SONOSITE INC
Form 10-Q
November 03, 2011
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

x **Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.**
September 30, 2011 For the quarterly period ended September 30, 2011

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	**91-1405022**
(State or Other Jurisdiction of	**(I.R.S. Employer**
Incorporation or Organization)	**Identification Number)**
21919 30th Drive SE, Bothell, WA	**98021-3904**
(Address of Principal Executive Offices)	**(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 x 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 x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or smaller reporting company. See definitions of a large accelerated filer, an accelerated filer, a non-accelerated filer or smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer	¨	Accelerated filer	x
Non-accelerated filer	¨	Smaller reporting company	¨

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

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	**13,938,655**
(Class)	**(Outstanding as of October 24, 2011)**

Table of Contents

SonoSite, Inc.

Quarterly Report on Form 10-Q

For the Quarter Ended September 30, 2011

Table of Contents

2

Table of Contents

PART I: FINANCIAL INFORMATION

Item 1. Financial Statements

SonoSite, Inc.

Condensed Consolidated Balance Sheets

(unaudited)

(In thousands, except share data)

	September 30, 2011	December 31, 2010
Assets		
Current assets:		
Cash and cash equivalents	$ 75,471	$ 78,690
Accounts receivable, less allowances of $968 and $932	78,473	81,516
Inventories	47,878	37,126
Deferred tax assets, current	8,939	7,801
Prepaid expenses and other current assets	19,205	12,384
Total current assets	229,966	217,517
Property and equipment, net	9,848	9,133
Investment in affiliate	8,000	8,000
Deferred tax asset, net	3,460	4,373
Goodwill	37,243	37,786
Identifiable intangible assets, net	40,698	47,423
Other assets	3,200	4,823
Total assets	$ 332,415	$ 329,055
Liabilities and Shareholders Equity		
Current liabilities:		
Accounts payable	$ 12,829	$ 10,597
Accrued expenses	23,532	32,535
Deferred revenue, current portion	6,929	6,042
Total current liabilities	43,290	49,174
Long-term debt, net	100,635	97,379
Deferred tax liability	2,768	1,811
Deferred revenue, net	13,072	15,236
Other non-current liabilities, net	11,821	12,565
Total liabilities	171,586	176,165
Commitments and contingencies		
Shareholders equity:		
Preferred stock, $1.00 par value Authorized shares 6,000,000 Issued and outstanding shares none		
Common stock, $0.01 par value Authorized shares 50,000,000 Issued and outstanding shares:		
As of September 30, 2011 and December 31, 2010 13,908,387 and 13,539,633	139	135
Additional paid-in-capital	309,812	298,870
Accumulated deficit	(148,340)	(148,975)

Accumulated other comprehensive (loss) income		(782)		2,860
Total shareholders equity		160,829		152,890
Total liabilities and shareholders equity	$	332,415	$	329,055

See accompanying notes to condensed consolidated financial statements.

3

Table of Contents

SonoSite, Inc.

Condensed Consolidated Statements of Income

(unaudited)

(In thousands, except net income per share amounts)

	Three Months Ended September 30, 2011	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
Revenue	$ 75,732	$ 68,538	$ 219,526	$ 186,064
Cost of revenue	21,542	19,675	64,148	53,150
Gross margin	54,190	48,863	155,378	132,914
Operating expenses:				
Research and development	10,716	8,455	30,807	23,263
Sales, general and administrative	39,584	35,320	114,695	95,745
Total operating expenses	50,300	43,775	145,502	119,008
Other income (expense):				
Interest income	163	129	467	513
Interest expense	(2,494)	(2,320)	(7,202)	(7,072)
Other expense, net	(982)	(1,608)	(2,054)	(1,939)
Total other expense, net	(3,313)	(3,799)	(8,789)	(8,498)
Income before income taxes	577	1,289	1,087	5,408
Income tax (benefit) provision	(143)	347	452	1,208
Net income	$ 720	$ 942	$ 635	$ 4,200
Net income per share:				
Basic	$ 0.05	$ 0.07	$ 0.05	$ 0.28
Diluted	$ 0.05	$ 0.07	$ 0.04	$ 0.27
Weighted average common shares outstanding:				
Basic	13,893	13,676	13,783	14,844
Diluted	14,323	14,147	14,285	15,347

See accompanying notes to condensed consolidated financial statements.

Table of Contents

SonoSite, Inc.

Condensed Consolidated Statements of Cash Flows

(unaudited)

(In thousands)

	Nine Months Ended September 30, 2011	2010
Operating activities:		
Net income	$ 635	$ 4,200
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Depreciation and amortization	7,671	5,796
Stock-based compensation	6,002	4,245
Deferred income tax benefit	(120)	(1,918)
Amortization of debt discount and debt issuance costs	3,830	3,663
Excess tax benefit from stock-based awards	(1,175)	(847)
Other adjustments	(425)	673
Changes in operating assets and liabilities:		
Accounts receivable	2,202	5,613
Inventories	(11,158)	(976)
Prepaid expenses and other assets	(3,954)	(1,993)
Accounts payable	2,973	1,133
Accrued expenses	(7,596)	(26)
Deferred revenue	(1,277)	(2,009)
Deferred liabilities	(1,750)	(27)
Net cash (used in) provided by operating activities	(4,142)	17,527
Investing activities:		
Purchase of investment securities		(79,921)
Proceeds from sales/maturities of investment securities		154,698
Purchases of property and equipment	(3,276)	(1,455)
Investment in affiliate		(8,000)
Purchase of VisualSonics, Inc. net of cash acquired		(61,217)
Net cash (used in) provided by investing activities	(3,276)	4,105
Financing activities:		
Excess tax benefit from exercise stock-based awards	1,175	847
Proceeds from exercise of stock-based awards	5,141	4,263
Minimum tax withholding on stock-based awards	(892)	(1,065)
Stock repurchases including transaction costs		(126,103)
Repayment of long-term debt	(298)	(8,871)
Payment of contingent purchase consideration for LumenVu, Inc.	(300)	(425)
Net cash provided by (used in) financing activities	4,826	(131,354)
Effect of exchange rate changes on cash and cash equivalents	(627)	(1,594)
Net change in cash and cash equivalents	(3,219)	(111,316)
Cash and cash equivalents at beginning of period	78,690	183,065
Cash and cash equivalents at end of period	$ 75,471	$ 71,749

