SONOSITE INC
Form 10-Q
May 15, 2003

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 March 31, 2003

OR

o 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	**91-1405022**
(State or Other Jurisdiction of Incorporation or Organization)	**(I.R.S. Employer 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 o

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). Yes x No o

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	**14,225,136**
(Class)	(Outstanding as of May 12, 2003)

SonoSite, Inc.

Quarterly Report on Form 10-Q
For the Three Months Ended March 31, 2003

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PART I: FINANCIAL INFORMATION

Item 1. Financial Statements

SonoSite, Inc.

Condensed Consolidated Balance Sheets
(unaudited)

	March 31, 2003	December 31, 2002
	(In thousands, except share data)	
Assets		
Current assets:		
Cash and cash equivalents	$ 25,636	$ 26,381
Short-term investment securities	23,170	10,019
Accounts receivable, less allowance for doubtful accounts of $866 and $832	16,731	20,101
Inventories	13,389	11,787
Prepaid expenses and other current assets	1,006	1,339
Total current assets	79,932	69,627
Property and equipment, net	5,727	6,092
Investment securities	16,110	29,421
Other assets	690	737
Total assets	$ 102,459	$ 105,877
Liabilities and Shareholders Equity		
Current liabilities:		
Accounts payable	$ 2,803	$ 4,310
Accrued expenses	5,384	5,404
Current portion of long-term obligations	141	136
Deferred revenue	3,317	3,072
Total current liabilities	11,645	12,922
Deferred rent	270	253
Long-term obligations, less current portion	51	88
Total liabilities	11,966	13,263

Commitments and contingencies

Shareholders equity:		
Preferred stock, $1.00 par value		
Authorized shares 6,000,000		
Issued and outstanding shares none		
Common stock, $.01 par value		
Authorized shares 50,000,000		
Issued and outstanding shares:		
As of March 31, 2003 14,216,512		
As of December 31, 2002 14,195,280	142	142
Additional paid-in-capital	177,151	177,007
Accumulated deficit	(88,196)	(85,632)
Accumulated other comprehensive income	1,396	1,097
Total shareholders equity	90,493	92,614
Total liabilities and shareholders equity	$ 102,459	$ 105,877

See accompanying notes to condensed consolidated financial statements.

SonoSite, Inc.

Condensed Consolidated Statements of Operations
(unaudited)

	Three Months Ended March 31,	
	2003	**2002**
	(In thousands, except loss per share)	
Revenue	$ 17,158	$ 12,843
Cost of revenue	6,367	5,395
Gross margin	10,791	7,448
Operating expenses:		
Research and development	2,833	3,248
Sales and marketing	8,890	6,331
General and administrative	2,005	1,525
Total operating expenses	13,728	11,104
Other income (expense):		
Interest income	270	122
Interest expense	(7)	(8)
Other income (expense)	110	(129)
Total other income (expense)	373	(15)
Net loss	$ (2,564)	$ (3,671)
Basic and diluted net loss per share	$ (0.18)	$ (0.32)
Weighted average common and potential common shares used in computing net loss per share	14,206	11,372

See accompanying notes to condensed consolidated financial statements.

SonoSite, Inc.

Condensed Consolidated Statements of Cash Flows
(unaudited)

	Three Months Ended March 31,	
	2003	**2002**
	(In thousands)	
Operating activities:		
Net loss	$ (2,564)	$ (3,671)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	601	576
Equity in losses of affiliates		134
Net gain on investments	(17)	
Amortization of premiums on investment securities	176	
Changes in operating assets and liabilities:		
Accounts receivable	3,438	2,475
Receivable from affiliate		34
Inventories	(1,563)	(184)
Prepaid expenses and other assets	380	109
Accounts payable	(1,511)	1,246
Accrued expenses	(27)	(156)
Deferred liabilities	266	285
Net cash provided by (used in) operating activities	(821)	848
Investing activities:		
Purchase of investments	(6,115)	
Proceeds from sales/maturities of investments	6,095	
Purchase of property and equipment	(236)	(326)
Net cash used in investing activities	(256)	(326)
Financing activities:		
Exercise of stock options	144	82
Repayment of long-term obligations	(32)	(31)
Cash used for offering costs		(15)

Net cash provided by financing activities	112	36
Effect of exchange rate changes on cash and cash equivalents	220	(10)
Net change in cash and cash equivalents	(745)	548
Cash and cash equivalents at beginning of period	26,381	33,116
Cash and cash equivalents at end of period	$ 25,636	$ 33,664
Supplemental disclosure of cash flow information:		
Cash paid for interest	$ 7	$ 8
Supplemental disclosure of non-cash investing and financing activities:		
Unrealized loss on investments	$ (4)	$
Offering costs included in accounts payable and accrued expenses	$	$ 479

See accompanying notes to condensed consolidated financial statements.

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 months ended March 31, 2003 are not necessarily indicative of our expected results for the entire year ending December 31, 2003 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, 2002, included in our Annual Report on Form 10-K. Certain amounts reported in previous periods have been reclassified to conform to current presentation.

Stock-based Compensation

At March 31, 2003, we had five 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. 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. The following table illustrates the effect on net loss and net loss per share if we had applied the fair value recognition provisions of SFAS No. 123, Accounting for Stock-Based Compensation, to stock-based employee compensation (in thousands, except per share data):

	Three Months Ended March 31,	
	2003	**2002**
Net loss, as reported	$ (2,564)	$ (3,671)
Less: Stock-based employee compensation expense determined under fair value based method	(1,400)	(1,968)
Pro forma net loss	$ (3,964)	$ (5,639)
Basic and diluted net loss per share:		
As reported	$ (0.18)	$ (0.32)
Pro forma	$ (0.28)	$ (0.50)

Financial Instruments

Cash Equivalents

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. 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 (loss) 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 March 31, 2003, 49% and 51% were receivable from international and domestic parties, prior to any allowance for doubtful accounts. The same percentages as of December 31, 2002 were 51% and 49% prior to any allowance for doubtful accounts.

For the three months ended March 31, 2003, revenue was 57% domestic and 43% international, compared to 51% domestic and 49% international for the three months ended March 31, 2002.

The following table presents individual customers whose outstanding receivable balance as a percentage of total trade receivables and/or revenue as a percentage of total revenue exceeded 10%:

Accounts Receivable:

	March 31, 2003	December 31, 2002
Japanese distributor		12 %
U.S. direct customer	12 %	12 %
Totals	12 %	24 %

Revenue:

	Three Months Ended March 31,	
	2003	2002
Japanese distributor		11 %

We maintain allowances 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 allowances 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, certain long-term other assets and debt, 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 and debt approximate fair value as interest rates on these instruments approximate market. Investment securities are carried at fair value.

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, and items that have been shipped to customers for which revenue recognition requirements have not been met, including products whose title and custody have passed to the customer. Adjustments to cost are recorded for obsolete material, earlier generation products and refurbished products held either as saleable inventory or as demonstration product. The adjustments reduce their carrying values to amounts not lower than that which will result in approximately normal profit margins upon sale. Inventory items for which title has passed to customers are evaluated for recoverability based on the same process we use to evaluate collection of accounts receivable. If market conditions are less favorable than those projected by management, additional downward inventory cost adjustments may be required.

Inventories consist of the following (in thousands):

	As of	
	March 31, 2003	**December 31, 2002**
Raw material	$ 4,955	$ 4,678
Work-in-process	534	120
Demonstration inventory	2,486	2,680
Finished goods	5,414	4,309
Total	$ 13,389	$ 11,787

At March 31, 2003 and December 31, 2002, finished goods includes approximately $0.3 million and $0.5 million of inventory whose title had passed to the customer and for which revenue has not yet been recognized.

Property and Equipment

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

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

Asset	Estimated Useful Lives
Equipment, other than computer	3-7 years
Software	3 years
Computer equipment	3-5 years
Furniture and fixtures	5 years
Leasehold improvements	Lesser of estimated useful life or expected remaining lease term

Direct internal and external costs for computer software developed for internal use are capitalized in accordance with 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. Such costs are insignificant for all periods presented.

