| Comprehensive income | \$ 798 | \$ 627 |

Indemnification Obligations and Guarantees (excluding product warranty)

We provide (i) indemnifications of varying scope and size to our customers and distributors against claims of intellectual property infringement made by third parties arising from the use of our products; (ii) indemnifications of varying scope and size to our customers against third party claims arising as a result of defects in our products; (iii) indemnifications of varying scope and size to consultants against third party claims arising from the services they provide to us; and (iv) guarantees to support obligations of some of our subsidiaries such as lease payments.

To date, we have not incurred material costs as a result of these obligations and do not expect to incur material costs in the future. Accordingly, we have not accrued any liabilities in our financial statements related to these indemnifications or guarantees.

Table of Contents

Fair value measurements

The following table presents the assets and liabilities measured or disclosed at fair value on a recurring basis at March 31, 2009 (in thousands):

| | Fair Value Measurements | | | |
|-----------------------|-------------------------|---|---|---|
| | Total Carrying Value | Quoted Prices in Active Markets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Investment securities | \$ 59,995 | \$ 58,005 | \$ -- | \$ 1,990 |
| Long-term debt | \$ 93,212 | \$ 102,382 | \$ -- | \$ -- |

Investment securities are measured at fair value using quoted market prices, with the exception of our investment in the Columbia Strategic Cash Portfolio, which is in the process of liquidation. This investment is measured at estimated fair value, which is the net asset value of the portfolio provided by the portfolio manager. The portfolio manager has measured fair value based upon quoted market prices and quoted prices of comparable securities, as well as good faith estimates. Long-term debt is measured at fair value for disclosure only using quoted market prices. There were no changes to the valuation techniques during the three months ended March 31, 2009. The carrying value of long-term debt was reduced as the result of the adoption of APB 14-1. See Change in Accounting Principle for additional information.

We perform impairment tests on certain assets, including goodwill and intangible assets at fair value on a nonrecurring basis annually in the fourth quarter or if and when a triggering event occurs. If there is an impairment, these assets would be measured at fair value. For the period ended March 31, 2009, there were no impairments recorded for goodwill and intangible assets.

The following table summarizes the activity of our level 3 investment securities (in thousands):

| | Three Months Ended March 31, | |
|--|------------------------------|-----------|
| | 2009 | 2008 |
| Balance, at beginning of period | \$ 2,765 | \$ 12,574 |
| Total gain (loss) (realized or unrealized) included in: | | |
| Other income (loss) | (4) | (153) |
| Other comprehensive income | 21 | -- |
| Sales and settlements | (792) | (4,232) |
| Balance, at end of period | \$ 1,990 | \$ 8,189 |
| Losses included in other income (loss) attributable to the change in unrealized losses relating to assets still held | \$ (4) | \$ (148) |

Change in Accounting Principle

Effective January 1, 2009, we adopted APB 14-1, which clarifies the accounting for convertible debt instruments that may be settled in cash (including partial cash settlement) upon conversion. APB 14-1 requires issuers to account separately for the liability and equity components of certain convertible debt instruments in a manner that reflects the issuer's nonconvertible debt borrowing rate when interest cost is recognized. APB 14-1 requires bifurcation of a

component of the conversion option, classification of that component in equity and the accretion of the resulting discount on the debt to be recognized as part of interest expense in our consolidated statement of income. APB 14-1 requires retrospective application to the terms of instruments as they existed for all periods presented. Our debt offering completed in July 2007 of \$225.0 million aggregate principal amount of 3.75% convertible senior notes ("Notes") falls within the scope of APB 14-1.

Table of Contents

Upon issuance of the Notes and prior to the adoption of APB 14-1, we evaluated the Notes using the “Working Draft of AICPA Technical Practice Aid” (“Technical Practice Aid”) prepared by the Convertible Debt, Convertible Preferred Shares, Warrants, and Other Equity-Related Financial Instruments Task Force to consider whether the conversion option on the Notes met the criteria to preclude recognition as a debt discount. We concluded the conversion feature should be equity classified and not recorded as a standalone derivative, and thus the conversion feature was exempt from bifurcation. Debt issuance costs of \$7.5 million were being amortized to interest expense over the term of the Notes.

Upon adoption of APB 14-1, we were required to bifurcate a component of the conversion option. We calculated the fair value of the liability component of the Notes using a discount rate of similar liabilities without conversion features and determined the carrying amount of the equity component by deducting the fair value of the liability component from the initial carrying value of the convertible debt. This resulted in an initial recognition of \$63.9 million of debt discount, to be amortized over a seven year period at an effective interest rate of 8.5%, and a corresponding deferred tax liability of \$23.6 million. Additionally, \$2.1 million of debt issuance costs, included in other assets in our consolidated balance sheet, were reclassified to equity on a proportionate basis as the equity component. The adoption of APB 14-1 did not require any changes to our recognition of our call options and warrants that had been previously classified as equity.

As a result of adopting APB 14-1, the change in accounting principle had the following effect on prior year balances (in thousands except per share data):

| | Three Months Ended March 31, 2008 | |
|--|--------------------------------------|----------------|
| | As Adjusted | As Reported |
| Selected Statement of Income Data | | |
| Operating income | \$ 2,394 | \$ 2,394 |
| Total other loss | (2,051) | (151) |
| Income before income taxes | 343 | 2,243 |
| Income tax provision | 153 | 998 |
| Net income | \$ 190 | \$ 1,245 |
| Net income per share: | | |
| Basic | \$ 0.01 | \$ 0.07 |
| Diluted | \$ 0.01 | \$ 0.07 |
| Shares used in computing net income per share: | | |
| Basic | 16,770 | 16,770 |
| Diluted | 17,406 | 17,406 |

We recognized an additional \$1.9 million in interest expense for the three months ended March 31, 2008. The additional interest expense was primarily related to the amortization of the debt discount.

