***UNDER YOUR SKIN:* Profile, SonoSite**

The company is the pioneer and market leader in hand-carried ultrasound (HCU) systems that combine in portables high-resolution imaging with advanced capabilities found on larger and more expensive cart-based systems.

The company is poised for its first-ever profitable year. Now riding a new product cycle, it has developed a new (third generation) chip set that will lead to higher-performance products in ever-smaller packages.

SonoSite Inc. (Kevin Goodwin, pres. & CEO), Bothell, Wash., was spun off in April 1998 from **ATL Ultrasound Inc**. to develop and commercialize high-performance hand-carried ultrasound systems.

ATL had accelerated research on tiny portable units after receiving a 1996 U.S. grant to develop a system for battlefield use. ATL – first with all-digital ultrasound for medical imaging – spun off SonoSite just before it was acquired by **Philips Medical Systems**.

The crux of SonoSite's opportunity: Technology once limited to ultrasound systems weighing 300 lbs. or more is now being squeezed into units weighing 7 lbs. or less.

Resulting mobility and ease of use create new applications of ultrasound – in doctors' offices, emergency rooms and surgical suites. A good analogy is computing: The muscle of the mainframe computer that once required an air-conditioned room now powers your PDA, laptop and cell phone. SonoSite has taken miniaturization to ultrasound.

SonoSite CEO Goodwin told a Wall Street healthcare conference last month, "We're disrupting the $3.5-billion traditional cart market; at the same time, we're spreading the market out because we can miniaturize. . . . We're taking share as we go and are creating new markets. . . . We have an installed base of over 15,000 systems, hold 60% market share now, and have the defining brand."

Ultrasound emerged in the late 1950s as a safe and noninvasive diagnostic tool based on low-power sound waves to provide real-time images of internal soft tissues and organs. Advances in image quality and functionality have helped expand the use of ultrasound imaging.

Standard ultrasound imaging – known as grayscale imaging – produces a two-dimensional image in which the relative shading and texture of tissues and organs enable a doctor to diagnose and monitor disease states and conditions. Color Doppler technology extends standard ultrasound imaging by generating a colorized image showing the presence, direction and velocity of blood flow.

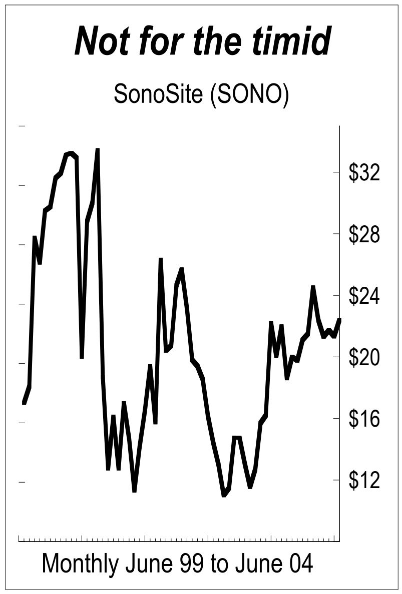
Size and complexity of cart-based systems generally limit their use to hospital imaging departments, where they are operated by specially trained doctors or technicians. Cart-based systems account for about 95% of the worldwide ultrasound market, estimated at $3.5-billion in a 2003 study by **Klein Biomedical Consultants**. The U.S. accounts for about 35% of the worldwide market; systems configured for both radiology and cardiology represent 20% of the international market, or $450-million.

Separate studies by Klein and by **Frost & Sullivan** estimate that 2003 sales of HCU products – approximately the size of a laptop computer and weighing 10 lbs. or less – totaled $160-million, up from $10-million in 1999, when SonoSite introduced its first product. SonoSite accounted for $85-million, or 53%, of last year's HCU sales.

SonoSite sells five systems. The bellwether is the high-end Titan, introduced last June and now generating about half of revenue. The system weighs 7.7 lbs., boots up in less than 12 seconds, and, boasts SonoSite, "combines the high performance of cart-based systems with the speed, flexibility and durability" of portables.

Upgrades were released in December for vascular imaging and connectivity, in May for ob/gyn calculations, and this month for cardiology. Titans start around $35,000 and go up to $60,000. The 180Plus – SonoSite's first product, released in September 1999 – is a 5.4-lb. system used for general ultrasound imaging.