Supplemental disclosure of cash flow information:				
Cash paid for income taxes	$	3,267	$	7,184
Cash paid for interest	$	4,313	$	4,476

See accompanying notes to condensed consolidated financial statements.

Table of Contents

SonoSite, Inc.

Notes to Condensed Consolidated Financial Statements

(unaudited)

Interim Financial Information

1. Summary of significant accounting policies

Basis of presentation and use of estimates

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 and nine months ended September 30, 2011 are not necessarily indicative of expected results for the entire year ending December 31, 2011 or for any other fiscal period. These condensed consolidated 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 condensed consolidated financial statements should be read in conjunction with the audited financial statements for the year ended December 31, 2010, included in our Annual Report on Form 10-K.

Fair value of financial instruments

We account for our assets and liabilities using a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect our market assumptions. These two types of inputs have created the following fair-value hierarchy:

Level 1 Quoted prices for identical instruments in active markets;

Level 2 Quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-derived valuations in which all significant inputs and significant value drivers are observable in active markets; and

Level 3 Valuations derived from valuation techniques in which one or more significant inputs or significant values are unobservable.

This hierarchy requires us to minimize the use of unobservable inputs and to use observable market data, if available, when determining fair value.

The fair value of these financial instruments was determined using the following levels of inputs as of September 30, 2011 (in thousands):

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:			
Cash equivalents-money market funds	$ 66,382	$	$
Total assets	$ 66,382	$	$

6

Table of Contents

The fair value of these financial instruments was determined using the following levels of inputs as of December 31, 2010 (in thousands):

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:			
Cash equivalents-money market funds	$ 70,473	$	$
Unamortized foreign currency option contract premiums		62	
Total assets	$ 70,473	$ 62	$
Liabilities:			
Foreign currency hedge contracts	$	$ 463	$
Total liabilities	$	$ 463	$

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 or our competitors impacts the markets 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):

	As of	
	September 30, 2011	December 31, 2010
Raw material	$ 19,960	$ 13,671
Demonstration product	14,288	13,008
Finished goods	13,630	10,447
Total	$ 47,878	$ 37,126

Revenue recognition

We recognize revenue on products and accessories when goods are shipped under an agreement with a customer, risk of loss and title have passed to the customer, sales returns are estimable and collection of any resulting receivable is reasonably assured. Revenue is recorded net of any discounts, trade-in allowances, and estimated returns. We estimate returns by reviewing our historical returns, considering customer reaction to new product introductions and current economic conditions. We make product upgrades available for purchase to our customers. We recognize licensing revenue using the proportional performance method, a ratable recognition approach over the life of the license. In addition to a standard warranty, we offer extended warranty and service contracts for coverage beyond the standard warranty period or coverage above what is covered by a standard warranty. Those service contracts are recorded as deferred revenue. For extended warranty and service contracts, revenue is recognized as services are provided or over the term of the contract.

Sales to distributors are generally made pursuant to standard distributor agreements. We recognize revenue when risk of loss and title has transferred to the distributor and collection of any resulting receivable is reasonably assured. Our only significant post-shipment obligation to distributors is our standard product warranty covering materials and workmanship. The distributor can only reject products for an obvious defect or shipping error, generally within 30 days of receipt, and in such cases, replacement products would be sent. Since the distributor s remedy is the replacement of the product and not a refund or credit and returns are estimable, we do not defer revenue associated with these sales. Costs associated with the repair of returned, defective products are captured in our warranty liability. Our standard distributor arrangements do not have any other return provisions.

Table of Contents

Our sales arrangements may contain multiple elements, which include hardware and software products. For the vast majority of our shipments, all deliverables are shipped together. However, in some cases certain elements of a multiple element arrangement are not delivered as of a reporting date. In September 2009, the Financial Accounting Standards Board (FASB) amended the accounting standards related to revenue recognition for arrangements with multiple deliverables and include some software elements. Effective January 1, 2010, we adopted new revenue recognition accounting guidance, which removes tangible products from the scope of the software revenue guidance if the products contain both software and non-software components that function together to deliver a product s essential functionality. It also provides guidance on determining whether software deliverables in an arrangement that includes a tangible product are within the scope of the software revenue guidance. Concurrently, we adopted guidance that provides principles and application direction on whether multiple deliverables exist, how the arrangement should be separated, and the consideration allocated. It also requires an entity to allocate revenue in an arrangement using estimated selling prices of deliverables if a vendor does not have vendor-specific objective evidence or third-party evidence of selling price. The guidance eliminates the use of the residual method, requires entities to allocate revenue using the relative-selling-price method and significantly expands the disclosure requirements for multiple-deliverable revenue arrangements. When the undelivered element represents services under extended service contracts, revenue equal to the stated price, less any allocable discount on the overall multi-element arrangement is deferred and recognized evenly over the contract term as those services are provided. Adoption of these pronouncements did not have a material effect on the consolidated financial statements.