Table of Contents

The adoption of APB 14-1 also resulted in changes in our consolidated balance sheet for the year ended December 31, 2008 as follows (in thousands):

| | Year Ended December 31, 2008 | |
|--|---------------------------------|----------------|
| | As Adjusted | As Reported |
| Condensed Balance Sheet Data | | |
| Total current assets | \$ 394,344 | \$ 390,327 |
| Total noncurrent assets | 32,538 | 38,960 |
| Total assets | \$ 426,882 | \$ 429,287 |
| Total current liabilities | \$ 40,865 | \$ 40,865 |
| Total noncurrent liabilities | 134,957 | 158,495 |
| Total liabilities | \$ 175,822 | \$ 199,360 |
| Common stock | \$ 171 | \$ 171 |
| Additional paid-in capital | 285,757 | 252,895 |
| Accumulated deficit | (36,036) | (24,307) |
| Accumulated other comprehensive income | 1,168 | 1,168 |
| Total liabilities and shareholders' equity | \$ 426,882 | \$ 429,287 |

Current assets increased by \$4.0 million due to an increase in the deferred tax benefit related to debt issuance costs. Noncurrent assets decreased by \$6.4 million due to the reclassification of \$5.3 in deferred tax assets to offset deferred tax liabilities and a \$1.1 million reclassification of debt issuance costs to equity. Noncurrent liabilities decreased by \$23.5 million due to a \$33.4 million reclassification of the equity component of long-term debt to additional paid-in capital, offset by a net increase in deferred tax liabilities of \$9.9 million. Equity balances were primarily affected by the reclassifications noted above and lower net income resulting from a decrease of \$7.4 million in gains on repurchase, a cumulative interest expense from 2007 and 2008 of \$11.1 million, offset by a \$6.8 million reduction in provision for income taxes.

Table of Contents

The following table summarizes the impact of the adoption of APB 14-1 on the affected balances within shareholders' equity (in thousands):

| | Additional paid-in capital(1) | Accumulated deficit |
|---|----------------------------------|------------------------|
| Balance at December 31, 2007, as reported | \$ 236,158 | \$ (44,893) |
| Adjustments for adoption of APB 14-1 to 2007 | | |
| Equity component of convertible debt | 63,886 | -- |
| Deferred tax liability related to equity component | (23,580) | -- |
| Debt issuance costs, net of deferred tax benefit of \$784 | (1,341) | -- |
| Net income adjustment | -- | (2,365) |
| Balance at December 31, 2007, as adjusted | \$ 275,123 | \$ (47,258) |
| Balance at December 31, 2008, as reported | \$ 252,895 | \$ (24,307) |
| Cumulative impact from 2007 adjustments | 38,965 | (2,365) |
| Adjustments for adoption of APB 14-1 to 2008 | | |
| Repurchase of convertible debt attributed to the equity component | (10,942) | -- |
| Repurchase impact on deferred tax liability related to the equity component | 7,012 | -- |
| Tax provision related to cancellation of debt | (2,173) | -- |
| Net income adjustment | -- | (9,364) |
| Balance at December 31, 2008, as adjusted | \$ 285,757 | \$ (36,036) |

(1) Balances include treasury stock of \$133

Table of Contents

The following table summarizes the carrying value of the debt and equity components subsequent to the adoption of APB 14-1 (in thousands):

| | Three Months Ended March 31, | |
|--------------------------|---------------------------------|------------|
| | 2009 | 2008 |
| Equity component | \$ 33,686 | \$ 34,746 |
| Senior convertible debt: | | |
| Outstanding | \$ 119,745 | \$ 144,745 |
| Debt Discount | 26,533 | 33,409 |
| Long term debt, net | \$ 93,212 | \$ 111,336 |

Upon repurchase or settlement of our Notes, we revalue the liability component, utilizing an interest rate of comparable nonconvertible debt. We allocate a portion of the consideration transferred to the liability component equal to the fair value of that component immediately prior to repurchase. Any difference between the consideration attributed to the liability component and the sum of the net carrying amount of the liability component and unamortized debt issuance costs is recognized as a gain or loss in the statement of income. Any remaining consideration is allocated to the reacquisition of the equity component and is recognized as a reduction of stockholders' equity.

In the first quarter of 2009, we repurchased \$25.0 million in principal amount of our Notes for \$20.5 million. As a result of these repurchases, we recorded a gain, net of deferred financing costs of \$0.5 million and costs to complete the repurchase transaction, of \$1.3 million in other income. We also partially unwound the associated convertible note hedges, which resulted in proceeds to us of approximately \$1.4 million for the sale of call options, offset by \$1.3 million we paid for the repurchase of warrants. The transaction also resulted in a write off of \$0.5 million of debt issuance costs. Following the repurchases, unamortized debt issuance costs approximated \$2.1 million. Interest expense for the period consisted of \$1.3 million related to the amortization of debt discount and debt issuance costs and \$1.3 million related to the contractual interest coupon. The remaining discount of \$26.5 million will be amortized over 5 years.