The carrying value of long-lived assets is evaluated for impairment when events or changes in circumstances occur, which may indicate the carrying amount of the asset may not be recoverable. 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 assets reported net book value.

Warranty liability

Our typical warranty period is one year and is included with the original purchase of our ultrasound imaging systems. The warranty liability is summarized as follows (in thousands):

	Balance at December 31, 2002	Charged to cost of revenue	Applied to liability	Balance at March 31, 2003
Three months ended March 31, 2003	$ 331	$ 94	$ (44)	$ 381

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. An increase in demand for some parts by other companies in our industry could also interrupt our supply of components. For example, in March 2003, one of our component suppliers, Philips Semiconductor (Philips), informed us that, commencing in September 2003, it would discontinue production of our integrated circuit chips using 0.35-micron technology. We

have designed and implemented a new chip using 0.2-micron technology that will continue to be produced by Philips to replace all but one of the discontinued chips. We expect to design and implement an additional new chip to replace the remaining 0.35-micron chip by early 2005. In the second quarter of 2003, we entered into a purchase commitment totaling approximately $3.6 million for supplies of 0.35-micron chips from Philips for our anticipated manufacturing needs until new chips have been incorporated in all of our products. Demand for our products, however, may exceed our forecasts, in which case we would require additional 0.35-micron chips to manufacture additional products. Conversely, if demand for our products falls short of our forecasts, we may experience excess inventory of 0.35-micron chips. If our actual demand for these chips varies significantly from our forecasted demand, we may experience delays in manufacturing, lost sales, a write-down of inventory or a deterioration in gross margin.

Accumulated Other Comprehensive Loss

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

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

	Three Months Ended March 31,	
	2003	2002
Net loss	$ (2,564)	$ (3,671)
Other comprehensive income (loss):		
Foreign currency translation adjustment	320	(43)
Unrealized holding losses arising during the period	(4)	
Less reclassification adjustment for gains included in net loss	(17)	
Comprehensive loss	$ (2,265)	$ (3,714)

Net Loss per Share

Basic and diluted net loss per share was computed by dividing the net loss by the weighted average common shares outstanding. Outstanding options to purchase our shares were not included in the computations of diluted net loss per share because to do so would be antidilutive. As of March 31, 2003 and 2002, our outstanding options totaled 2,863,128 and 2,715,718.

Foreign Currency Translation

The functional currencies of our international subsidiaries 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. Net sales, costs and expenses of international operations are translated at average rates of exchange prevailing during the period. Realized and unrealized gains and losses on currency transactions were immaterial in all periods presented.

Litigation

On July 24, 2001, Neutrino Development Corporation 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 by SonoSite as a result of our use, sale and manufacture of the SonoSite 180, SonoSite 180 PLUS, SonoHeart and SonoHeart PLUS devices. 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 alternative defenses of non-infringement and patent invalidity, and including 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. The court has not yet ruled on the issues presented in that hearing. On October 10, 2002, the court granted our motion to stay the proceedings until it issues its Markman order and rules on our summary judgment motion. We believe we have good and sufficient defenses to the claims of patent infringement asserted against us by Neutrino and we are vigorously defending ourselves in this matter, however this litigation may result in an adverse

judgment.

Segment Reporting

We currently have one reporting 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 March 31,	
	2003	**2002**
United States	$ 9,834	$ 6,568
Europe, Africa and the Middle East	5,072	3,115
Japan	137	1,379
Other Asia (a)	1,118	650
Canada, Australia, South and Latin America	997	1,131
Total revenue	$ 17,158	$ 12,843

(a) Other Asia includes primarily China, India and Taiwan.

New Accounting Pronouncements

In June 2001, the FASB issued SFAS No. 143, Accounting for Asset Retirement Obligations, which provides the accounting requirements for retirement obligations associated with tangible long-lived assets. SFAS No. 143 requires entities to record the fair value of a liability for an asset retirement obligation in the period in which it is incurred. SFAS No. 143 is effective for our 2003 fiscal year and we adopted this statement on January 1, 2003. The adoption of this statement did not have a material impact on our financial statements.

In November 2002, the Emerging Issues Task Force (EITF) reached a consensus on EITF 00-21, Revenue Arrangements with Multiple Deliverables with respect to determining when and how to allocate revenue from sales with multiple deliverables. The EITF 00-21 consensus provides a framework for determining when and how to allocate revenue from sales with multiple deliverables based on a determination of whether the multiple deliverables qualify to be accounted for as separate units of accounting. The consensus is effective prospectively for arrangements entered into in fiscal periods beginning after June 15, 2003. We do not expect that the adoption of this consensus will have a material impact on our financial statements.

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

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

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

Words such as believe, anticipate, expect and intend may identify forward-looking statements, but the absence o 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 under the caption Important Factors That May Affect Our Business, Our Results of Operations and Our Stock Price in this report. 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

We are a leading provider of point-of-care, high performance, all-digital ultrasound imaging systems for use in a variety of clinical applications and settings. Our proprietary technologies have enabled us to design point-of-care diagnostic ultrasound systems that combine all-digital, high-resolution imaging with advanced features and capabilities traditionally found on cart-based ultrasound systems. We believe that the portability, high quality and cost effectiveness of our products are expanding existing markets and will create new markets for ultrasound imaging by bringing ultrasound out of the imaging center to the point of care such as the patient s bedside or the physician s examining table.

The size and complexity of traditional ultrasound systems typically compel physicians to refer patients to a highly trained sonographer employed by an imaging center, such as a hospital s radiology department. By providing ultrasound at the primary point of care, our easy-to-use systems can eliminate delays associated with the referral process and enable physicians to use ultrasound more frequently and in a wider variety of clinical settings. This increased accessibility creates the potential for enhanced patient care through earlier diagnosis of diseases and conditions.

We currently focus on six key market segments: radiology, obstetrics and gynecology, emergency medicine, surgery, cardiology and vascular medicine. Our current products include the SonoSite 180PLUS, for general ultrasound imaging, the SonoHeart ELITE, specifically configured for cardiovascular applications, the iLook 15, intended for quick look diagnostics in areas such as emergency medicine, radiology, surgery or intensive care, and the iLook 25, designed to provide visual imaging for physicians and nurses while performing vascular access procedures. Our SonoSite 180PLUS and SonoHeart ELITE products are used together with any of our seven interchangeable point-of-care components, or transducers, that are designed for specific clinical applications. Our iLook products each have a single transducer for specific clinical applications. On April 9, 2003, we introduced our newest product, the SonoSite TITAN . The TITAN is based on the next generation of our proprietary ASIC (Application Specific Integrated Circuit) technology for high-resolution general ultrasound imaging. We anticipate that the first shipments of TITAN will occur in the latter part of June 2003.

We were formerly a division of ATL Ultrasound, Inc., or ATL. On April 6, 1998, we were spun off as an independent, publicly owned Washington corporation to further the development and commercialization of point-of-care, high performance, all-digital ultrasound imaging systems. ATL retained no ownership in us following the spin-off. We entered into a technology transfer and license agreement with ATL pursuant to which we took ownership of certain ultrasound technology developed as part of a government grant and also patent rights, which had been established or were being pursued for that technology. As part of this agreement, we also entered into a cross-license whereby we have the exclusive right to use certain ATL technology existing on April 6, 1998 or developed by ATL during the three-year period following April 6, 1998 in ultrasound systems weighing 15 pounds or less, and ATL has the exclusive right to use our technology existing on April 6, 1998 or developed by us during the same three-year period in ultrasound systems weighing more than 15 pounds. On April 6, 2003, this cross-license became nonexclusive and, except for the patented technology of each party, extends to all ultrasound systems regardless of weight. We sold our first products in September 1999.

Critical Accounting Policies and Estimates

The discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues 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.

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

Accounts receivable. We provide an allowance for doubtful accounts based upon specific customer risks and a general provision based upon historical trends. Losses can be difficult to anticipate. For example, in 2002, we wrote

off approximately $400,000 of our Argentine receivables due to adverse economic conditions in Argentina. An increase in losses beyond those expected by management would reduce earnings when they become known.

