SONOSITE INC
Form 10-Q
November 09, 2005

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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.

For the quarterly period ended September 30, 2005

OR

Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

For the transition period from to ________ 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)**	**91-1405022** **(I.R.S. Employer Identification Number)**
21919 30th Drive SE, Bothell, WA **(Address of Principal Executive Offices)**	**98021-3904** **(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 is an accelerated filer (as defined in Exchange Act Rule 12b-2). Yes X No

Indicate by check mark whether the registrant is a shell company (as defined in Exchange Act Rule 12b-2). 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 **(Class)**	**15,776,269** **(Outstanding as of November 3–, 2005)**

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SonoSite, Inc.

Quarterly Report on Form 10-Q
For the Quarter Ended September 30, 2005

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PART I: FINANCIAL INFORMATION

Item 1. Financial Statements

SonoSite, Inc.

Condensed Consolidated Balance Sheets
(unaudited)

(In thousands, except share data) Assets	September 30, 2005	December 31, 2004
Current assets:		
Cash and cash equivalents	$ 21,224	$ 17,272
Short-term investment securities	19,944	14,319
Accounts receivable, less allowances of $927 and $942	34,114	33,586
Inventories	23,583	17,990
Deferred income taxes	5,532	3,596

Prepaid expenses and other current assets	2,870	2,476
Total current assets	107,267	89,239
Property and equipment, net	7,654	7,632
Investment securities	22,869	32,490
Deferred income taxes	21,332	21,189
Goodwill	1,008	972
Identifiable intangible assets, net	1,929	1,768
Other assets	1,388	1,802
Total assets	$ 163,447	$ 155,092
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable	$ 4,569	$ 6,360
Accrued expenses	10,318	10,747
Deferred revenue	4,865	4,522
Total current liabilities	19,752	21,629
Deferred rent	288	228
Total liabilities	20,040	21,857
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 September 30, 2005--15,747,167		
As of December 31, 2004--15,250,783	157	152
Additional paid-in-capital	208,614	196,318
Deferred stock compensation	(1,809)	--
Accumulated deficit	(64,325)	(64,444)
Accumulated other comprehensive income	770	1,209
Total shareholders' equity	143,407	133,235
Total liabilities and shareholders' equity	$ 163,447	$ 155,092

See accompanying notes to condensed consolidated financial statements.

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SonoSite, Inc.

Condensed Consolidated Statements of Operations
(unaudited)

(In thousands, except loss per share)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Revenue	$ 34,809	$ 29,124	$ 102,289	$ 78,714
Cost of revenue	10,297	9,601	30,784	26,632
Gross margin	24,512	19,523	71,505	52,082
Operating expenses:				
Research and development	3,803	2,943	11,017	9,063
Sales and marketing	15,464	12,652	50,277	36,400
General and administrative	3,175	2,686	9,656	7,065
Total operating expenses	22,442	18,281	70,950	52,528
Other income (expense):				
Interest income	459	241	1,147	680
Interest expense	--	--	--	(2)
Other	(5)	101	(795)	(112)
Total other income (expense)	454	342	352	566
Income before income taxes	2,524	1,584	907	120
Provision for income taxes	1,078	169	788	169
Net income (loss)	$ 1,446	$ 1,415	$ 119	$ (49)
Basic net income (loss) per share	$ 0.09	$ 0.10	$ 0.01	$ (0.00)
Diluted net income (loss) per share	$ 0.09	$ 0.09	$ 0.01	$ (0.00)
Weighted average common and potential common shares used in computing:				
Basic net income (loss) per share	15,630	14,837	15,461	14,742
Diluted net income (loss) per share	16,285	15,738	16,100	14,742

See accompanying notes to condensed consolidated financial statements.

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SonoSite, Inc.