Additionally, during the quarter, the carrying value of the equity component was reduced by \$2.9 million, the allocated amount from repurchases of our senior convertible debt, and \$0.2 million from the write-off of the deferred tax asset related to debt issuance costs, offset by a \$2.1 million reduction of the deferred tax liability related to the debt discount. These were noncash items from the repurchase transaction.

In the fourth quarter of 2008, we repurchased \$80.3 million in principal amount of our senior convertible notes for \$62.4 million. As a result of these repurchases, we recorded a gain, net of deferred financing costs and costs to complete the repurchase transaction, of \$8.2 million in other income, or \$15.7 million in other income prior to adoption of APB 14-1. The payment received from partially unwinding the associated convertible note hedges resulted in proceeds to us of approximately \$6.4 million, offset by \$5.9 million we paid for the repurchase of warrants. The transaction also resulted in a write off of \$1.5 million of debt issuance costs, or \$2.2 million prior to adoption of APB 14-1. Following the repurchases, debt issuance costs approximated \$2.7 million, or \$3.9 million prior to the adoption of APB 14-1.

In July 2007, we completed the offering of the Notes, which are due in 2014. The Notes may be converted, under certain circumstances described below, based on an initial conversion rate of 26.1792 shares of common stock per \$1,000 principal amount of notes (which is equivalent to an initial conversion price of approximately \$38.20 per share). The net proceeds from the issuance of the Notes were \$217.6 million, after deducting debt issuance costs. The Notes have no restrictive covenants and the if-converted value is approximately equivalent to the current principal

outstanding.

The net proceeds from the issuance of the Notes, net of issuance costs, the convertible note hedge transaction, and the warrant transaction were \$208.5 million.

We pay cash interest on the Notes at an annual rate of 3.75%, payable semi-annually on January 15 and July 15 of each year, which began on January 15, 2008.

13

Table of Contents

In connection with the offering, we used a portion of the offering proceeds to enter into a convertible note hedge transaction whereby we purchased a call option for up to 2.5 million shares of our common stock at a price of \$38.1982 per share. These options, which hedge approximately 42% of the risk of additional share issuance, expire on July 15, 2014 and must be settled in net shares. The cost of the call option was \$28.6 million and has been recorded as a reduction to stockholders' equity. The tax benefit from the deduction related to the purchase of the call option as part of the convertible note hedge transaction is recorded to additional paid in capital over the term of the hedge transaction.

Additionally, to partially offset the cost of the convertible note hedge transaction, we sold warrants to purchase up to 2.5 million shares of our common stock at a price of \$46.965 per share. The warrants expire on various dates from October 15, 2014 through the 60th scheduled trading day following October 15, 2014 and must be settled in net shares. We received approximately \$19.5 million in cash proceeds from the sales of these warrants and they were recorded as an increase to stockholders equity.

Holders of our remaining outstanding Notes may convert their Notes based on an initial conversion rate of 26.1792 shares of our common stock per \$1,000 principal amount of notes, subject to adjustment, at their option at any time prior to April 15, 2014 under the following circumstances: (1) during any fiscal quarter beginning after September 30, 2007 (and only during such fiscal quarter), if the last reported sale price of our common stock for at least 20 trading days during the 30 consecutive trading days ending on the last trading day of the immediately preceding fiscal quarter is greater than or equal to 130% of the applicable conversion price on each applicable trading day of such preceding fiscal quarter; (2) during the five business day period after any ten consecutive trading day period in which the trading price per note for each day of that ten consecutive trading day period was less than 98% of the product of the last reported sale price of our common stock and the conversion rate on such day; or (3) upon the occurrence of specified corporate transactions. On or after April 15, 2014, holders may convert their Notes at any time prior to the close of business on the third scheduled trading day immediately preceding the maturity date.

Upon conversion, we will pay cash and shares of our common stock, if any, based on a daily conversion rate multiplied by a volume weighted average price of our common stock during a specified period following the conversion date. Conversions will be settled in cash up to the principal amount of the Notes, with any conversion value above the principal amount settled in shares of our common stock. Holders of the Notes may require us to repurchase the notes for cash equal to 100% of the principal amount to be repurchased plus accrued and unpaid interest upon the occurrence of a fundamental change. In addition, we will adjust the conversion rate for holders who elect to convert notes in connection with a fundamental change. We may not redeem any of the Notes at our option prior to maturity.

Hedging activities

On January 1, 2009, we adopted Financial Accounting Standards Board ("FASB") Statement No.161, "Disclosures about Derivative Instruments and Hedging Activities" which requires enhanced disclosures regarding an entity's derivative and hedging activities. As of March 31, 2009, we had \$40.7 million in notional amount of foreign currency forward contracts. The currencies hedged were the British pound, the European Union euro, the Japanese yen, the Australian dollar and the Canadian dollar. The fair value of these contracts as of March 31, 2009 was not material to our results of operations or financial position. These contracts expire on April 30, 2009 and serve as economic hedges of a substantial portion of our intercompany balances denominated in a currency other than the USD. The recognized gains and losses, which are included in other income on the consolidated statement of income, of foreign currency hedge contracts and the intercompany receivables are as follows (in thousands):

| | |
|------|--------------------|
| | Three Months Ended |
| | March 31, |
| 2009 | 2008 |