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 and collection of any resulting receivable is reasonably assured. For service contracts, revenue is recognized over the term of the contract. Sales discounts are recorded as a reduction in revenue.

In connection with sales to certain specific international customers, we sometimes conclude that full collection of the related accounts receivable is not reasonably assured due to extended payment terms or the financial condition of our customer and, consequently, we do not recognize revenue or cost of revenue at the time of title transfer. In instances where collection is not reasonably assured, revenue and cost of revenue are recorded when cash is received. Additionally, in cases of nonstandard delivery and acceptance criteria, we do not recognize revenue at shipment, but rather when the delivery and acceptance criteria have been satisfied.

Valuation of 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 and items that have been shipped to customers for which revenue recognition requirements have not been met. Cost adjustments are recorded for obsolete material, earlier generation products and used product held either as saleable inventory or as demonstration product, if necessary to reduce their carrying values to amounts not lower than that which will result in approximately normal profit margins upon sale. Inventory items for which title has passed to customers are evaluated for recoverability based on the same process we use to evaluate collection of accounts receivable.

We make judgments regarding the carrying value of our inventory based on current market conditions. Market conditions may change depending upon competitive product introductions, consumer demand and reimbursement criteria in the medical community. If market conditions change or if the introduction of new products by us impacts the market for our previously released products, we may be required to write-down the cost of our inventory.

Warranty expense. We accrue estimated warranty expenses at the time of sale for costs expected to be incurred under our product warranties. This provision for warranty expenses is made based upon our historical experience and management s judgment. We have limited history with our products. Any unexpected increase in defects would result in an increase in warranty expense and a reduction in earnings.

Results of Operations for the Three Months Ended March 31, 2003 and March 31, 2002

Revenue

Revenue increased to $17.2 million for the three months ended March 31, 2003, compared to $12.8 million for the three months ended March 31, 2002. The increase was primarily due to an increase in sales in the United States and Europe.

Total U.S. revenue increased to $9.8 million, or 57% of total revenue, for the three months ended March 31, 2003, compared to $6.6 million, or 51%, for the three months ended March 31, 2002, due to improved sales force productivity and increased military sales.

Revenue from Japan decreased to $137,000, or 0.8% of total revenue, for the three months ended March 31, 2003, compared to $1.4 million, or 11%, for the three months ended March 31, 2002, due to transitional channel changes in Japan.

Revenue from Europe, Africa and the Middle East increased to $5.1 million, or 30% of total revenue, for the three months ended March 31, 2003, compared to $3.1 million, or 24%, for the three months ended March 31, 2002, due to an increase in direct sales in the United Kingdom, France, Germany and Spain. We began the expansion of our direct sales efforts in France, Germany and Spain in 2002.

Revenue from Canada, South and Latin America and Asia (excluding Japan) increased to $2.1 million, or 12% of total revenue, for the three months ended March 31, 2003, compared to $1.8 million, or 14%, for the three months

ended March 31, 2002, due to an increase in orders from Asia, primarily from our distributors in China, Taiwan and India.

Gross margin

Gross margin increased to 62.9% for the three months ended March 31, 2003, compared to 58.0% for the three months ended March 31, 2002. The increase in gross margin was primarily due to improved manufacturing efficiencies and increased selling prices. The increased selling prices resulted primarily from an increase in sales with advanced-feature configurations and an increase in the percentage of direct sales compared with distributor sales.

Operating expenses

Research and development expenses were $2.8 million for the three months ended March 31, 2003, compared to $3.2 million for the three months ended March 31, 2002. Research and development expenses decreased primarily due to expenses incurred in the first quarter of 2002 associated with the development the SonoSite TITAN, the SonoHeart ELITE and the iLook products. Also, there was a reduction in product development costs in the first quarter of 2003 as we neared completion of the TITAN.

Sales and marketing expenses were $8.9 million for the three months ended March 31, 2003, compared to $6.3 million for the three months ended March 31, 2002. The increase was primarily due to an increase in direct selling expenses associated with the increase in the number of sales representatives in Europe and clinical application specialists in the U.S., and an increase in compensation expense associated with the increase in revenue. Also contributing to the increase were expenses associated with the reconfiguration of our U.S. sales territories.

General and administrative expenses were $2.0 million for the three months ended March 31, 2003, compared to $1.5 million for the three months ended March 31, 2002. The increase in general and administrative expenses is primarily due to expenses to support our growth.

Other income (expense)

Other income increased to $373,000 for the three months ended March 31, 2003, compared to a loss of $15,000 for the three months ended March 31, 2002, primarily due to investment income on proceeds from the sale of 2,700,000 shares of common stock at 17.25 per share in May 2002. The increase was also due to foreign currency transaction gains of approximately $93,000.

Liquidity and Capital Resources

Our cash and cash equivalents balance was $25.6 million as of March 31, 2003, compared to $26.4 million as of December 31, 2002. Cash and cash equivalents were primarily invested in money market accounts.

Operating activities used cash of $821,000 for the three months ended March 31, 2003 compared to cash provided of $848,000 million for the three months ended March 31, 2002. The increase in cash used in 2003 compared with 2002 was primarily due to an increase in inventory to support increased business activity and a decrease in accounts payable, and was partially offset by a reduction in our net loss and a larger decrease in accounts receivable.

Investing activities used cash of $256,000 for the three months ended March 31, 2003, compared to cash used of $326,000 for the three months ended March 31, 2002. The decrease in cash used in 2003 compared with 2002 was primarily due to a reduction in purchases of property and equipment.

We anticipate using cash to invest in high quality investment instruments in 2003, the extent of which will be dependent upon the interest rate environment during the year and the timing of cash flows from our operations during the year.

Financing activities provided cash of $112,000 for the three months ended March 31, 2003, compared to $36,000 for the three months ended March 31, 2002. The main source of cash provided by financing activities was the exercise of employee stock options.

We anticipate that cash used in operations will decrease in 2003 compared to 2002 primarily due to anticipated decreases in our net loss. This decrease will be dependent upon our ability to successfully sell our products, collect our

receivables, control our inventories and manage our expenses.

We believe that our existing cash and cash generated from operations will be sufficient to fund our operations and capital expenditure requirements through 2003. Nevertheless, we may experience an increased need for additional cash due to:

- any significant decline in our revenues or gross margins;
- any delay or inability to collect accounts receivable;
- any acquisition or strategic investment in another business;
- any significant increase in expenditures as a result of expansion of our sales and marketing infrastructure, our manufacturing capability, including commitments to purchase significant quantities of components, and our product development activities;
- any significant increase in our sales and marketing expenditures as a result of our introduction of new products; and
- any significant increase in expenditures related to the Neutrino patent infringement litigation.

Important Factors That May Affect Our Business, Our Results of Operations and Our Stock Price

If our products, including our new TITAN modular ultrasound system, do not gain market acceptance, we will fail to generate sufficient revenue to maintain our business.

The market for point-of-care, high performance ultrasound systems is relatively new and largely undeveloped. Our products represent a new technological alternative to traditional ultrasound examinations. We seek to sell our products to current users of ultrasound, as well as to physicians and other healthcare providers who do not currently use ultrasound. The success of our products depends on their acceptance by the medical community, patients and third-party payors as medically useful, safe and cost-effective.

On April 9, 2003, we introduced our newest product, the SonoSite TITAN ultrasound system. The TITAN system has a modular design allowing both stationary and mobile usage and is based on the next generation of our proprietary ASIC, or application specific integrated circuit, technology. Along with the point-of-care market, we have positioned the TITAN system to compete in the mid-range of the traditional stationary ultrasound cart market. Revenue from sales of the TITAN system could represent up to 50% of our revenue for the second quarter of 2003.

Users of stationary ultrasound carts may not accept the TITAN system, which could discourage widespread new users and uses for the TITAN. Our existing customers may not accept the TITAN due to pricing and functionality differences. If demand for the TITAN does not meet our projections, we may experience excess inventory levels and may be unable to generate sufficient revenue to grow our business. If we are unable to gain market acceptance for our products generally, we will fail to generate sufficient revenue to maintain our business.

If we experience production difficulties in manufacturing our TITAN system, we may fail to meet second quarter 2003 revenue projections.