Warranty expense

We generally offer a five year warranty for our products. 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 using management s judgment based upon our historical and anticipated product failure rates and service repair costs. Our warranty period for certain older generation products is one year. We periodically assess the adequacy of the warranty reserve and adjust the amount as necessary. The warranty is included with the original purchase.

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

	Three months Ended September 30,		Nine months Ended September 30,	
	2011	**2010**	**2011**	**2010**
Beginning of period	$ 11,111	$ 9,430	$ 10,427	$ 8,400
Charged to cost of revenue	1,490	1,441	4,260	4,009
Liability from acquisition				129
Applied to liability	(1,335)	(987)	(3,421)	(2,654)
End of period	$ 11,266	$ 9,884	$ 11,266	$ 9,884

Income taxes

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 arising since our inception or obtained through acquisition.

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 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. A valuation allowance is established when necessary to reduce deferred tax assets to the amount, if any, expected to be realized.

The determination of our provision for income taxes requires judgment, the use of estimates, and the interpretation and application of complex tax laws. Judgment is required in assessing the timing and amounts of deductible and taxable items and the probability of sustaining uncertain tax positions. The benefits of uncertain tax positions are recorded in our financial statements only after determining a more-likely-than-not probability that the uncertain tax positions will withstand challenge, if any, from tax authorities. When facts and circumstances change, we reassess these probabilities and record any changes in the financial statements as appropriate.

8

Table of Contents

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, warrants, and unvested 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. The call option we purchased 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 September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Net income	$ 720	$ 942	$ 635	$ 4,200
Basic weighted average common shares outstanding	13,893	13,676	13,783	14,844
Effect of dilutive stock options and unvested restricted stock units	430	471	502	503
Diluted weighted average common shares outstanding	14,323	14,147	14,285	15,347
Net income per share:				
Basic	$ 0.05	$ 0.07	$ 0.05	$ 0.28
Diluted	$ 0.05	$ 0.07	$ 0.04	$ 0.27

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 September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Stock options and unvested restricted stock units	644	743	430	741
Warrants outstanding (1)	1,121	1,121	1,121	1,121
Total common shares excluded from diluted net income per share	1,765	1,864	1,551	1,862

(1) As further detailed in note 5, in July 2007 we issued warrants to purchase up to 2.5 million shares of our common stock with a strike price of $46.965, which are anti-dilutive since the strike price of the warrants is greater than the market price of our common stock. In 2009 and 2008, we repurchased warrants that were for the purchase of up to 0.4 million and 1.0 million shares respectively.

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 approximately $38.20 per share.

Other comprehensive (loss) income

Foreign currency translation adjustments and unrealized gains or losses on our available-for-sale securities are included in accumulated other comprehensive (loss) income.

The following are the components of accumulated other comprehensive (loss) income (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	**2010**	**2011**	**2010**
Net income	$ 720	$ 942	$ 635	$ 4,200
Other comprehensive (loss) income:				
Foreign currency translation adjustment	(6,147)	364	(3,642)	(161)
Unrealized gain (loss) arising during the period		4		(13)
Comprehensive (loss) income	$ (5,427)	$ 1,310	$ (3,007)	$ 4,026

Table of Contents

2. Cash and cash equivalents

The following table summarizes our cash, and cash equivalents at fair value (in thousands):

	September 30, 2011	December 31, 2010
Cash	$ 9,089	$ 8,217
Cash equivalents:		
Money market accounts	66,382	70,473
Total cash and cash equivalents	$ 75,471	$ 78,690

Cash and cash equivalents primarily consist of money market accounts with major U.S. banks. The carrying value of cash and cash equivalents held in money market accounts approximates the fair value.

3. Acquisition

In June 2010, we acquired all of the outstanding stock of VisualSonics, Inc. (VisualSonics), a leader in the development, manufacturing, and marketing of ultra high-resolution, ultrasound-based imaging technology (micro-ultrasound) designed to enable discovery research, medical diagnosis and imaging small physiological structures in humans and animals. VisualSonics micro-ultrasound product platform currently serves the pre-clinical research market. We intend to integrate VisualSonics micro-ultrasound technology with our miniaturization competency and user design to deliver ultra high-frequency micro-ultrasound into clinical medicine.

During the measurement period, the preliminary amounts were updated based upon new information received related to the facts and circumstances that existed at the acquisition date. During the measurement period for the six months ended June 30, 2011 we obtained information related to the tax effects of the acquisition and the ability to utilize pre-acquisition tax credits to offset tax liabilities arising on the distribution of certain assets acquired. This resulted in a decrease to deferred tax assets of $1.2 million and an increase to goodwill of $1.2 million. The measurement period ended on June 30, 2011.

The results of VisualSonics operations have been included in our consolidated financial statements since the date of acquisition. For comparability purposes, the following table presents our pro forma revenue and earnings for the nine months ended September 30, 2010 had the acquisition date been January 1, 2010 (in thousands):

	Nine Months Ended September 30, 2010	
	Revenue	Net income (loss)
Results of operations as reported	$ 186,064	$ 4,200
Add: VisualSonics operations through June 30, 2010	15,648	(1,657)
Pro forma results	$ 201,712	$ 2,543

VisualSonics earnings were adjusted to reflect the statutory tax rate utilized by VisualSonics in the pro forma period presented. VisualSonics operations exclude non-recurring expenses related to long-term debt and liability classified equity instruments, but include amortization of intangible assets and stock-based compensation resulting from this acquisition.