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| | | | | |
|-----------------------------------|----|---------|----|---------|
| Foreign currency hedges | \$ | 2,415 | \$ | (2,557) |
| Intercompany receivables | | (2,066) | | 2,322 |
| Net gain (loss) related to hedges | \$ | 349 | \$ | (235) |

14

Table of Contents

Segment reporting

We currently have one reportable segment. We market our products in the United States and internationally through our direct sales force and our indirect distribution channels. Our chief operating decision maker evaluates resource allocation decisions and our performance based upon revenue recorded in geographic regions and does not receive financial information about expense allocation on a disaggregated basis. Certain amounts reported in previous periods have been reclassified to conform to current period presentation. Geographic regions are determined by the shipping destination. Revenue by geographic location is as follows (in thousands):

| | Three Months Ended March 31, | |
|------------------------------------|---------------------------------|-----------|
| | 2009 | 2008 |
| United States | \$ 23,231 | \$ 22,134 |
| Europe, Africa and the Middle East | 14,263 | 17,481 |
| Latin America and Canada | 4,769 | 5,877 |
| Asia Pacific | 9,542 | 7,007 |
| Total revenue | \$ 51,805 | \$ 52,499 |

Contingencies

On May 15, 2007, GE Healthcare (“GE”) filed a lawsuit against us in the federal district court in the Western District of Wisconsin. The lawsuit alleged that certain of our products willfully infringed certain of GE’s U.S. patents relating to ultrasound technology. We filed a counterclaim against GE and certain of its affiliates, and filed an answer denying all of GE’s claims and alleging that the asserted patents are either invalid, not infringed, or both. In rulings issued on July 24, 2008, the trial judge granted summary judgment motions in our favor on five of the six patents that GE had asserted against us. The court ruled that one of the GE patents is invalid and that our products do not infringe the other four GE patents. The trial judge also granted summary judgment in GE’s favor on two of our four asserted patents finding that GE’s accused products did not infringe our asserted patents. On July 28, the parties filed a stipulation for dismissal without prejudice for the remaining claims and counterclaims for the three remaining patents that have yet to be ruled on by summary judgment in this case, thereby negating the need for a trial. On July 31, 2008, the court granted the parties’ request for dismissal of the remaining claims and counterclaims that had not been ruled on by the judge. The parties have appealed certain of the trial court’s summary judgment decisions and other rulings to the Court of Appeals for the Federal Circuit. We do not expect an appellate decision until the second half of 2009.

On May 22, 2008, GE filed a second suit in the same federal court in Wisconsin seeking to invalidate our U.S. patent 5,722,412. We have counterclaimed that the new ultrasound systems GE proposes to market and sell infringe this patent. The trial is scheduled for early June 2009.

We have not accrued any amounts for potential losses related to these matters. Because of uncertainties related to the potential outcome and any range of loss on the pending litigation, management is unable to make a reasonable estimate of the liability that could result from an unfavorable outcome. As additional information becomes available, we will assess the potential liability related to these matters. If and when we determine that a negative outcome of such matters is probable and reasonably estimable we will record accruals for losses. Our estimates regarding such losses could differ from actual results. Revisions in our estimates of the potential liability could materially impact our results of operations, financial position and cash flow. We expense legal costs as incurred.

Adjustments

Our results for the first quarter of 2009 include correction of various prior year errors deemed immaterial in 2008. These corrections had the effect of decreasing revenue by \$0.1 million and net income by \$0.2 million (\$0.01 earnings per diluted share) for the three months ended March 31, 2009. These corrections were not deemed material to the estimated full year financial results for 2009.

Table of Contents

Recent accounting pronouncements

In April 2009, the FASB issued FSP No. FAS 157-4, “Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly” (“FSP 157-4”), which provides additional guidance for estimating fair value when the volume and level of activity for an asset or liability have decreased. FSP 157-4 permits a value other than the quoted market price to be used in determining fair value when certain circumstances are met that would indicate that the quoted market prices may not be determinative of fair value. FSP 157-4 is effective for periods ending after June 15, 2009 and is to be applied prospectively. We do not believe the adoption of FSP 157-4 will have a significant impact on our future consolidated financial statements.

In April 2009, the FASB issued FSP No. FAS 115-2 and FAS 124-2, “Recognition and Presentation of Other-Than-Temporary Impairments” (“FSP 115-2”), which amends the other-than-temporary impairment guidance for debt securities and changes the existing impairment model for such securities. It also modifies the presentation of other-than-temporary losses and increases the frequency of and expands the required disclosures related to other-than-temporary impairments. FSP 115-2 is effective for periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. We have elected not to early adopt and are currently reviewing the provisions of FSP 115-2 to determine the impact on our future consolidated financial statements.

Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

This quarterly report on Form 10-Q contains forward-looking statements. Forward-looking statements provide our current expectations or forecasts of future events. Forward-looking statements in this report include, without limitation:

- information concerning possible or assumed future results of operations, trends in financial results and business plans, including those relating to earnings growth and revenue growth;
- statements about the level of our costs and operating expenses relative to our revenues, and about the expected composition of our revenues;
- statements about our future capital requirements and the sufficiency of our cash, cash equivalents, investments and available bank borrowings to meet these requirements;
- other statements about our plans, objectives, expectations and intentions; and
- other statements that are not historical facts.

Words such as “believe,” “anticipate,” “expect” and “intend” may identify forward-looking statements, but the absence of these words does not necessarily mean that a statement is not forward-looking. Forward-looking statements are subject to known and unknown risks and uncertainties, and are based on potentially inaccurate assumptions that could cause actual results to differ materially from those expected or implied by the forward-looking statements. You should not unduly rely on these forward-looking statements, which speak only as of the date of this report.