We anticipate that our first TITAN ultrasound system shipments will occur in the latter part of June 2003. We will manufacture the SonoSite TITAN ultrasound system at our Bothell, Washington facility. If we encounter engineering or technical difficulties in manufacturing this new product, we may incur delays in delivery of the TITAN system to customers that could adversely affect our revenues for the second quarter of 2003 and beyond.

If we are unable to compete effectively, we will fail to generate sufficient revenue to maintain our business.

We currently face competition from companies that manufacture cart-based and portable ultrasound systems. The dominant competitors in this industry are GE Medical Systems, a unit of General Electric Company, Siemens AG and Philips Medical Systems, a unit of Koninklijke Philips Electronics, N.V. that owns two other competitors, Agilent Healthcare Solutions Group and ATL, our former parent company. These competitors are very large, global organizations and have the following advantages over us:

- greater financial and infrastructure resources;
- larger research and development staffs;
- greater experience in product manufacturing, marketing and distribution;
- greater brand name recognition; and

long-standing relationships with many of our potential customers.

These manufacturers of cart-based and portable ultrasound systems could use their greater resources to increase and withstand competition through various means, including price and payment terms, product quality, market penetration, employee compensation, hospital systems integration and complementary services such as warranty protection, maintenance and product training. Existing product supply relationships between these companies and our potential customers could discourage widespread adoption of our products due to brand loyalty or preferred customer discounts. Competition from these companies for employees with experience in the primary point-of-care market could result in higher turnover of our employees. If we are unable to respond to competitive pressures from the cart-based and portable ultrasound markets, we could experience delayed or reduced market acceptance of our products, higher expenses and lower revenue.

In addition, as the market for point-of-care, high performance ultrasound systems develops, we expect competition to increase as potential and existing competitors enter the point-of-care market or modify their existing products to more closely approximate the combined portability, quality, performance and cost or our products. Our current competitors in the point-of-care market include GE Medical Systems, Agilent/Philips Medical Systems, Biosound Esaote, Inc., Medison America Inc., a subsidiary of Medison Company, Ltd., and Terason, a division of TeraTech Corporation. Other potential entrants to the point-of-care market include ZONARE Medical Systems, Inc. (formerly Novasonics, Inc.). These competitors may develop highly portable or point-of-care ultrasound systems that offer the same or greater reliability and quality, perform greater or more useful functions, or are more cost-effective than our products. Some of these competitors may also be able to use their marketing resources to gain a competitive advantage by more effectively building brand awareness of their products. If we are unable to compete effectively with new entrants to the point-of-care, high performance ultrasound market, we will be unable to generate sufficient revenue to maintain our business.

If our competitors develop and market medical imaging devices that render our products obsolete or noncompetitive, we will be unable to compete.

The life cycles of our products are difficult to estimate. Our products could become obsolete or unmarketable if:

our competitors introduce ultrasound systems that are superior to ours;

other products using new technologies emerge; or

industry standards exceed our products capabilities.

If we fail to enhance our existing products or develop and market new products, our products will become obsolete and we will be unable to compete.

If healthcare reimbursement practices or reform restricts coverage available to our customers for the use of our products, we may experience limited market acceptance of our products.

Market acceptance of our products depends in part on the extent to which our customers will receive reimbursement for the use of our products from governmental authorities such as Medicare, private health insurers and other third-party payors. Our customers generally have received reimbursement for ultrasound procedures performed using our products consistent with reimbursement criteria applicable to ultrasound procedures generally. The continuing efforts of governmental authorities, private health insurers and other third-party payors to contain or reduce the costs of healthcare through various means may, however, limit market acceptance of our products and, therefore, may affect our ability to market our current products, commercialize our potential products and become profitable. Reimbursement coverage, to the extent available, may not be adequate to enable us to achieve market acceptance of our products. In addition, we believe that third-party payors will attempt to reduce healthcare costs by limiting both coverage and level of reimbursement for new products cleared by the FDA or comparable foreign agencies. Our products enable new kinds of medical procedures involving novel ultrasound applications for which there is no reimbursement history. The efforts of government and third-party payors to contain or reduce the cost of healthcare could restrict physicians and other healthcare providers willingness to select our products and implement new ultrasound procedures, which could delay or reduce market acceptance of our products.

We recently became aware of policies adopted in February, March and April 2003 by five Medicare carriers, including Cigna and Noridian, that preclude Medicare reimbursement for ultrasound procedures conducted with hand-carried ultrasound units described as lightweight ultrasound machines with Doppler capability. The notices

restrict coverage for devices that allow only a limited view of structures . These policies apply to Medicare reimbursement of health care providers in seventeen states, including California and upstate New York.

These policies have created ambiguity as to whether procedures performed with our ultrasound systems will be separately reimbursed by the Medicare carriers. It is our understanding from federal Medicare officials that these policies were not intended to preclude separate reimbursement for procedures performed with ultrasound systems such as our 180PLUS and SonoHeart Elite systems, which are labeled as hand-carried ultrasound, but are nonetheless fully functional. Rather, the notices were intended to cover hand-held Doppler devices with limited functionality. We have contacted the carriers medical directors and are seeking to clarify that these policies do not apply to procedures performed with our systems. We believe that these policies will be clarified, but we expect that it will take several months to secure clarification. Any clarifications of the policies may not apply to all of our ultrasound systems. Ultimately, none of these policies may be clarified in our favor. If these reimbursement policies continue in force or are adopted by additional health insurance carriers, market acceptance of our present and future products may be limited.

Additionally, there has been and will likely continue to be a number of federal and state proposals to implement government controls on pricing. The existence and adoption of these proposals could affect our ability to successfully market our current products and commercialize new products.

Changes in the health care industry may require us to decrease the selling price for our products or could result in a reduction in the size of the market for our products, each of which could have a negative impact on our financial performance

Trends toward managed care, health care cost containment, and other changes in government and private sector initiatives in the United States and other countries in which we do business are placing increased emphasis on the delivery of more cost-effective medical therapies which could adversely affect the sale and/or the prices of our products. For example:

- major third-party payers of hospital and pre-hospital services, including Medicare, Medicaid and private health care insurers, have substantially revised their payment methodologies during the last few years which has resulted in stricter standards for reimbursement of hospital and pre-hospital charges for certain medical procedures;

- numerous legislative proposals have been considered that would result in major reforms in the U.S. health care system that could have an adverse effect on our business;

- there has been a consolidation among health care facilities and purchasers of medical devices in the United States who prefer to limit the number of suppliers from whom they purchase medical products, and these entities may decide to stop purchasing our products or demand discounts on our prices;

- there is economic pressure to contain health care costs in international markets; and

- there are proposed and existing laws and regulations in domestic and international markets regulating pricing and profitability of companies in the health care industry.

Both the pressure to reduce prices for our products in response to these trends and the decrease in the size of the market as a result of these trends could adversely affect our levels of revenues and profitability of sales, which could have a material adverse effect on our business.

Our single technological platform renders us less able to withstand adverse changes in the ultrasound market.

Although we market our products for use in a variety of clinical applications and settings, we have only a single technological platform upon which all our ultrasound systems are based. Any attempt to design a new platform for ultrasound imaging will require substantial amounts of time and money, and may not be successful. If our platform becomes obsolete, unmarketable or unaccepted by the ultrasound market for any reason, and we are unable or slow to develop a new platform to replace it, we will be unable to generate sufficient revenue to maintain our business.

If traditional providers of ultrasound examinations discourage potential new users from adopting our products, we could experience limited demand for our products.

In traditional ultrasound practice, physicians and other healthcare providers typically refer patients to centralized locations where radiologists and other specialized personnel provide ultrasound examinations. Although our products

are currently used by radiologists, our products also enable the delivery of ultrasound examinations at the primary point of care by the examining physician or healthcare provider. Radiologists and other ultrasound specialists have a professional and financial interest in maintaining traditional ultrasound practice. If these traditional providers of ultrasound examinations discourage other healthcare providers from adopting our products, we could experience limited demand for our products.

If the training and education necessary to conduct ultrasound examinations discourage new users from adopting our products, we could experience limited demand for our products.