Condensed Consolidated Statements of Cash Flows
(unaudited)

(In thousands)	Nine Months Ended September 30,	
	2005	2004

Operating activities:		
Net income (loss)	$ 119	$ (49)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	2,355	2,200
Equity in losses of affiliates	49	7
Net loss (gain) on investments	20	(39)
Amortization of premiums on investment securities	379	548
Stock-based compensation	65	76
Deferred income taxes	795	--
Changes in operating assets and liabilities:		
Accounts receivable	(1,714)	860
Inventories	(5,966)	(532)
Prepaid expenses and other assets	(144)	(2,474)
Accounts payable	(1,749)	2,177
Accrued expenses	(210)	2,485
Deferred liabilities	458	40
Net cash provided by (used in) operating activities	(5,543)	5,299
Investing activities:		
Purchases of investment securities	(33,321)	(25,868)
Proceeds from sales/maturities of investment securities	36,825	23,772
Purchases of property and equipment	(2,126)	(3,652)
Purchase of SonoMetric Health, Inc.	--	(2,070)
Purchase of SonoSite China Medical Ltd.	(402)	--
Net cash provided by (used in) investing activities	976	(7,818)
Financing activities:		
Exercise of stock options	7,461	3,693
Repayment of long-term obligations	--	(88)
Net cash provided by financing activities	7,461	3,605
Effect of exchange rate changes on cash and cash equivalents	1,058	(249)
Net change in cash and cash equivalents	3,952	837
Cash and cash equivalents at beginning of period	17,272	13,683
Cash and cash equivalents at end of period	$ 21,224	$ 14,520
Supplemental disclosure of cash flow information:		
Cash paid for income taxes	$ 276	$ --

See accompanying notes to condensed consolidated financial statements.

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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 furnished 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, 2005 are not necessarily indicative of expected results for the entire year ending December 31, 2005 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, 2004, included in our Annual Report on Form 10-K.

Certain prior year amounts have been reclassified to conform to current period presentation.

Stock-based compensation

At September 30, 2005, we had seven stock-based employee compensation plans. We account for those plans under the intrinsic value method in accordance with the provisions of Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25") and related interpretations. Accordingly, compensation cost related to stock option grants to employees has been recognized only to the extent that the fair market value of the stock exceeds the exercise price of the stock option at the date of the grant. We recognize compensation expense for restricted stock unit grants over the applicable vesting period.

The following table illustrates the effect on net income (loss) and net income (loss) per share if we had applied the fair value recognition provisions of Statement of Financial Accounting Standards ("SFAS") No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123"), to stock-based employee compensation (in thousands, except per share data):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Net income (loss), as reported	$ 1,446	$ 1,415	$ 119	$ (49)
Add: Stock-based employee compensation expense, as reported, net of related tax effects	76	--	110	--
Less: Stock-based employee compensation expense determined under fair value based method, net of related tax effects	(804)	(1,068)	(2,207)	(3,559)
Pro forma net income (loss)	$ 718	$ 347	$ (1,978)	$ (3,608)
Basic net income (loss) per share:				
As reported	$ 0.09	$ 0.10	$ 0.01	$ (0.00)
Pro forma	$ 0.05	$ 0.02	$ (0.13)	$ (0.24)
Diluted net income (loss) per share:				
As reported	$ 0.09	$ 0.09	$ 0.01	$ (0.00)
Pro forma	$ 0.04	$ 0.02	$ (0.13)	$ (0.24)

For the nine months ended September 30, 2005 and 2004, we excluded equity instruments from the calculation of diluted pro forma net loss per share because the effect of including such instruments is antidilutive.

We account for non-employee stock-based compensation in accordance with SFAS 123 and FASB Emerging Issues Task Force ("EITF"), Issue No. 96-18, "Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services."

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Cash and cash equivalents

Cash and cash equivalents consist of money market accounts with major U.S. banks and highly liquid debt instruments with original or remaining maturities at purchase of three months or less.

Investment securities

Investment securities consist of high-grade U.S. government or corporate debt and high-grade asset-backed securities. While our intent is to hold our securities until maturity, we classify all securities as available-for-sale, as the sale of such securities may be required prior to maturity to implement management strategies. These securities are carried at fair value, with the unrealized gains and losses reported as a component of other comprehensive income until realized. Realized gains and losses from the sale of available-for-sale securities, if any, are determined on a specific identification basis.

A decline in market value of any available-for-sale security below cost that is determined to be other than temporary results in a revaluation of its carrying amount to fair value. The impairment is charged to earnings and a new cost basis for the security is established. Premiums and discounts are amortized or accreted over the life of the related security as an adjustment to yield using the effective interest method. Interest income is recognized when earned.

Accounts receivable

In the ordinary course of business, we grant credit to a broad customer base. Of the accounts receivable balance at September 30, 2005, 44% and 56% were receivable from domestic and international parties, prior to any allowances. The same percentages as of December 31, 2004 were 39% and 61% prior to any allowances.