We undertake no obligation to publicly update any forward-looking statement, whether as a result of new information, future events or otherwise. You are advised, however, to consult any further disclosures we make on related subjects in our future quarterly reports on Form 10-Q, current reports on Form 8-K and annual reports on Form 10-K. Also note that we provide a cautionary discussion of risks, uncertainties and possibly inaccurate assumptions relevant to our business in Item 1A. “Risk Factors” section of our Annual Report on Form 10-K for the year ended December 31, 2008. These are risks that could cause our actual results to differ materially from those anticipated in our forward-looking statements or from our expected or historical results. Other factors besides the risks, uncertainties and possibly inaccurate assumptions described in this report could also affect actual results.

Overview

The following Management's Discussion and Analysis ("MD&A") is intended to help the reader understand the results of operations and financial condition of SonoSite, Inc. MD&A is provided as a supplement to, and should be read in conjunction with, our consolidated financial statements and the accompanying notes to the consolidated financial statements.

Table of Contents

Our business strategy is to lead in the design, development and commercialization of high performance, innovative ultrasound technology and HCU systems. We intend to sustain long-term growth of our business through technological innovation, broadening of sales distribution channels, entry and maintenance of strategic relationships, expanding into new clinical and geographic markets, and delivering high-quality products to customers. We are focusing on the development of innovative products with the objective of improving patient care and efficiency through ease of use, high performance imaging, and providing quicker results to physicians and clinicians. We are also investing in research and development in existing and new lines of business and other areas that we believe may contribute to our long-term growth. Recognizing that one of our greatest challenges is the current state of the global economy, we are focused on increasing sales force efficiency and effective cost management.

Over the last few years, we have laid a foundation for long-term growth by introducing innovative products, entering into strategic relationships, expanding into new markets, and providing high quality products with an industry-leading 5-year warranty. In fiscal year 2009, we plan to continue to build on this foundation and to execute well in key areas, including continuing to innovate using existing and new technologies, to build and maintain key relationships in the sales distribution channels, to improve sales force productivity, to deliver high quality products, and to manage expenses.

Results of Operations

Revenue

Revenue decreased to \$51.8 million for the three months ended March 31, 2009 from \$52.5 million for the three months ended March 31, 2008. The decrease in 2009 compared to 2008 was attributable to a slowdown in hospital capital spending and an unfavorable foreign exchange impact of approximately 8% for the quarter.

U.S. revenue increased to \$23.2 million for the three months ended March 31, 2009 from \$22.1 million for the three months ended March 31, 2008. The increase in the first quarter 2009 compared to 2008 was primarily attributable to an increased volume of orders within the enterprise group, partially offset by a 14% decline in direct hospital sales due to reduced hospital capital spending within the difficult economic environment.

Revenue from Europe, Africa and the Middle East decreased to \$14.3 million for the three months ended March 31, 2009 from \$17.5 million for the three months ended March 31, 2008. The decrease was primarily due to an unfavorable foreign exchange impact of 19% for the three months ended March 31, 2009. On a constant currency basis, sales remained relatively consistent.

Revenue from Latin America and Canada decreased to \$4.8 million for the three months ended March 31, 2009 from \$5.9 million for the three months ended March 31, 2008. The decrease was primarily due to decreased sales in Latin America as well as an unfavorable foreign exchange impact of 9%, partially offset by an increase in sales in Canada for the three months ended March 31, 2009.

Revenue from Asia Pacific increased to \$9.5 million for the three months ended March 31, 2009 from \$7.0 million for the three months ended March 31, 2008. The increase was primarily due to increased sales in Japan and Asia, partially offset by an unfavorable foreign exchange of 5% for the quarter.

Fiscal Year 2009 Outlook

Given current economic conditions and foreign currency trends, we anticipate that revenue could potentially be flat to down 10% in 2009 compared to 2008. We expect to introduce new products and features, to develop the U.S. physicians' office market, and to expand our international operations. The expansion of our international markets, as

well as the development of the U.S. hospital and physician office markets, considering current economic conditions, may not be as successful as anticipated and we may encounter regulatory and other issues in selling our products. Our revenue has been significantly and may be further impacted by fluctuations in foreign exchange rates in the countries in which we sell our products. Increased competition may also impact our anticipated growth in revenue. We currently face competition from larger companies that manufacture cart-based and portable ultrasound systems and have greater financial and other resources.

17

Table of Contents

Gross margin

Gross margin was 68% for the three months ended March 31, 2009 and 72% for the three months ended March 31, 2008. The gross margin decreased over the prior year quarter as a result of an unfavorable foreign exchange of approximately 2%, a change in product mix of approximately 1%, and an increase in operating costs of approximately 1%.

Fiscal Year 2009 Outlook

Increased competition from existing and new competitors as well as pricing pressure due to economic conditions could result in lower average realized prices and could lower our gross margin. Our gross margin can be expected to fluctuate in future periods based on the mix of business between direct, government and distributor sales; mix of U.S. and international sales; and our product and accessories sales mixes. Changes in our cost of inventory also may impact our gross margin. Adjustments to reduce carrying costs are recorded for obsolete material, earlier generation products and used or refurbished products held either as saleable inventory or as demonstration product. If market conditions change or the introduction of new products by us impacts the market for our previously released products, we may be required to further write down the carrying value of our inventory, resulting in a negative impact on gross margins. We rely on our sales forecasts by product to determine production volume. To the extent our sales forecasts or product mix estimates are inaccurate, we may produce excess inventory or experience inventory shortages, which may result in an increase in our costs of revenue, a decrease in our gross margin or lost sales. Our gross margin may also be impacted by fluctuations in foreign exchange rates.