We seek to sell our products to customers already experienced in ultrasound procedures, as well as to physicians and other healthcare providers who do not currently use ultrasound imaging systems or administer ultrasound examinations. Although customers who are experienced in ultrasound procedures will need little, if any, specialized training to use our products, any new users of ultrasound will require training and education to properly administer ultrasound examinations. If these potential customers are unable or unwilling to be trained due to cost, time constraints, unavailability of courses or other reasons, we could experience limited demand for our products.

If our suppliers, including our single-source suppliers, fail to supply us with the components that we need to manufacture our products on a timely basis, we could experience production delays, cost increases and lost sales.

We depend on suppliers, including some single-source suppliers, to provide highly specialized parts, such as custom-designed integrated circuits, cable assemblies and transducer components. We also depend on single-source suppliers to provide other components, such as image displays, batteries, capacitors and cables. We do not maintain significant inventories of 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 components. An increase in demand for some parts by other companies could also interrupt our supply of components. We have in the past experienced supply problems in timeliness and quality, but to date these problems have not resulted in lost sales or lower demand. Nevertheless, if we experience an interruption of supply or are required to switch suppliers, the manufacture and delivery of our products could be interrupted, our manufacturing costs could substantially increase and we could lose substantial amounts of product sales.

In March 2003, one of our component suppliers, Philips Semiconductor (Philips), informed us that, commencing in September 2003, it would discontinue production of our integrated circuit chips using 0.35-micron technology. We have designed and implemented a new chip using 0.2-micron technology that will continue to be produced by Philips to replace all but one of the discontinued chips. We expect to design and implement an additional new chip to replace the remaining 0.35-micron chip by early 2005. In the second quarter of 2003, we entered into a purchase commitment totaling approximately $3.6 million for supplies of 0.35-micron chips from Philips for our anticipated manufacturing needs until new chips have been incorporated in all of our products. Demand for our products, however, may exceed our forecasts, in which case we would require additional 0.35-micron chips to manufacture additional products. Conversely, if demand for our products falls short of our forecasts, we may experience excess inventory of 0.35-micron chips. If our actual demand for these chips varies significantly from our forecasted demand, we may experience delays in manufacturing, lost sales, a write-down of inventory or a deterioration in gross margin.

If our suppliers or we fail to comply with U.S. and foreign governmental regulations applicable to our products and manufacturing practices, we could experience product introduction delays, production delays, cost increases and lost sales.

Our products, our manufacturing activities and the manufacturing activities of our third-party medical device manufacturers are subject to extensive regulation by a number of governmental agencies, including the FDA and comparable international agencies. Our third-party manufacturers and we are or will be required to:

obtain prior clearance or approval from these agencies before we can market and sell our products;

undergo rigorous inspections by domestic and international agencies; and

satisfy content requirements for all of our sales and promotional materials.

The manufacture and sale of our products are subject to extensive regulation by numerous governmental authorities, principally the FDA, as well as several other state and foreign agencies. The FDA requires that all medical devices introduced to the market be preceded either by pre-market notification clearance under Section 510(k) of the Federal Food, Drug & Cosmetic Act, or an approved pre-market approval application, or PMA. By granting 510(k) clearance, the FDA indicates agreement with an applicant s determination that the product for which clearance has been sought is substantially equivalent to medical devices that were on the market prior to 1976 or have subsequently received clearance. The process of obtaining 510(k) clearance typically takes approximately two to three months. To

date, we have not been required to file any PMAs and all of our products have received 510(k) clearance. In addition, foreign regulatory agencies also require similar pre-market clearance or registration before our products can be marketed or offered for sale in their countries. Any delays, or failures, in obtaining such clearances may result in lost sales and revenue.

In addition, the FDA requires us and our key medical device suppliers to demonstrate and maintain compliance with the FDA s Quality System Regulation, or QSR, which covers the methods and documentation of the design, testing, production, control, quality assurance, labeling, packaging, shipping and servicing of our products. The FDA enforces the QSR through periodic inspections; the FDA inspected our manufacturing facility in August 2001. In addition, the British Standards Institution has performed several management systems assessments of our manufacturing processes. These inspections resulted in observations to which we submitted responses, and we believe these responses have been accepted by those agencies. Any failure to take corrective action in response to a QSR inspection could force a shutdown of our manufacturing operations, and a recall of, or field action relating to, our products. Also, in August 2001, the FDA classified as a class II field action a May 2000 software upgrade we issued to correct an error in an algorithm contained in one of our products. We appealed the FDA s classification and have received verbal confirmation that we satisfied the requirements to complete the field action. We are seeking final written closure of this matter from the FDA.

Compliance with the regulations of these agencies, including the Environmental Protection Agency and the Occupational Safety and Health Administration, may require us to incur substantial costs and may delay or prevent the introduction of new or improved products. Although to date these actions by regulatory bodies have not required us to incur substantial costs or delay product shipments, we expect to experience further inspections and incur additional costs as a result of governmental regulation. If we fail to comply with the laws and regulations pertaining to our business, we may be subject to fines, sanctions, including the temporary or permanent suspension of operations, product field actions, criminal prosecution and marketing restrictions. Our third-party medical device manufacturers may also be subject to the same sanctions if they fail to comply with the laws and regulations, and, as a result, may fail to supply us with components required to manufacture our products.

Our reliance on a single manufacturing facility may impair our ability to respond to natural disasters or other unforeseen catastrophic events.

Our sole manufacturing facility is located in a single building in Bothell, Washington. Despite precautions taken by us, a natural disaster such as an earthquake or other unanticipated catastrophic events at this building could significantly impair our ability to manufacture our products and operate our business. Our facility and certain manufacturing equipment would be difficult to replace and could require substantial replacement lead-time. Such catastrophic events may also destroy any inventory of product or components. While we carry insurance for natural disasters and business interruption, the occurrence of such an event could result in losses that exceed the amount of our insurance coverage, which would impair our financial results.

We have a history of losses, we expect future losses and we may never achieve sustained profitability.

With the exception of the fiscal quarter ended December 31, 2002, we have incurred net losses in each quarter since we commenced operations. As of March 31, 2003, we had an accumulated deficit of approximately $88.2 million. Although we incurred a loss in the fiscal quarter ended March 31, 2003, we expect to achieve profitability on an annual basis in 2003. Even if we do achieve one or more profitable periods, however, we may be unable to sustain or increase future profitability on a quarterly or annual basis. Additionally, our losses may increase if we cannot increase or sustain our revenue. With the exception of the fiscal quarter ended December 31, 2002, our revenue from product sales has been insufficient to cover our expenses. We expect that our operating expenses will substantially increase in the foreseeable future as we expand our sales and marketing infrastructure, our administrative support and possibly our product development activities. Our expansion efforts, to be successful, may require more funding than we currently anticipate. Accordingly, we will need to generate significant additional revenue in the future before we will be able to sustain or increase profitability. If we cannot generate such revenue, we may never be profitable. If we fail to achieve sustained profitability, the market price for our common stock will likely fall.

A failure to manage our growth could impair our ability to achieve our business objectives.

We have experienced rapid growth since our inception as a stand-alone company. Our revenue increased from $32.0 million in 2000 to $45.7 million in 2001 and $73.0 million in 2002. During 2002, we added over 100 new employees, primarily in manufacturing and sales and marketing. During 2002, we introduced five new products and continued our expansion into Europe. We expect continued significant growth as we continue to develop, manufacture, market and sell our products. Our growth could strain our existing management, operational and financial resources. In order to manage our growth effectively, we will need to expand our manufacturing and quality assurance staff, our sales staff and our manufacturing capabilities. In addition, we will need to improve the productivity and efficiency of our existing operational, financial and management resources and information systems. We may be unable to hire and retain the personnel necessary to operate and expand our business. We also may be unable to increase the productivity and efficiency of our existing resources. If we fail to timely improve or augment our existing resources in response to our growth, we may be unable to effectively manage our business and achieve our objectives.

Our foreign distributors may be unwilling or unable to devote sufficient resources to market and sell our products, which could delay or reduce market acceptance and sales of our products outside the United States.