For the three months ended September 30, 2005, revenue was 59% domestic and 41% international, compared to 56% domestic and 44% international for the three months ended September 30, 2004. For the nine months ended September 30, 2005, revenue was 52% domestic and 48% international, compared to 53% domestic and 47% international for the nine months ended September 30, 2004.

We maintain an allowance for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. When we determine that amounts owed from customers are uncollectible, such amounts are charged off against the allowance for doubtful accounts. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

Fair value of financial instruments

The carrying value of our financial instruments, including cash and cash equivalents, accounts receivable, accounts payable and certain long-term other assets, approximates fair value. Cash and cash equivalents, accounts receivable and accounts payable approximate fair value due to their short-term nature. Other long-term assets approximate fair value as interest rates on these items approximate market. Our investment securities, which consist of high-grade debt securities, are carried at fair value. We may incur unrealized losses due to changes in market value attributable to changes in interest rates and not credit quality. We have the ability and intent to hold our investments until a recovery of fair value, which may be maturity. Accordingly, we view any unrealized losses as temporary at September 30, 2005.

We utilize foreign currency forward contracts to reduce our exposure to foreign currency risk due to fluctuations in exchange rates underlying the value of intercompany accounts receivable denominated in foreign currencies. We recognize all derivative financial instruments (foreign currency forward contracts) in accordance with SFAS No. 133 "Accounting for Derivative Instruments and Hedging Activities," as amended. Changes in the fair value of derivative instruments are recorded in earnings unless hedge accounting criteria are met. For derivative instruments designated as fair value hedges, the changes in fair value of both the derivative instrument and the hedged item are recorded in earnings. For derivative instruments designed as cash flow and net investment hedges, the effective portions of changes in the fair value of the derivative are recorded in other comprehensive income. The ineffective portions are recognized in earnings. As of September 30, 2005, we had $28.9 million in foreign currency forward contracts that expire on December 30, 2005.

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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 refurbished products held either as saleable inventory or as demonstration product. If market conditions are less favorable than those projected by management, additional downward inventory cost adjustments may be required.

Inventories consisted of the following, net of valuation adjustments (in thousands):

	As of	
	September 30, 2005	December 31, 2004
Raw material	$ 10,586	$ 5,965
Work-in-process	104	--
Demonstration inventory	5,108	4,112
Finished goods	7,785	7,913
Total	$ 23,583	$ 17,990

Property and equipment

Property and equipment are stated at historical cost, less accumulated depreciation and amortization. Maintenance and repair costs are expensed as incurred, and additions and improvements to property and equipment are capitalized.

Depreciation and amortization are calculated using the straight-line method over estimated useful lives as follows:

Asset	Estimated Useful Lives
Equipment and computers	3-5 years
Software	3-5 years
Furniture and fixtures	5 years
Leasehold improvements	Lesser of estimated useful life or remaining lease term

Direct internal and external costs for computer software developed for internal use are capitalized in accordance with Statement of Position ("SOP") 98-1, "Accounting for Costs of Computer Software Developed or Obtained for Internal Use." Capitalized costs are amortized using the straight-line method over the estimated useful lives beginning when each module is complete and ready for use.

The carrying value of long-lived assets is evaluated for impairment when events or changes in circumstances occur that may indicate the carrying amount of the asset may not be recoverable. For definite-lived intangible assets, we evaluate the carrying value of the assets by comparing the estimated future undiscounted cash flows generated from the use of the asset and its eventual disposition with the asset's reported net book value. For indefinite-lived intangible assets, we evaluate the carrying value of the asset by comparing its estimated fair market value with its reported net book value.

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Warranty liability

Our typical warranty period is one year except for the recently introduced SonoSite MicroMaxx (TM) system ("MicroMaxx system"), which has, with certain exceptions, a five-year warranty period. The warranty is included with the original purchase. The warranty liability is summarized as follows (in thousands):

	Balance at beginning of period	Charged to cost of revenue	Applied to liability	Balance at end of period
Three months ended September 30, 2005	$ 573	$ 365	$ (141)	$ 797
Three months ended September 30, 2004	$ 431	$ 155	$ (155)	$ 431
Nine months ended September 30, 2005	$ 561	$ 678	$ (442)	$ 797
Nine months ended September 30, 2004	$ 381	$ 452	$ (402)	$ 431

Concentration of credit and supply risk

Financial instruments that potentially subject us to concentrations of credit risk consist principally of cash equivalents, investments and accounts receivable.