Pro forma information set forth above is for informational purposes only and should not be considered indicative of actual results that would have been achieved if VisualSonics had been acquired at the beginning of 2010, or results that may be obtained in any future period.

Table of Contents

4. Income tax (benefit) provision

The income tax (benefit) provision for the three and nine months ended September 30, 2011 is based on projections of total year pre-tax income and the annual effective tax rate. The annual effective tax rate is applied to our ordinary worldwide pre-tax income. Discrete items are individually computed and recognized when the items occur. The following table summarizes our income tax (benefit) provision (in thousands except percentages):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Income tax (benefit) provision	$ (143)	$ 347	$ 452	$ 1,208
Effective tax rate	(24.8)%	26.9%	41.6%	22.3%

5. Long-term debt

In July 2007, we completed the offering of $225.0 million aggregate principal amount of 3.75% convertible senior notes (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.

To account for the Notes, we bifurcated 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, which were included in other assets in our consolidated balance sheet, were classified as equity on a proportionate basis as the equity component.

The following table summarizes the carrying value of the debt and equity components (in thousands):

	As of	
	September 30, 2011	December 31, 2010
Convertible senior notes:		
Outstanding	$ 114,745	$ 114,745
Debt discount	(14,110)	(17,647)
Convertible senior notes, net	$ 100,635	$ 97,098
Equity component	$ 33,957	$ 33,957

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.

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.

11

Table of Contents

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.

The debt discount and debt issuance costs are being amortized through July 2014. Interest expense for the amortization of debt discount and debt issuance costs was $1.3 million and $3.8 million for the three and nine months ended September 30, 2011. Interest expense for the contractual coupon was $1.2 million and $3.3 million for the three and nine months ended September 30, 2011. Interest expense for the amortization of debt discount and debt issuance costs was $1.2 million and $3.7 million for the three and nine months ended September 30, 2010. Interest expense for the contractual coupon was $1.1 million and $3.2 million for the three and nine months ended September 30, 2010.

Our senior convertible debt is measured for disclosure only at fair value using quoted market prices. As of September 30, 2011 and December 31, 2010, the fair value of our senior convertible debt was $120.4 million and $126.0 million, respectively.

6. Hedging activities

We are exposed to foreign currency risk from both trade intercompany receivable balances denominated in currencies other than the local currency and from translation of our foreign subsidiaries operating results. We enter into foreign currency forward and option contracts to reduce the impact of fluctuations on earnings associated with foreign currency exchange rate changes. These foreign currencies include the Australian dollar, the British pound, the Canadian dollar, the European Union euro, and the Japanese yen. We use foreign exchange contracts to mitigate risk and do not intend to engage in speculative transactions. Currently our foreign exchange contracts do not qualify for derivative hedge accounting. We seek to manage the counterparty risk associated with engaging in foreign currency contracts by limiting transactions to counterparties with which we have established banking relationships.

We use foreign currency forward contracts to hedge a substantial portion of our intercompany receivable balances denominated in currencies other than the USD. As of September 30, 2011, we had $53.1 million in notional amount of foreign currency contracts that expire through October 31, 2011. Gains and losses in the fair value of these contracts are intended to offset the losses and gains, resulting from the changes in the underlying intercompany balances. The fair value of these contracts as of September 30, 2011 was not material to our results of operations or our financial position.

Recognized gains and losses, which are included in other income (expense) on the condensed consolidated statements of income, are as follows (in thousands):

	Three Months Ended September 30, 2011	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
Hedges of intercompany balances				
Gain (loss) on foreign currency hedges	$ 1,585	$ (4,306)	$ (997)	$ (2,922)
Loss (gain) on translation of intercompany receivables	(2,527)	3,960	(590)	1,854
Hedges of translation of foreign operations				
Loss on foreign currency hedges	(5)	(1,198)	(310)	(551)
Loss related to hedge activities	$ (947)	$ (1,544)	$ (1,897)	$ (1,619)

7. Segment reporting

Public companies are required to report financial and descriptive information about their reportable operating segments as required by FASB ASC Topic No. 280, Segment Reporting. We market our products in the United States and internationally through our direct sales force and our indirect distribution channels.

Our chief executive officer reviews financial information presented on a company wide basis, accompanied by disaggregated information about revenues by geographic regions for purposes of allocating resources and evaluating financial performance. Each of our geographic regions report directly to our chief operating decision maker. We do not specifically allocate operating expenses to geographic regions, nor do we allocate specific assets. Therefore, geographic region information reported includes only revenues. Accordingly, we have a single operating and reporting segment.

Table of Contents

Geographic regions are determined by the shipping destination. Revenue by geographic region is as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
United States	$ 43,682	$ 35,112	$ 116,149	$ 92,083
Europe, Africa and the Middle East	15,071	17,167	48,067	46,738
Latin America and Canada	5,622	4,999	20,106	14,509
Asia Pacific	11,357	11,260	35,204	32,734
Total revenue	$ 75,732	$ 68,538	$ 219,526	$ 186,064

Revenue from individual countries or customers in foreign countries is not material.