We currently depend on foreign distributors to help promote market acceptance and demand for our products in countries in which we do not have a direct sales force. For example, sales to our distributor in Japan, Olympus, represented 10% of our revenue in 2002, but only 1% of our revenue in the three months ended March 31, 2003. Foreign distributors that are in the business of distributing other medical products may not devote the resources and support required within these countries to generate awareness of our products and grow or maintain product sales. If these distributors are unwilling or unable to market and sell our products, we could experience delayed or reduced market acceptance and sales of our products outside the United States.

In Japan, we have not achieved revenue growth the past two fiscal years. In late 2002, we examined the market for our product and confirmed a significant market opportunity that was not being realized by Olympus and their dealer network. In an effort to develop this market opportunity, Olympus will add direct resources and redirect the efforts of its dealers in the first half of 2003. We expect that this transition will result in reduced revenues in Japan in the first half of fiscal 2003 compared with the same period in 2002.

Our lack of customer purchase commitments and our limited order backlog make it difficult to predict sales and plan manufacturing requirements, which can lead to lower revenues, higher expenses and reduced margins.

We do not generally have volume purchase commitments with our customers, who typically order products on a purchase order basis. In limited circumstances, customer orders may be cancelled, changed or delayed on short notice. Lack of significant order backlog makes it difficult for us to forecast future sales with certainty. Varying sales cycles with our customers make it difficult to accurately forecast component and product requirements. These factors expose us to a number of risks:

- if we overestimate our requirements, we may be obligated to purchase more components or third-party products than is required;
- if we underestimate our requirements, our third-party manufacturers and suppliers may have an inadequate product or product component inventory, which could interrupt manufacturing of our products and result in delays in shipments and revenues;
- we may also experience shortages of product components from time to time, which also could delay the manufacturing of our products; and
- over or under production can lead to higher expense, lower than anticipated revenues, and reduced margins.

Our creation, maintenance and expansion of direct sales and distribution operations in Europe and Asia will require a significant investment of our financial and management resources and may fail to generate a substantial increase in sales.

We have historically relied on third-party distributors to sell our products in Europe and Asia. In 2001, we commenced operations in the United Kingdom and France, and in 2002, we commenced operations in Germany and Spain to sell our products directly in each of those countries. In 2002, we began the process of terminating a joint venture that distributed our products in China, which we expect to have completed in 2003 along with the formation of a joint venture with a new partner that has greater financial and marketing resources. We expect our foreign direct

sales operations to grow. Establishing, maintaining and expanding these operations will require us to:

- substantially increase our costs of operations;
- temporarily divert existing management resources;
- establish an efficient and self-reliant local infrastructure;
- attract, hire and train qualified local sales and administrative personnel;
- comply with additional local regulatory requirements; and
- expand our information, financial, distribution and control systems to manage expanded global operations.

Our movement into Europe and Asia has required, and will continue to require, substantial financial and management resources. The costs of this expansion are unpredictable, difficult to control and may exceed budgeted amounts. Despite our expenditures and efforts, we may not generate a substantial increase in European or Asian revenue, which would impair our operating results.

Our foreign revenue is subject to currency fluctuation and other risks associated with doing business outside the United States.

The percentage of our revenue originating outside the United States equaled 42% in 2002 and 43% in the three months ended March 31, 2003. Of this foreign revenue, approximately 25% originated in Japan in 2002 and 2% in the three months ended March 31, 2003. Our revenue from international sales may be adversely affected by any of the following risks:

currency rate fluctuations;

adverse political or economic conditions;

reduced protection for intellectual property rights;

longer receivables collection periods and greater difficulty in receivables collection;

localizing products for foreign markets; and

compliance with export laws, including license requirements, trade restrictions and tariff increases.

As of March 31, 2003, 49% of our outstanding accounts receivable balance was from international customers. We regularly review our receivable positions in foreign countries for any indication that collection may be at risk. For example, due to economic events in Argentina, including the decision to allow the Argentine peso to float against the U.S. dollar, we wrote off $400,000 of our Argentine receivables in 2002, for which we had already established an allowance.

Our efforts to integrate the business and technology of any future acquisition, even if successful, may result in significant costs or create significant disruptions that outweigh the benefits of any such acquisition.

As part of our business strategy, we may acquire other companies, products or technologies. We may fail in our attempt to successfully integrate into our business the operations, technology, products, customers, suppliers and personnel of any such acquired business or technology. Even if integration is successful, any such acquisition may include costs for:

integration of operations, including combining teams and processes in various functional areas;

integration of new technology into our products;

fees and expenses of professionals involved in completing the integration process; and

potential existing liabilities of any future acquisition target.

Additionally, our efforts to consummate an acquisition or to successfully integrate any such acquisition could place a significant burden on our management and internal resources, disrupting our business. If we fail in our attempts to integrate any acquired business or technology, or if the costs and burdens of such acquisition or integration outweigh the benefits of such acquisition, our financial resources or financial results could be impaired.

The loss of any principal member of our management team or product development staff, on whom we rely heavily, could impair our ability to compete.

Our success depends heavily on our ability to retain the services of the principal members of our management team and product development staff. Competition among medical device companies for qualified employees is intense. We may fail to retain these key employees, and we may fail to attract qualified replacements if they do leave. We do not maintain key-person insurance on any of our employees. We do not have employment agreements with any of our employees, except in certain countries outside the United States. The loss of any of our key employees could significantly delay or prevent the achievement of our product development or business objectives.

If we are unable to protect and enforce our intellectual property rights, we may be unable to compete effectively.

Much of our value arises out of our proprietary technology and intellectual property for the design, manufacture and use of point-of-care ultrasound imaging systems. Our success and ability to compete effectively depend on our ability to protect our proprietary information. We rely on patent, copyright, trade secret and trademark laws to protect our proprietary technology and limit the ability of others to compete with us using the same or similar technology.

We currently hold eleven patents relating to our technology. A number of other patents are pending in the United States and in foreign jurisdictions. Additionally, we have a license from our former parent, ATL, to use certain ATL technology and ATL technological developments in our point-of-care products. This license is exclusive through April 5, 2003, and nonexclusive after that date. We also enter into confidentiality or license agreements with our employees, consultants and corporate partners, and generally control access to, and the distribution of, our product designs, documentation and other proprietary information, as well as the designs, documentation and other information that we license from others.

Our efforts afford only limited protection and may not adequately protect our rights to the extent necessary to sustain any competitive advantage we may have. Despite our efforts to protect our intellectual property, we may experience:

- unauthorized use of our technology by competitors;
- independent development of the same or similar technology by a competitor, coupled with a lack of enforceable patents on our part;
- failure of our pending patent applications to result in issued patents;
- successful interference actions to our patents, successful patent infringement lawsuits or successful oppositions to our patents and patent applications;
- unauthorized disclosure or use of our proprietary information by former employees or affiliates; and
- failure by our commercial partners to comply with their obligations to share technology or use our technology in a limited manner.

Policing unauthorized use of our intellectual property will be difficult and may be cost-prohibitive. We may fail to prevent misappropriation of our technology, particularly in countries where the laws may not protect our proprietary rights to the same extent as do the laws of the United States. If we cannot prevent other companies from using our proprietary technology or if our patents are found invalid or otherwise unenforceable, we may be unable to compete effectively against other manufacturers of ultrasound systems, which could decrease our market share.

Existing or potential intellectual property claims and litigation may divert our resources and subject us to significant liability for damages, substantial litigation expense and the loss of our proprietary rights.

In order to protect or enforce our patent rights, we may initiate patent litigation. In addition, others may initiate patent litigation against us. We may become subject to interference proceedings conducted in patent and trademark offices to determine the priority of inventions. There are numerous issued and pending patents in the ultrasound field. The validity and breadth of medical technology patents may involve complex legal and factual questions for which important legal principles may remain unresolved. In addition, because patent applications can take many years to result in issued patents and are maintained in confidence by the U.S. Patent and Trademark Office while pending, there may be currently pending applications of which we are unaware, which may later result in issued patents that our products may infringe. There could also be existing patents of which we are not aware that one or more of our products may infringe. Litigation may be necessary to:

- assert or defend against claims of infringement;

enforce our issued and licensed patents;

protect our trade secrets or know-how; or

determine the enforceability, scope and validity of the proprietary rights of others.