Operating expenses

Research and development expenses were \$7.7 million for the three months ended March 31, 2009, compared to \$6.2 million for the three months ended March 31, 2008. The increase compared to the prior year was primarily attributable to increased headcount and other costs related to development of new features and products.

Sales, general and administrative expenses were \$25.8 million for the three months ended March 31, 2009, compared to \$29.2 million for the three months ended March 31, 2008. The decrease in the quarter compared to prior year was primarily attributable to foreign exchange rates and a decrease in sales costs.

Fiscal Year 2009 Outlook

We anticipate that operating expenses will decrease in 2009 compared to 2008 through effective cost management.

Other loss

Total other loss was \$0.2 million for the three months ended March 31, 2009 compared to \$2.1 million for the three months ended March 31, 2008. The decrease in loss was primarily attributable to the gain recognized on the repurchase of our convertible senior notes and lower interest expense as a result of less outstanding debt compared to the prior year; partially offset by lower interest income on our investment balances resulting from lower interest rates. Amounts reported in comparable prior periods have been restated due to the adoption of Financial Accounting Standards Board Staff Position (FSP) No. APB 14-1, "Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)" ("APB 14-1") on January 1, 2009.

Fiscal Year 2009 Outlook

We anticipate that other income will decrease in 2009 as we do not expect to repurchase the same amount of convertible senior notes and will incur additional interest expense as a result of the adoption of APB 14-1 and lower interest rates for interest income.

Table of Contents

Income tax expense

Income tax provision was \$0.5 million for the three months ended March 31, 2009, compared to \$0.2 million for the three months ended March 31, 2008. The decrease in our consolidated effective tax rate for the three months ended March 31, 2009, as compared to 2008, results primarily from the reinstatement of the U.S. research and development tax credit in late 2008 and our qualification for the domestic production activities tax deduction. Amounts reported in comparable prior periods have been restated due to the adoption of APB 14-1.

Fiscal Year 2009 Outlook

We anticipate that our annual consolidated effective tax rate will approximate 39% for fiscal year 2009.

Warranty expense

We expect our warranty liability and expense to continue to increase significantly due to the five-year warranty offered with the MicroMaxx system, M-Turbo system and S Series ultrasound tools as our installed base increases. Should actual failure rates or repair or replacement costs for any of our products differ from estimates, revisions to the estimated warranty liability may be required and our results may be materially affected.

Liquidity and Capital Resources

Our cash and cash equivalents balance was \$198.1 million as of March 31, 2009, compared to \$209.3 million as of December 31, 2008. Cash and cash equivalents were primarily invested in money market accounts. Our short-term and long-term investment securities totaled \$60.0 million as of March 31, 2009, compared to \$70.5 million as of December 31, 2008. Investment securities generally consist of high-grade U.S. government or corporate debt. We have the ability to hold our securities until maturity, however, we classify all securities as available-for-sale, as the sale of such securities may be required prior to maturity to implement management strategies.

As of March 31, 2009, we had \$2.0 million in the Columbia Strategic Cash Portfolio, which is in the process of liquidation. Distributions from this portfolio are solely at the discretion of the portfolio manager. We have recorded \$0.9 million as a short-term investment and \$1.1 million as a long-term investment.

Operating activities used cash of \$0.9 million for the three months ended March 31, 2009, compared to cash provided of \$7.3 million for the three months ended March 31, 2008. Net income for the three months ended March 31, 2009 was adjusted by non-cash stock-based compensation expense of \$2.5 million, depreciation and amortization of \$1.0 million, amortization of debt discount and debt issuance costs of \$1.3 million, and deferred income taxes of \$1.5 million. Operating assets and liabilities were primarily impacted by the timing of payments and receipts. For the three month period ended March 31, 2009 operating assets provided \$3.8 million and operating liabilities used \$10.6 million. The change in operating assets is due to accounts receivable collections being less than sales for the first quarter of 2009, and the change in operating liabilities is due primarily to the timing of payments of accounts payable and accrued expenses.

Investing activities provided cash of \$8.9 million for the three months ended March 31, 2009, compared to cash used of \$23.6 million for the three months ended March 31, 2008. The cash provided in 2009 was primarily due to net proceeds from the sale or maturity of investment securities of \$10.4 million, offset by purchases of property and equipment of \$1.1 million and payment of \$0.4 million of earn-out consideration associated with the acquisition of SonoMetric Health, Inc.

Financing activities used cash of \$20.9 million for the three months ended March 31, 2009, compared to cash provided of \$0.7 million for the three months ended March 31, 2008. Cash used in financing activities was due to the repurchase of our convertible debt and associated warrants for \$21.8 million and minimum tax withholding on stock-based awards of \$0.5 million partially offset by the sale of call options for \$1.4 million.

Table of Contents

We believe that our existing cash and cash generated from operations will be sufficient to fund our operations and anticipated capital expenditures and repurchases of convertible debt in 2009. Nevertheless, we may experience an increased need for additional cash due to:

- any significant decline in our revenue or gross margin;
- any delay or inability to collect accounts receivable;
- any acquisition or strategic investment in another business;
- any significant increase in expenditures as a result of expansion of our sales and marketing infrastructure, our manufacturing capability or our product development activities; and
- any significant increase in our sales and marketing expenditures as a result of our introduction of new products.