We depend on some single-source suppliers to provide highly specialized parts and other components, and may experience an interruption of supply if a supplier is unable or unwilling to meet our time, quantity and quality requirements. There are relatively few alternative sources of supply for some of these items. A change in demand for some parts by other companies in our industry could also interrupt our supply of components.

Comprehensive income (loss)

Unrealized gains or losses on our available-for-sale securities and foreign currency translation adjustments are included in comprehensive income (loss).

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Net income (loss)	$ 1,446	$ 1,415	$ 119	$ (49)
Other comprehensive income (loss):				
Foreign currency translation adjustment	(44)	81	(381)	(279)
Unrealized holding gains (losses) arising during the period, net of tax	(92)	87	(71)	(206)
Less reclassification adjustment for losses (gains) included in net income (loss), net of tax	3	3	13	(39)
Comprehensive income (loss)	$ 1,313	$ 1,586	$ (320)	$ (573)

Net income (loss) per share

Basic net income (loss) per share is based on the weighted average of all common shares issued and outstanding, and is calculated by dividing net income (loss) by the weighted average shares outstanding during the period. Diluted net income (loss) per share is calculated by dividing net income (loss) by the weighted average number of common shares used in the basic net income (loss) per share calculation plus the number of common shares that would be issued assuming exercise of all potentially dilutive common shares outstanding using the treasury stock method.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Net income (loss)	$ 1,446	$ 1,415	$ 119	$ (49)
Weighted average common shares outstanding used in computing basic net income (loss) per share	15,630	14,837	15,461	14,742
Effect of dilutive stock options and restricted stock units	655	901	639	--
Weighted average common shares outstanding used in computing diluted net income (loss) per share	16,285	15,738	16,100	14,742

We exclude equity instruments from the calculation of diluted weighted average shares outstanding if the effect of including such instruments is antidilutive to net income (loss) per share. Accordingly, certain employee stock options and restricted stock units totaling 10,000 and 374,000 shares for the three months ended September 30, 2005 and 2004 and 148,000 and 2,686,000 shares for the nine months ended September 30, 2005 and 2004 have been excluded from the calculation of diluted weighted average shares.

Income taxes

The income tax provision for the three and nine month periods ended September 30, 2005 was computed in accordance withAPB Opinion No. 28, "Interim Financial Reporting," and FASB Interpretation No. 18, "Accounting for Income Taxes in Interim Periods," and was based on projections of total year pre-tax income and the projected total year tax provision computed in accordance with SFAS No. 109, "Accounting for Income Taxes." We are required to estimate the effective income tax rate in each of the jurisdictions in which we operate. 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. 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.

Foreign currency translation

The functional currencies of our international subsidiaries consisting primarily of the British pound, the European Union euro and the Japanese yen, are the local currency of the country in which the subsidiary is located. Assets and liabilities denominated in foreign currencies are translated at the exchange rate on the balance sheet date. Revenues, costs and expenses of international operations are translated at average rates of exchange prevailing during the period. Net realized and unrealized gains on currency transactions were $9,000 and $116,000 for the three months ended September 30, 2005 and 2004, compared with losses of $806,000 and $70,000 for the nine months ended September 30, 2005 and 2004, and are included in other income (expense).

Indemnification Obligations and Guarantees

We apply the disclosure provisions of FASB Interpretation No. ("FIN") 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" ("FIN 45") to our agreements that contain guarantee or indemnification clauses. 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 give rise only to the disclosure provisions of FIN 45.

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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.

Litigation

On July 24, 2001, Neutrino Development Corporation ("Neutrino") filed a complaint against us in U.S. District Court, Southern District of Texas, Houston Division, alleging infringement of U.S. Patent 6,221,021, ("the '021 patent"), by SonoSite as a result of our use, sale and manufacture of the SonoSite 180, SonoSite 180PLUS, SonoHeart and SonoHeart Plus devices. Subsequently, the SonoHeart ELITE, iLook, TITAN and MicroMaxx systems were also added to the lawsuit. The complaint asserts claims for preliminary and permanent injunctive relief enjoining all alleged acts of infringement, compensatory and enhanced damages, attorney's fees and costs, and pre- and post-judgment interest. On August 14, 2001, we filed an answer asserting affirmative defenses of non-infringement and patent invalidity, and included a counterclaim seeking a declaratory judgment of non-infringement and invalidity regarding Neutrino's patent. On October 4, 2001, the court denied a request by Neutrino for preliminary injunctive relief to prevent us from manufacturing and selling our products pending the ultimate disposition of the litigation. On February 20, 2002, in what is known as a "Markman" hearing, the parties presented their arguments regarding the proper construction of Neutrino's patent claims.