Long-lived assets, excluding deferred tax assets and certain other assets, by geographic location are as follows (in thousands):

	As of	
	September 30, 2011	December 31, 2010
United States	$ 17,294	$ 18,071
International	3,754	3,885
Total long-lived assets	$ 21,048	$ 21,956

8. Commitments and contingencies

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. These indemnifications and guarantees require only disclosure. 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 consolidated financial statements related to these indemnifications or guarantees.

Table of Contents

9. Accounting pronouncements issued not yet adopted

In September 2011, the FASB issued Accounting Standards Update No. 2011-08, *Goodwill and Other (Topic 350)- Testing Goodwill for Impairment* (ASU 2011-08) in an effort to reduce the cost and complexity of the annual goodwill impairment test by providing entities an option to perform a qualitative assessment to determine whether further impairment testing is necessary. ASU 2011-08 is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. An entity can choose to early adopt if its annual test date is before the issuance of the final standard, provided that the entity has not yet performed its 2011 annual impairment test or issued its financial statements. An entity has the option to first assess qualitative factors to determine whether it is necessary to perform the current two-step test. If an entity believes, as a result of its qualitative assessment, that it is more-likely-than-not that the fair value of a reporting unit is less than its carrying amount, the quantitative impairment test is required. Otherwise, no further testing is required. We are currently evaluating the impact of adopting ASU 2011-08, but currently believe there will be no significant impact on our consolidated financial statements.

In June 2011, the FASB issued Accounting Standards Update No. 2011-05, *Comprehensive Income (Topic 220)-Presentation of Comprehensive Income* (ASU 2011-05), to require an entity to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. ASU 2011-05 eliminates the option to present the components of other comprehensive income as part of the statement of equity. ASU 2011-05 is effective for us in the first quarter of fiscal 2012 and will be applied retrospectively. We believe there will be no significant impact on our consolidated financial statements as a result of adoption of ASU 2011-05.

In May 2011, the FASB issued Accounting Standards Update No. 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and International Financial Reporting Standards* (Topic 820)-Fair Value Measurement (ASU 2011-04), to provide a consistent definition of fair value and ensure that the fair value measurement and disclosure requirements are similar between U.S. GAAP and International Financial Reporting Standards. ASU 2011-04 changes certain fair value measurement principles and enhances the disclosure requirements particularly for level 3 fair value measurements. ASU 2011-04 is effective for us in the first quarter of fiscal 2012 and will be applied prospectively. We are currently evaluating the impact of adopting ASU 2011-04, but currently believe there will be no significant impact on our 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:

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, 2010. 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 condensed consolidated financial statements and the accompanying notes to the condensed consolidated financial statements.

Our business strategy is to lead in the design, development and commercialization of high performance, innovative ultrasound technology and hand-carried ultrasound (HCU) systems. We intend to sustain long-term growth of our business through technological innovation, broadening of sales distribution channels, entering into and maintaining 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 also are 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. We are focused on increasing sales force efficiency and effective cost management.

In August 2009, we acquired all of the outstanding stock of CardioDynamics International Corporation (CDIC), a leader in impedance cardiography (ICG) for noninvasive hemodynamic assessment that develops, manufactures, and markets ICG devices and sensors. The ICG product line provides non-invasive assessment of cardiac output and other hemodynamic parameters. The business combination enables us to expand our distribution platform and product offerings into the primary care setting.

In June 2010, we acquired all of the outstanding stock of VisualSonics, Inc. (VisualSonics) a leader in high-frequency, high-resolution, ultrasound-based imaging systems (or micro-ultrasound systems) designed specifically for live imaging of small animals. Live imaging is a useful tool for life sciences research and for the pre-clinical stage of the drug development process. VisualSonics technology provides clinicians and research scientists with a simple method for viewing and quantifying extremely small physiological structures and for imaging living tissue with near-microscopic resolution. This business combination positions us for long-term growth in both the clinical point-of-care markets and the pre-clinical markets. In March 2011 we introduced Photoacoustics , a new technology that will give cardiovascular and cancer researchers tools for real time in-vivo research at functional, anatomical and molecular levels without the use of radiation. We anticipate that it will integrate in time to clinical medicine.

Over the last few years, we have laid a foundation in the clinical market for long-term growth through expansion in four vertical markets including acute, primary care, musculoskeletal, and field medicine. We will be introducing innovative products, entering into strategic relationships, expanding into new markets, and providing high quality products with industry-leading liability and warranty coverage. In fiscal year 2011, 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 distribution channels, to improve sales productivity, delivering high quality products, and managing the expense structure.

Key opportunities include the following:

Product Innovation Our clinical products provide exceptional reliability, image quality, and ease of use in a lightweight design that can be either hand-carried, used on a stand or mounted on a wall or ceiling. We are committed to continuing to develop our next generation of products and expanding our existing product base by using new and existing technologies. In 2010 we introduced Enhanced Needle Visualization, a significant development in ultrasound imaging that enables improved needle tracking with increased confidence during deep needle procedures. We will continue to release new and innovative products in 2011. In March 2011, we introduced photoacoustics product to the pre-clinical market. It is a fusion of sensitivity and specificity of light and high resolution of high-frequency ultrasound. We anticipate that our photoacoustics products will provide researchers better tools as well as opening new market for cancer research.