We may become involved in the defense and prosecution, if necessary, of intellectual property suits, patent interferences, opposition proceedings and other administrative proceedings. For example, on July 24, 2001, Neutrino Development Corporation filed a complaint against us, which alleged that our sale and manufacture of our point-of-care ultrasound systems infringed upon a patent held by Neutrino. We responded to the claim, asserting alternative defenses of noninfringement and patent invalidity. In addition, we filed a counterclaim seeking a declaratory judgment of noninfringement and invalidity regarding Neutrino s patent. We defeated Neutrino s request for a preliminary injunction preventing us from manufacturing and selling our products for the duration 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. The court has not yet ruled on the issues presented in that hearing, and may issue a ruling at any time. On October 10, 2002, the court granted our motion to stay the proceedings until it issues its Markman order and rules on our summary judgment motion. Although we continue to vigorously defend ourselves against this claim, this litigation may result in an adverse judgment against us. Sales of the allegedly infringing products represented virtually all of our revenue for the three months ended March 31, 2003 and the years ended December 31, 2002, 2001 and 2000. We have been forced to incur substantial expenses in defense of this claim, and we may incur additional substantial litigation expenses until the claim is resolved.

Our involvement in intellectual property claims and litigation could:

- divert existing management, scientific and financial resources;
- subject us to significant liabilities;
- allow our competitors to market competitive products without obtaining a license from us;
- cause product shipment delays and lost sales;
- require us to enter into royalty or licensing agreements, which may not be available on terms acceptable to us, if at all; or
- force us to modify or discontinue selling our products, or to develop new products.

The termination or other loss of our license to use certain ATL technology would significantly impair our ability to manufacture, market and sell our products.

We license certain technology from ATL that is incorporated into our single technology platform, and we use this ATL technology in all of our point-of-care ultrasound imaging systems. Virtually all of our revenue is attributable to products incorporating this ATL technology.

ATL may terminate our license in the event of an uncured material default by us in our obligations under the license agreement. Although many key aspects of our technology platform including the high level of miniaturization that allows us to manufacture our systems are independently owned by us under the terms of our spin-off from ATL, the termination or other loss of our license to use ATL technology would significantly impair our ability to manufacture, market and sell our products. If this happens, we may be unable to generate sufficient revenue to maintain our business.

Compliance with governmental regulation of our business could be costly and time-consuming, and could prevent us from introducing new products in a timely manner.

Our products, our manufacturing activities and the manufacturing activities of our third-party medical device manufacturers are subject to extensive regulation by a number of governmental agencies, including the FDA and comparable international agencies. Our third-party manufacturers and we are or will be required to:

- obtain prior clearance or approval from these agencies before we can market and sell our products;
- undergo rigorous inspections by domestic and international agencies; and
- satisfy content requirements for all of our sales and promotional materials.

Compliance with the regulations of these agencies, including the Environmental Protection Agency and the Occupational Safety and Health Administration, may require us to incur substantial costs and may delay or prevent the introduction of new or improved products. We may be subject to fines, sanctions, including the temporary or permanent suspension of operations, product field actions, criminal prosecution and marketing restrictions, if we fail to comply with the laws and regulations pertaining to our business. Our third-party medical device manufacturers may

also be subject to the same sanctions and, as a result, may fail to supply us with components required to manufacture our products.

Product liability and other claims and product field actions could increase our costs, delay or reduce our sales and damage our reputation, which could significantly impair our financial condition.

Our business exposes us to the risk of product liability, malpractice or warranty claims inherent in the sale and support of medical device products, including those based on claims that the use or failure of one of our products resulted in a misdiagnosis or harm to a patient. Such claims may damage our reputation by raising questions about our products safety and efficacy, and could interfere with our efforts to market our products. Although to date we have not been involved in any medical malpractice or product liability litigation, we may incur significant liability if such litigation were to occur. We may also face adverse publicity resulting from product field actions or regulatory proceedings brought against us. Although we currently maintain liability insurance in amounts we believe are commercially reasonable, any product liability we incur may exceed our insurance coverage. Liability insurance is expensive and may cease to be available on acceptable terms, if at all. A product liability or other claim or product field action not covered by our insurance or exceeding our coverage could significantly impair our financial condition. In addition, a product field action or a liability claim against us could significantly harm our reputation and make it more difficult to obtain the funding and commercial relationships necessary to maintain our business.

If our stock price continues to be volatile, your shares may decline in value.

The market price for our common stock, as well as for securities of emerging growth companies generally, has been volatile in the past and is likely to continue to be volatile. You may be unable to resell your shares at or above the price you paid due to a number of factors, many of which are beyond our control, including:

- the difference between quarterly operating results and those expected by investors or securities analysts;
- changes in earnings estimates by analysts;
- the loss of significant orders;
- announcements of technological innovations or new products by our competitors;
- changes in the structure of healthcare financing and payment systems;
- general conditions in the medical industry or global economy;
- a lack of liquidity in the market for our stock; and
- a significant sale or sales of our common stock by one or more of our shareholders.

Our future capital-raising activities or acquisition of businesses or assets could involve the issuance of equity securities, which would dilute your investment and could result in a decline in the trading price of our common stock.

To meet our long-term funding requirements, we may sell securities in the public or private equity markets if and when conditions are favorable, even if we do not have an immediate need for additional capital at that time. For example, in May 2002, we raised net proceeds of $42.6 million through the sale of 2,700,000 shares of our common stock. Furthermore, we may enter into financing transactions at prices that represent a substantial discount to market price. In addition, we may issue a significant amount of our securities in connection with our purchase of or strategic investment in other businesses or assets. Raising funds or paying for acquisitions through the issuance of equity securities will dilute the ownership of our existing shareholders. A negative reaction by investors and securities analysts to any sale or issuance of our equity securities could result in a decline in the trading price of our common stock.

If we incur tax liability in connection with our spin-off from ATL, we would be required to pay a potentially significant expense, which would diminish our financial resources.

Our spin-off was treated by ATL as a tax-free spin-off under Section 355 of the Internal Revenue Code of 1986. If ATL were to recognize taxable gain from the spin-off, the Internal Revenue Service, or IRS, could impose that liability on any member of the ATL consolidated group as constituted prior to the spin-off, including us. Generally, the IRS may assert that our spin-off from ATL is a taxable transaction until the expiration of the statute of limitations applicable to ATL with respect to the spin-off transaction. The expiration of the statute of limitations with respect to the spin-off transaction depends upon the actions and tax filings of ATL and the special rules applicable to spin-offs in general, which special rules could result in the extension of the general statute of limitations for an indefinite period of time. In the event of a tax liability, ATL has agreed to cover 85% of any such liability, unless the tax is imposed due

to our actions solely or by ATL solely, in which case, we have agreed with ATL that the party who is solely at fault shall bear all of the tax liability. We are unaware of any actions that would result in a tax liability to us under the indemnity agreement regarding the spin-off transaction. We are aware that ATL was acquired in a transaction subsequent to the spin-off transaction, which could potentially result in the spin-off being treated as a taxable transaction, but which resulting tax liability in our view would be the sole responsibility of ATL pursuant to our agreement with ATL. ATL may refuse, however, to indemnify us for a tax liability arising out of the spin-off transaction or may argue that it did not cause the tax liability to be imposed. In such event, we may incur a significant expense for all or a portion of the taxes related to the spin-off.

The concentrated ownership of our common stock could delay or prevent a change of control, which could cause a decline in the market price of our common stock.

As of February 28, 2003, our executive officers, directors and affiliated entities together beneficially owned approximately 4.4% of the outstanding shares of our common stock. Seven other shareholders owned in the aggregate approximately 50.5% of the outstanding shares of our common stock. Among these shareholders, the State of Wisconsin Investment Board, or SWIB, owned approximately 16.1% of the outstanding shares of our common stock and WM Advisors owned approximately 10.2%. As a result, these shareholders or any other concentrated owner may be able to exert significant influence over all matters requiring shareholder approval, including the election of directors, matters relating to the attraction and retention of employees, such as stock option plans, and approval of significant corporate transactions that could include certain matters relating to future financing arrangements and unsolicited tender offers. This concentration of ownership may delay, deter or prevent a third party from acquiring control over us at a premium over the then-current market price of our common stock, which could result in a decline in our stock price.