On August 20, 2003, the U.S. District Court in the Southern District of Texas issued a decision interpreting certain terms used in the '021 patent. This decision does not discuss whether the patent is valid or whether the patent would apply to any of our products. In the order, the court, in resolving disputed terms in the Markman hearing, adopted our construction of the term "a portable body designed to be hand held", and adopted Neutrino's construction of the terms "the moveably connected transducer mounting assembly" and "ultrasound emitter". The court denied our motion for summary judgment. We subsequently filed a new summary judgment motion using the court's construction of the claim language that the '021 patent is invalid based on prior art. Neutrino filed a summary judgment motion based on its allegations of infringement.

On September 30, 2004, the Texas court issued its rulings on the summary judgment motions. First, the court denied our motion for summary judgment based on invalidity, finding that there are issues of fact in dispute that must be resolved by a jury at trial. Second, the court granted Neutrino's motion for summary judgment of infringement, finding that the SonoSite products infringe the '021 patent as the court has construed the claims in the Markman hearing. As a result, the court ordered us and Neutrino to enter into mediation, which was required to be completed by January 31, 2005. Mediation was unsuccessful and the court set a jury trial date for the fall of 2005. However, as of the date of this filing, no specific trial date has yet been set. The parties have completed the filing of pretrial motions and expert reports, discovery, and depositions. Prior to the start of trial, the court must rule on numerous motions filed by the parties that are pending before it.

Neutrino also filed suit in the Middle District of Florida on August 19, 2003 against a former SonoSite distributor alleging that the sale of our products by such distributor infringes the '021 patent. SonoSite assumed the defense of the distributor in accordance with our contractual obligations under the distribution agreement. In December 2004, Neutrino agreed to dismissal of all claims in this suit in return for SonoSite's consent to Neutrino's filing of a Second Amended Complaint in the Texas proceeding to add the SonoSite TITAN, SonoHeart ELITE and iLook systems to the Texas suit. Neutrino had also previously filed a similar suit in the Middle District of Tennessee against another medical device distributor for selling a SonoSite product. The Tennessee case was dismissed based on a final judgment and permanent injunction filed a month after the case was filed. The Florida action and the Tennessee judgment have no effect on the Texas proceedings.

We believe that we have good and sufficient defenses to the claims of patent infringement asserted against us by Neutrino and we are vigorously defending ourselves in these matters. If we are not successful in our defense of these claims, we could be forced to pay damages related to past product sales, modify or discontinue selling our products or may enter into royalty or licensing agreements for future product sales, which may not be available on terms acceptable to us, if at all, and which could adversely affect our financial condition, results of operations and cash flow. Sales of the allegedly infringing products represented the majority of our revenue for the nine-month periods ended September 30, 2005 and 2004.

We have not accrued any amounts for potential losses related to the Neutrino matter. Because of uncertainties related to the potential outcome and any range of loss on this matter, 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 this matter. We will record accruals for losses if and when we determine the negative outcome of such matters to be probable and reasonably estimable. 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.

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Acquisition

As of March 31, 2005, we had a 30% ownership interest in SonoSite China Medical Ltd. ("SCM"), a joint venture in China to market our products there. In April 2005, we acquired the remaining 70% of SCM for approximately $402,000. The results of SCM's operations have been included in our consolidated financial statements since that date. The estimated fair value of the assets acquired and liabilities assumed at the date of acquisition was approximately $43,000 for net tangible assets and $359,000 for indefinite-lived intangible assets. The indefinite-lived intangible assets are comprised primarily of reacquired distribution rights. We have determined that they have indefinite lives because there are no legal, regulatory or contractual provisions that may limit their useful lives.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	**2004**	**2005**	**2004**
United States	$ 20,390	$ 16,236	$ 53,282	$ 41,906
Europe, Africa and the Middle East	7,672	6,999	28,972	23,743
Japan	3,103	3,105		