Sales and Marketing Our sales and marketing organization will continue to focus on creating greater awareness of the benefits of point-of-care ultrasound in order to better penetrate established markets, accelerate growth in emerging markets and identify new markets. Over the past two years we have implemented a strategy in our sales channels to better cover key accounts and drive awareness of the safety, cost and efficiency benefits of point-of-care at the institutional level. We believe that this will continue to help us more effectively address considerations that are important at the administrative level, and that complement the clinical benefits we have been communicating at the clinician level. We intend to expand VisualSonics geographic market coverage to better address the growth opportunities outside of North America. Additionally, we intend to augment the resources we have to address attractive growth opportunities in emerging economies for our entire business.

Strategic Relationships and Acquisitions We are focused on building relationships and gaining access to products and technologies that will enable us to continue to penetrate and develop point-of-care visualization. We believe that new relationships, products, and technologies can accelerate market penetration to customers not served by our direct sales force. Through our acquisition of VisualSonics we intend to integrate micro-ultrasound and photoacoustics technology with our miniaturization competency and user design to deliver ultra high-frequency micro-ultrasound into clinical medicine. During 2010, we invested in Carticept Medical Inc. (Carticept), a privately held company that develops innovative injection products for the treatment of musculoskeletal injuries. We believe this relationship will expand our access to the market segment for ultrasound-guided injections.

Results of Operations

The increase in revenue over the prior year quarter was attributable to improved execution against our marketing strategies. We believe our strong and growing product pipeline, alongside our expanding distribution capability, has positioned us well to capitalize on a growing market for point of care ultrasound. As we enhance our product offerings, integrate the acquisition of VisualSonics and develop strategic alliances, we believe opportunities to increase revenue will grow.

Table of Contents

The following financial information sets forth our results of operations and is derived from our condensed consolidated financial statements (in thousands except percentages):

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2011		2010		2011		2010	
Revenue	$ 75,732	100.0%	$ 68,538	100.0%	$ 219,526	100.0%	$ 186,064	100.0%
Cost of revenue	21,542	28.4%	19,675	28.7%	64,148	29.2%	53,150	28.6%
Gross margin	54,190	71.6%	48,863	71.3%	155,378	70.8%	132,914	71.4%
Operating expenses:								
Research and development	10,716	14.1%	8,455	12.3%	30,807	14.0%	23,263	12.5%
Selling, general and administrative	39,584	52.3%	35,320	51.5%	114,695	52.2%	95,745	51.5%
Total operating expenses	50,300	66.4%	43,775	63.8%	145,502	66.2%	119,008	64.0%
Operating income	3,890	5.2%	5,088	7.5%	9,876	4.6%	13,906	7.4%
Other expense, net	(3,313)	(4.4)%	(3,799)	(5.5)%	(8,789)	(4.0)%	(8,498)	(4.6)%
Income before income taxes	577	0.8%	1,289	2.0%	1,087	0.6%	5,408	2.8%
Income tax (benefit) provision	(143)	(0.2)%	347	0.5%	452	0.2%	1,208	0.6%
Net income	$ 720	1.0%	$ 942	1.5%	$ 635	0.4%	$ 4,200	2.2%

17

Table of Contents

Revenue

Overall revenue increased for the three and nine months ended September 30, 2011 compared to the three and nine months ended September 30, 2010. The increase for the three months ended September 30, 2011 was primarily attributable to the organic growth from the U.S. Direct and enterprise channels, and a favorable impact from exchange rates of $1.5 million or 2.1% over the prior year quarter. The increase for the nine months ended September 30, 2011 was primarily attributable to revenue growth from the acquisition of pre-clinical VisualSonics, organic growth from the U.S. Direct and enterprise channels, and a favorable impact from exchange rates of $5.2 million or 2.8% over the prior year. Revenue is as follows (in thousands except percentages):

	Three Months Ended September 30,		Percentage	Nine Months Ended September 30,		Percentage
	2011	2010	Change	2011	2010	Change
Revenue:						
US-Clinical	$ 38,239	$ 31,266	22.3%	$ 103,363	$ 88,237	17.1%
International-Clinical	29,337	28,560	2.7%	91,512	89,115	2.7%
Pre-clinical	8,156	8,712	(6.4)%	24,651	8,712	182.9%
Total revenue	$ 75,732	$ 68,538	10.5%	$ 219,526	$ 186,064	18.0%

US-Clinical

US-Clinical revenue for three months ended September 30, 2011 increased by 22.3% compared to the three months ended September 30, 2010 due primarily to an increase in US direct and enterprise sales, offset by a decrease in revenue from primary care sales. US-Clinical revenue for nine months ended September 30, 2011 increased by 17.1% compared to the nine months ended September 30, 2010 due primarily to an increase in US direct and enterprise sales, offset by a decrease in revenue from primary care sales.

International-Clinical

International-Clinical revenue for the three months ended September 30, 2011 increased by 2.7% compared to the three months ended September 30, 2010 due primarily to increased revenues from Canada, Europe (excluding France) and Asia (excluding Australia), offset by decreases in France, Australia and Latin America. Changes in exchange rates had a 5.0% combined favorable impact on revenue for the three months ended September 30, 2011 over the prior year quarter. International-Clinical revenue for the nine months ended September 30, 2011 increased by 2.7% compared to the nine months ended September 30, 2010 due primarily to increased revenues from Canada, Germany, India and China, offset by decreases in Europe. Changes in exchange rates had a 5.9% combined favorable impact on revenue for the nine months ended September 30, 2011 over the prior year.