Risk Factors

A complete listing of our risk factors is contained in the Item 1A. “Risk Factors” section of our Annual Report on Form 10-K for the year ended December 31, 2008.

Critical Accounting Policies and Estimates

The discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with instructions for Form 10-Q and Article 10 of Regulation S-X. The preparation of these consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates, including those related to product returns, bad debts, inventories, investments, warranty obligations, service contracts, incentive compensation, contingencies and litigation. We base our estimates on historical experience and on various other assumptions that we believe are reasonable under the circumstances. The results form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

As discussed in Item 7, “Management Discussion and Analysis of Financial Condition and Results of Operations” of our annual report on Form 10-K for the year ended December 31, 2008, our critical accounting policies and estimates include revenue recognition, investments, valuation of inventories, warranty expense, income taxes, stock-based compensation, convertible debt and hedge transaction and acquisitions.

Long term debt. On January 1, 2009, we adopted APB 14-1, which clarifies the accounting for convertible debt instruments that may be settled in cash (including partial cash settlement) upon conversion. We bifurcated a component of the conversion option and classified that component in equity. The value of the equity component was calculated by first measuring the fair value of the liability component, using the discount rate of a similar liability that does not have a conversion feature, as of the issuance date. The difference between the proceeds for the convertible debt and the amount reflected as the liability component was recorded as the equity component. We recognize the accretion of the resulting discount as part of interest expense in our consolidated statement of income.

Upon settlement of our Notes, we revalue the liability component, utilizing an interest rate of comparable nonconvertible debt. We allocate a portion of the consideration transferred to the liability component equal to the fair value of that component immediately prior to repurchase. Any difference between the consideration attributed to the liability component and the sum of the net carrying amount of the liability component and unamortized debt issuance costs is recognized as a gain or loss in the statement of income. Any remaining consideration is allocated to the reacquisition of the equity component and is recognized as a reduction of stockholders’ equity.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Interest rate risk

We are exposed to market risk relating to changes in interest rates, which could adversely affect the value of our investments in marketable securities.

20

Table of Contents

As of March 31, 2009, our investment portfolio consisted of \$58.0 million of interest-bearing debt securities with maturities of less than one year. Generally we have the ability to hold these securities until maturity; however, we have classified them as available-for-sale in the event of unanticipated cash needs. The interest bearing securities are subject to interest rate risk and will fall in value if market interest rates increase. We believe that the impact on the fair market value of our securities and related earnings for 2008 from a hypothetical 10% increase in market interest rates would not have a material impact on the investment portfolio.

As of March 31, 2009, we also had \$2.0 million in Columbia Strategic Cash Portfolio, which is in the process of liquidation. Distributions from this portfolio are solely at the discretion of the portfolio manager. We have recorded \$0.9 million as a short-term investment and \$1.1 million as a long-term investment based on the expected liquidation schedule.

Foreign currency risk

Except for sales transacted by our wholly-owned subsidiaries, we transact substantially all our sales in USDs; therefore, the obligations of many of our international customers are in USDs. Our exposure to risk from fluctuations in foreign currencies relates to revenues and expenses transacted by subsidiaries in foreign currencies. Additionally, we have exposure related to the strengthening of the USD against the local currency of our international subsidiaries, which may result in foreign exchange losses on transactions with them, and our international customers, which may impact our sales to our customers and our ability to collect amounts owed by them.

Total sales denominated in a currency other than USD were \$19.7 million, or 38% of our total consolidated revenues for the year ended March 31, 2009. As a result, our results of operations could be adversely affected by certain movements in exchange rates.

As of March 31, 2009, 69% of our accounts receivable balance was from international customers, of which 57%, or \$23.3 million, was denominated in a currency other than USD. Although we regularly review our receivable positions in foreign countries for any indication that collection may be at risk, our revenue from international sales may be adversely affected by longer receivables collection periods and greater difficulty in receivables collection.

The British pound, the Euro and the Japanese yen represented the majority of financial transactions executed in a currency not denominated in USDs. We regularly review our receivable positions in foreign countries for any indication that collection may be at risk. In addition, we utilize letters of credit where they are warranted in order to mitigate our collection risk.

We periodically enter into foreign currency forward contracts to reduce the impact of adverse fluctuations on earnings associated with foreign currency exchange rate changes. As of March 31, 2009, we had \$40.7 million in notional amount of foreign currency forward contracts that expire April 30, 2009. They serve as hedges of a substantial portion of our intercompany balances denominated in a currency other than the USD. These foreign currencies primarily include the British pound, the Euro, the Canadian dollar, the Australian dollar and the Japanese yen. A sensitivity analysis of a change in the fair value of these contracts indicates that if the USD weakened by 10% against the applicable foreign currency, the fair value of these contracts would decrease by approximately \$4.1 million. Conversely, if the USD strengthened by 10% against the applicable foreign currency, the fair value of these contracts would increase by approximately \$4.1 million. Gains and losses in the fair value of these contracts are intended to offset the losses and gains on the underlying intercompany balances. These offsetting gains and losses are not reflected in the sensitivity analysis above. The fair value of these contracts as of March 31, 2009 was not material to our results of operations or our financial position.