Our restated articles of incorporation, our bylaws, Washington law and some of our agreements contain provisions that could discourage a takeover and prevent shareholders from receiving a premium for their shares.

There are provisions in our restated articles of incorporation, our bylaws and Washington law that make it more difficult for a third party to obtain control of us, even if doing so would be beneficial to our shareholders.

Additionally, our acquisition may be made more difficult or expensive by the following:

change of control provisions in our license agreement with ATL, which require us to pay ATL:

$150 million if, prior to April 6, 2003, any single person or entity obtains, directly or indirectly, voting control of a majority of our common stock or the power to elect our entire board of directors; or

$75 million if, at any time between April 6, 2003 and April 6, 2006, any single person or entity engaged in the medical diagnostic imaging business, other than through the sale or manufacture of our products, obtains, directly or indirectly, voting control of a majority of our common stock or the power to elect our entire board of directors;

acceleration provisions in benefit plans and change-in-control agreements with our employees; and

our shareholder rights plan, which is designed to dilute a hostile acquiror s interest so that the acquisition becomes prohibitively expensive. Under our rights plan, each of our shareholders has one share purchase right for each share of common stock held, with each right having an exercise price approximating our board of directors estimate of the long-term value of one share of our common stock. The rights are triggered if an acquiror acquires, or successfully makes a tender offer for, 15% or more of our outstanding common stock. In such event, each shareholder other than the acquiror would have the right to purchase, at the exercise price, a number of newly issued shares of our capital stock at a 50% discount. If the acquiror were to acquire 50% or more of our assets or earning power, each shareholder would have the right to purchase, at the exercise price, a number of shares of acquiror s stock at a 50% discount. Our board of directors may redeem the rights at a nominal cost at any time before a person acquires 15% or

more of our outstanding common stock, which allows board-approved transactions to proceed. In addition, our board of directors may exchange all or part of the rights (other than rights held by the acquiror) for such number of shares of our common stock equal in value to the exercise price. Such an exchange produces the desired dilution without actually requiring our shareholders to purchase shares. Our rights plan excludes SWIB s ownership of our common stock so long as such ownership does not reach 20% of our outstanding common stock.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Interest rate risk

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

As of March 31, 2003, our portfolio consisted of $23.2 million of interest-bearing debt securities with maturities of less than one year and $16.1 million of interest-bearing debt securities with maturities of more than one year. Our intent is to hold these securities until maturity, but we have classified them as available-for-sale in the event of unanticipated cash needs. The interest bearing securities are subject to interest rate risk and will fall in value if market interest rates increase. We believe that the impact on the fair market value of our securities and related earnings for the remainder of 2003 from a hypothetical 10% increase in market interest rates would not have a material impact on the investment portfolio.

Foreign currency risk

Except for sales transacted by our wholly owned subsidiaries, we transact all our sales in U.S. dollars, or USDs; therefore, the obligations of many of our international customers are in USDs. Our exposure to risk from fluctuations in foreign currencies relates primarily to the strengthening of the USD against the local currency of our international customers, which may impact our ability to collect amounts owed by our international customers.

As of March 31, 2003, 49% of our outstanding accounts receivable balance was from international customers, of which 44%, or approximately $3.8 million was denominated in a currency other than USDs. Total sales for the three months ended March 31, 2003 denominated in a currency other than USDs were approximately $3.6 million, or 21% of total consolidated revenues. The British pound and the Euro represented the majority of financial transactions executed in a currency not denominated in USDs. A change in exchange rates compared to the USD of 10% would not have a significant impact on our statement of financial position or results of operations. Historically, the impact on us of changes in exchange rates compared to the USD has been insignificant. We regularly review our receivable positions in foreign countries for any indication that collection may be at risk. In addition, we utilize letters of credit where they are warranted in order to mitigate our collection risk. As of March 31, 2003, we did not have any foreign currency hedging contracts.

Item 4. Controls and Procedures

Evaluation of disclosure controls and procedures

The term disclosure controls and procedures is defined in Rules 13a-14(c) and 15d-14(c) of the Exchange Act. These rules refer to the controls and other procedures of a company that are designed to ensure that the information required to be disclosed by a company in the reports that it files under the Exchange Act is recorded, processed, summarized and reported within required time periods. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed in our Exchange Act reports is accumulated and communicated to management, including our principal executive officer and our chief financial officer, as appropriate to allow timely decisions regarding required disclosure.

Our chief executive officer and our chief financial officer have evaluated the effectiveness of our disclosure controls and procedures as of a date, or evaluation date, within 90 days before the filing of this Quarterly Report, and they have concluded that, as of the evaluation date, our disclosure controls and procedures were effective.

Changes in internal controls

There were no significant changes in SonoSite s internal controls or, to SonoSite s knowledge, in other factors that could significantly affect SonoSite s disclosure controls and procedures subsequent to the evaluation date.

PART II: OTHER INFORMATION

Item 1. Legal Proceedings

On July 24, 2001, Neutrino Development Corporation 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 as a result of our use, sale and manufacture of the SonoSite 180, SonoSite 180PLUS, SonoHeart and SonoHeart PLUS systems. 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 alternative defenses of noninfringement and patent invalidity, and included a counterclaim seeking a declaratory judgment of noninfringement 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. The court has not yet ruled on the issues presented in that hearing. On October 10, 2002, the court granted our motion to stay the proceedings until it issues its Markman order and rules on our summary judgment motion. We believe we have good and sufficient defenses to the claims of patent infringement asserted against us by Neutrino and we are vigorously defending ourselves in this matter, however this litigation may result in an adverse judgment.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

Exhibit No.	Description
99.1	Certification of Principal Executive Officer pursuant to 18 U.S.C. Section 1350
99.2	Certification of Principal Financial Officer pursuant to 18 U.S.C. Section 1350

(b) Reports on Form 8-K

No reports were filed on Form 8-K during the three months ended March 31, 2003.

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

SONOSITE, INC.
(Registrant)

Dated: May 14, 2003

By: /s/ MICHAEL J. SCHUH

Michael J. Schuh
Vice President-Finance, Chief Financial Officer and Treasurer
(Authorized Officer and Principal Financial Officer)

CHIEF EXECUTIVE OFFICER CERTIFICATION

I, Kevin M. Goodwin, Chief Executive Officer, certify that:

1. I have reviewed this quarterly report on Form 10-Q of SonoSite, Inc.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

   a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

   b) evaluated the effectiveness of the registrant s disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the Evaluation Date); and

   c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant s other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant s auditors and the audit committee of registrant s board of directors (or persons performing the equivalent function):

   a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant s ability to record, process, summarize and report financial data and have identified for the registrant s auditors any material weaknesses in internal controls; and

   b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant s internal controls; and

6. The registrant s other certifying officer and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

May 14, 2003

/s/ KEVIN M. GOODWIN

Kevin M. Goodwin
President and Chief Executive Officer
(Principal Executive Officer)

CHIEF FINANCIAL OFFICER CERTIFICATION

I, Michael J. Schuh, Chief Financial Officer, certify that:

1. I have reviewed this quarterly report on Form 10-Q of SonoSite, Inc.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

   a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

   b) evaluated the effectiveness of the registrant s disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the Evaluation Date); and

   c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant s other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant s auditors and the audit committee of registrant s board of directors (or persons performing the equivalent function):

   a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant s ability to record, process, summarize and report financial data and have identified for the registrant s auditors any material weaknesses in internal controls; and

   b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant s internal controls; and

6. The registrant s other certifying officer and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

May 14, 2003

/s/ MICHAEL J. SCHUH

Michael J. Schuh
Vice President-Finance, Chief Financial Officer and Treasurer
(Principal Financial Officer)

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