Pre-clinical

On June 30, 2010, we acquired all of the outstanding stock of VisualSonics. Revenue from VisualSonics for the three months ended September 30, 2011 decreased by 6.4% compared to the three months ended September 30, 2010 due primarily to delays in pre-clinical funding internationally. Revenue from VisualSonics for the nine months ended September 30, 2011 was $24.7 million.

Gross margin

	Three Months Ended September 30,		Percentage of Revenue		Nine Months Ended September 30,		Percentage of Revenue	
	2011	2010	2011	2010	2011	2010	2011	2010
Gross Margin	$ 54,190	$ 48,863	71.6%	71.3%	$ 155,378	$ 132,914	70.8%	71.4%

Gross margin for the three months ended September 30, 2011 increased by 0.3 percentage points compared to the three months ended September 30, 2010 due to improved margins for VisualSonics that were slightly offset by international pricing pressure. Changes in exchange rates had a 0.6% combined favorable impact on gross margin for the three months ended September 30, 2011 as compared to the three months ended September 30, 2010. Gross margin for the nine months ended September 30, 2011 decreased by 0.6 percentage points compared to the nine months ended September 30, 2010 due to international pricing pressure. Changes in exchange rates had a 0.7% combined favorable impact on gross margin for the nine months ended September 30, 2011 as compared to the nine months ended September 30, 2010.

Table of Contents

Operating expenses

	Three Months Ended September 30, 2011	2010	Percentage of Revenue 2011	2010	Nine Months Ended September 30, 2011	2010	Percentage of Revenue 2011	2010
Research and development	$ 10,716	$ 8,455	14.1%	12.3%	$ 30,807	$ 23,263	14.0%	12.5%
Sales, general and administrative	$ 39,584	$ 35,320	52.3%	51.5%	$ 114,695	$ 95,745	52.2%	51.5%

Research and development expenses were $10.7 million for the three months ended September 30, 2011, compared to $8.5 million for the three months ended September 30, 2010. The increase for the three months ended September 30, 2011 compared to the prior year quarter was primarily attributable to an increase in headcount and expenses associated with new product development. Research and development expenses were $30.8 million for the nine months ended September 30, 2011, compared to $23.3 million for the nine months ended September 30, 2010. The increase for the nine months ended September 30, 2011 compared to the prior year was primarily attributable to the addition of VisualSonics and an increase in headcount and expenses associated with new product development.

Sales, general and administrative expenses were $39.6 million for the three months ended September 30, 2011, compared to $35.3 million for the three months ended September 30, 2010. The increase for the three months ended September 30, 2011 compared to the prior year quarter was primarily attributable to increased payroll and marketing expenses, offset by decreased consulting and bad debt expense. Sales, general and administrative expenses were $114.7 million for the nine months ended September 30, 2011, compared to $95.7 million for the nine months ended September 30, 2010. The increase for the nine months ended September 30, 2011 compared to the prior year was primarily attributable to the addition of VisualSonics, increased payroll expenses and marketing expenses, offset by decreased outside services and costs associated with the acquisition of VisualSonics.

Other expense

	Three Months Ended September 30, 2011	2010	Percentage of Revenue 2011	2010	Nine Months Ended September 30, 2011	2010	Percentage of Revenue 2011	2010
Other expense	$ 3,313	$ 3,799	(4.4)%	(5.5)%	$ 8,789	$ 8,498	(4.0)%	(4.6)%

Total other expense was $3.3 million for the three months ended September 30, 2011, compared to $3.8 million for the three months ended September 30, 2010. The decrease for the three months ended September 30, 2011 compared to the prior year quarter was due to lower losses on foreign exchange hedges. Total other expense was $8.8 million for the nine months ended September 30, 2011, compared to $8.5 million for the nine months ended September 30, 2010. The increase for the nine months September 30, 2011 compared to the prior year was due to higher losses on foreign exchange hedges and interest expense.

Income tax (benefit) provision

	Three Months Ended September 30, 2011	2010	Nine Months Ended September 30, 2011	2010
Income tax (benefit) provision	$ (143)	$ 347	$ 452	$ 1,208
Effective tax rate	(24.8)%	26.9%	41.6%	22.3%

The income tax (benefit) provision is based on a blended federal and state rate applied to U.S. income and the applicable foreign rates applied to foreign income. For the year ended December 31, 2011, we have forecasted an annual tax rate of 38.4%. This annual forecast includes an estimated increase in the valuation allowance on VisualSonics net operating losses and tax credits generated during the year because it is more likely than not these losses and credits will not be realized.

Table of Contents

The decrease in our consolidated effective tax rate for the three months ended September 30, 2011 as compared to the same period for 2010 resulted from favorable resolution of uncertain tax positions during 2011 as compared to non-deductible transaction costs incurred in 2010 and no benefit recognized related to research and experimentation credits in 2010 as compared to 2011. Additionally in 2011 no tax benefit has been recognized for the losses generated by VisualSonics due to uncertainty regarding future realization. The increase in our consolidated effective tax rate for the nine months ended September 30, 2011 as compared to the same period for 2010 resulted from favorable resolution of uncertain tax positions upon completion of tax audits in certain foreign jurisdictions during 2010 as compared to 2011 and in 2011 no tax benefit has been recognized for the losses generated by VisualSonics due to uncertainty regarding future realization.

Liquidity and Capital Resources

Our cash and cash equivalents balance was $75.5 million as of September 30, 2011, compared to $78.7 million as of December 31, 2010. Cash and cash equivalents were primarily invested in money market accounts.