Table of Contents

Current Credit and Financial Markets

The recent worldwide financial and credit crisis has reduced the availability of liquidity and credit for our customers to fund the continuation and expansion of their business operations. The shortage of liquidity and credit combined with recent substantial losses in worldwide equity markets could lead to an extended worldwide economic recession. This trend could adversely affect our customers' ability to commit to capital spending or to pay and could lead to pressure to reduce prices for our products and could cause a decrease in the size of the market and adversely affect our revenue and profitability, which could harm our business. Our revenues may be impacted by our customers' ability to finance the purchase of our systems and cost control efforts implemented by our customers. We have observed indications of an economic slowdown, which has impacted U.S. hospital purchase behavior. Based on our analysis, economic conditions may continue to drive delays in orders. Increased competition may also impact our anticipated growth in revenue.

Item 4. Controls and Procedures

Evaluation of disclosure controls and procedures

As of March 31, 2009, our chief executive officer and our chief financial officer have evaluated the effectiveness of our disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934 (the Exchange Act), and they have concluded that our disclosure controls and procedures were effective to ensure that the information required to be disclosed by us in reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission.

Changes in internal control over financial reporting

We continue to review, revise and improve the effectiveness of our internal controls. There have been no changes in the Company's internal controls over financial reporting during the first quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II: OTHER INFORMATION

Item 1. Legal Proceedings

On May 15, 2007, GE Healthcare ("GE") filed a lawsuit against us in the federal district court in the Western District of Wisconsin. The lawsuit alleged that certain of our products willfully infringed certain of GE's U.S. patents relating to ultrasound technology. We filed a counterclaim against GE and certain of its affiliates, and filed an answer denying all of GE's claims and alleging that the asserted patents are either invalid, not infringed, or both. In rulings issued on July 24, 2008, the trial judge granted summary judgment motions in our favor on five of the six patents that GE had asserted against us. The court ruled that one of the GE patents is invalid and that our products do not infringe the other four GE patents. The trial judge also granted summary judgment in GE's favor on two of our four asserted patents finding that GE's accused products did not infringe our asserted patents. On July 28, the parties filed a stipulation for dismissal without prejudice for the remaining claims and counterclaims for the three remaining patents that have yet to be ruled on by summary judgment in this case, thereby negating the need for a trial. On July 31, 2008, the court granted the parties' request for dismissal of the remaining claims and counterclaims that had not been ruled on by the judge. The parties have appealed certain of the trial court's summary judgment decisions and other rulings to the Court of Appeals for the Federal Circuit. We do not expect an appellate decision until the second half of 2009.

On May 22, 2008, GE filed a second suit in the same federal court in Wisconsin seeking to invalidate our U.S. patent 5,722,412. We have counterclaimed that the new ultrasound systems GE proposes to market and sell infringe this patent. The trial is scheduled for early June 2009.

Table of Contents

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

On April 21, 2009, we held our annual meeting of shareholders. As of the record date, February 27, 2009, there were 17,069,727 shares of common stock outstanding and entitled to vote at the meeting. At the meeting, 15,949,339 shares were represented, either in person or by proxy. The following proposals were adopted by the margins indicated:

1. To elect nine directors to our board of directors to serve until the 2010 annual meeting of shareholders.

Number of Shares

| | For | Withheld |
|-----------------------|------------|-----------|
| Kirby Cramer | 9,607,368 | 6,341,971 |
| Carmen Diersen | 14,395,856 | 1,553,483 |
| Steven Goldstein | 14,200,844 | 1,748,495 |
| Kevin Goodwin | 10,446,146 | 5,503,193 |
| Paul Haack | 15,511,515 | 437,824 |
| Robert Hauser | 9,407,680 | 6,541,659 |
| Richard Martin | 15,776,357 | 172,982 |
| William Parzybok, Jr. | 14,357,032 | 1,592,307 |
| Jacques Souquet | 15,024,599 | 924,740 |

2. To ratify the appointment of KPMG LLP as our independent registered public accounting firm for the year ending December 31, 2009.

| For | Against | Abstain |
|------------|---------|---------|
| 15,286,873 | 597,993 | 56,077 |

Table of Contents

Item 6. Exhibits

| Exhibit No. | Description |
|----------------|---|
| 10.1 | SonoSite, Inc. FY2009 Variable Incentive Bonus Plan |
| 31.1 | Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 31.2 | Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| | Certification of Principal Executive Officer pursuant to 18 U.S.C. Section 1350 Section 906 of the Sarbanes-Oxley |
| 32.1 | Act of 2002) |
| | Certification of Principal Financial Officer pursuant to 18 U.S.C. Section 1350 Section 906 of the Sarbanes-Oxley |
| 32.2 | Act of 2002) |

Table of Contents

SIGNATURE

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

Dated: May 1, 2009

SONOSITE, INC.

(Registrant)

By: /s/ MICHAEL J. SCHUH

Michael J. Schuh

Vice President, Chief Financial Officer and Treasurer

Authorized Officer and Principal Financial Officer)

Table of Contents

INDEX TO EXHIBITS

| Exhibit No. | Description |
|----------------|--|
| 10.1 | SonoSite, Inc. FY2009 Variable Incentive Bonus Plan |
| 31.1 | Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 31.2 | Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 32.1 | Certification of Principal Executive Officer pursuant to 18 U.S.C. Section 1350 Section 906 of the Sarbanes-Oxley Act of 2002) |
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