Cash Flows

	Nine Months Ended September 30,	
	2011	**2010**
Net cash (used in) provided by:		
Operating activities	$ (4,142)	$ 17,527
Investing activities	(3,276)	4,105
Financing activities	4,826	(131,354)
Effect of exchange rate changes on cash and cash equivalents	(627)	(1,594)
Net change in cash and cash equivalents	$ (3,219)	$ (111,316)

Operating activities used cash of $4.1 million for the nine months ended September 30, 2011, compared to providing cash of $17.5 million for the nine months ended September 30, 2010. The decrease in cash flows from operating activities for the nine months ended September 30, 2011 compared to the nine months ended September 30, 2010 was primarily driven by a decrease in earnings and accrued expenses along with the increase in inventory in support of market expansion and new products offerings.

Table of Contents

Investing activities used cash of $3.3 million for the nine months ended September 30, 2011, compared to cash provided of $4.1 million for the nine months ended September 30, 2010. The decrease in cash flows used from investing activities for the nine months ended September 30, 2011 compared to September 30, 2010 was due to the $61.4 million acquisition of VisualSonics, our $8.0 million investment in Carticept, offset by net cash provided by maturities of investment securities.

Financing activities provided cash of $4.8 million for the nine months ended September 30, 2011, compared to cash used of $131.4 million for the nine months ended September 30, 2010. The increase in cash flows from financing activities for the nine months ended September 30, 2011, compared to September 30, 2010, resulted primarily from increased stock exercises for the nine months ended September 30, 2011, offset by the repayment of $8.9 million of long term debt and $126.1 million of stock repurchases during the nine months ended September, 30 2010.

We currently believe that our existing cash balances and anticipated future cash flows from operations will be sufficient to meet our ongoing operating capital expenditure requirements for the foreseeable future.

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, 2010. There were no significant changes in those risk factors during the ninie months ended September 30, 2011.

Critical Accounting Policies and Estimates

The discussion and analysis of our financial condition and results of operations are based upon our condensed 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 condensed 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, 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, 2010, our critical accounting policies and estimates include revenue recognition, business combination, valuation of investments and inventories, warranty expense, income taxes, stock-based compensation, and convertible debt. There were no significant changes to these critical accounting policies during 2011.

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.

As of September 30, 2011, our cash and cash equivalents consisted of $66.4 million of interest-bearing money market accounts. We believe that the impact on the fair market value of our securities and related earnings for 2011 from a hypothetical 10% increase or decrease in market interest rates would not have a material impact on cash and cash equivalents.

Foreign currency risk

Because of our international presence, we are exposed to foreign currency risk from both trade and intercompany balances denominated in currencies other than the local currency and from translation of our foreign subsidiaries operating results. We enter into foreign currency forward and option contracts to reduce the impact of fluctuations on earnings associated with foreign currency exchange rate changes. These foreign currencies include the Australian dollar, the British pound, the Canadian dollar, the European Union euro, and the Japanese yen. We use foreign exchange contracts to mitigate risk and do not intend to engage in speculative transactions. Currently our foreign exchange contracts do not qualify for derivative hedge accounting. We seek to manage the counterparty risk associated with engaging in foreign currency contracts by limiting transactions to counterparties with which we have established banking relationships.

A sensitivity analysis of a change in the fair value of these contracts, totaling $53.1 million in notional amount, indicates that if the USD weakened by 10% against the applicable foreign currency, the fair value of these contracts would decrease by approximately $5.3 million. Conversely, if the USD strengthened by 10% against the applicable foreign currency, the fair value of these contracts would increase by approximately $5.3 million. The offsetting gains and losses resulting from the changes in the intercompany balances as described above are not reflected in the sensitivity analysis above.

Table of Contents

Item 4. Controls and Procedures

Evaluation of disclosure controls and procedures

As of September 30, 2011, 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 and that such information is accumulated and communicated to our management, including our chief executive officer and our chief financial officer, as appropriate, to allow timely decisions regarding required disclosure.

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 our internal controls over financial reporting during the third quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

PART II: OTHER INFORMATION

Item 1. Legal Proceedings

We currently do not have any material outstanding claims that we have initiated or that have been initiated against us.

Table of Contents

Item 6. Exhibits

Exhibit No.	Description
4.1 (A)	First Amendment to Amended and Restated Rights Agreement (originally dated November 28, 2007) between SonoSite, Inc. and Computershare Trust Company, N.A. as Rights Agent, dated September 6, 2011. (exhibit 4.1)
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)
32.2	Certification of Principal Financial Officer pursuant to 18 U.S.C. Section 1350 Section 906 of the Sarbanes-Oxley Act of 2002)
101	The following financial information from Sonosite, Inc. s Quarterly Report on Form 10-Q for the quarter ended September 30, 2011 is formatted in XBRL: (i) the Unaudited Consolidated Condensed Statements of Income, (ii) the Unaudited Consolidated Condensed Balance Sheets, (iii) the Unaudited Consolidated Condensed Statements of Cash Flows, and (iv) the Notes to Unaudited Consolidated Condensed Financial Statements, tagged as blocks of text
(A)	Incorporated by reference to the designated exhibit included in SonoSite s report on Form 8-K filed on September 8, 2011.

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.

SONOSITE, INC.

(Registrant)

Dated: November 3, 2011

By: /s/ MARCUS Y. SMITH
Marcus Y. Smith
Senior Vice President, Chief Financial Officer and Treasurer
(Authorized Officer and Principal Financial Officer)