The SonoHeart Elite is a point-of-care system for cardiovascular applications. iLook imaging tools, each weighing about 3 lbs., are the smallest all-digital systems. The iLook 15 provides imaging for cardiac and abdominal procedures; the iLook 25 provides high-quality images of blood vessels for guidance in vascular-access procedures. SonoSite sees significant clinical market opportunities in three areas – mobile diagnostics, visual procedures and physical examinations. The mobile diagnostic market – diagnostic exams in radiology, cardiology, ob/gyn and vascular applications, plus emerging applications such as emergency medicine and surgery – accounted for approximately 80% of the total HCU market in 2003.



Visual procedures – use of ultrasound to guide interventions such as biopsies or line insertions (e.g. catheters) – accounted for about 20% of the HCU market last year.

Routine use of ultrasound during physical exams by the nation's 225,000 primary-care physicians obviously would create a huge market for SonoSite. Preventive cardiology is one potential application.

In late May, SonoSite acquired **SonoMetric Health Inc**., a Salt Lake City developer of software called SonoCalc. In conjunction with an ultrasound exam, the software can detect thickening of the walls of carotid arteries; problems here can be an important early indicator of heart disease. SonoSite plans to incorporate SonoCalc – cleared by the FDA last year – into products next year.

What else is ahead? Management says 2004 will be SonoSite's first full year of profitability. It sees annual revenue growth of at least 25% over the next three years – and profit margins of 65%.

Says Goodwin, "The third generation of our chip set is coming . . . a major inflection point [and] major step forward in the underlying technology. A high-end machine in a 7-lb. package will sell for well under $10,000; at the same time, we'll have a $2,000 machine in PDA size and things in-between."

SonoSite now has 60% of the HCU market, but undoubtedly faces increasing competition. The likeliest threats come from the Big 3 in the cart-based ultrasound market: **GE Medical Systems** (a unit of General Electric Co.), Germany's **Siemens AG**, and **Philips Medical Systems** (a unit of Dutch powerhouse Koninklijke Philips Electronics). "The biggest fear is GE; no one else has come up with credible competition," says Seattle-based analyst Robert Toomey of **RBC Dain Rauscher**.

SonoSite's sales have climbed from $45.6-million in 2001 to $73.0-million in 2002 to $84.8-million in 2003. Losses have narrowed from $1.59 a diluted share in 2001 to 59 cents in 2002 to 12 cents last year.

Goodwin calls 2003 "a bad year because of international problems" – start-up problems with new subsidiaries in Europe, a management change at the Japanese distributor and shifts in reimbursement policies in Germany, along with some uncovered sales territories in the U.S.

“Our problem is not sales demand or technology capabilities,” Goodwin told a healthcare conference last month. “It’s sales execution.”

SonoSite appears to have overcome many of these problems, judging from first-quarter results that easily beat Wall Street consensus. Sales rose 37% from the year-ago quarter to $23.5-million. The loss dropped to $1.4-million, 10 cents a share, from $2.6-million, 18 cents a share.

U.S. revenue grew 20% from the year-ago quarter and accounted for 50% of the total; international rose 60%, boosted by strong hospital demand in the U.K. and Japan. The company expects “to approach breakeven” in the current quarter. Goodwin said last month, “2004 is the year for full-year profitability; our U.S. business will ramp up as the year goes on.”

SonoSite stock (NASDAQ symbol SONO; $22.39 June 18) has experienced some sharp swings over the company’s six-year history (chart). A couple of analysts upgraded the stock in late April after the release of first-quarter results, although it has fallen roughly 10% from the recent high. Market capitalization is $330-million. Shares outstanding total 14.7-million.

RBC Dain analyst Toomey now has an “outperform – speculative risk” rating on SonoSite stock with a price target of $36. His reasons for liking the stock now: “its advanced proprietary technology, first-to-market position, leading market share, strong product line, virtually no competition, significant sales traction with the new Titan system, expectations for profitability in 2004, strong balance sheet and strong long-term growth prospects.”

Toomey’s $36 price target is based on assigning a multiple of four to his revenue estimate for 2005 of $140-million. Toomey says this is in line with or less than historic multiples for emerging medical technology peers. Toomey estimates SonoSite will earn nearly $4-million, about 26 cents a share, this year on revenue of $110-million. His early line for 2005 is profit of $10.8-million, about 71 cents a share, on revenue of $140-million.

Toomey adds, “I’ve always had confidence in their technology; it’s the best. They’re leveraging that technology into a large virgin market, and they have had some execution issues on the marketing side. But they’ve hit all their milestones on the technology side.”

What could go wrong? “The biggest risk is that some new technology comes along that makes digital ultrasound obsolete, or that a lower-cost imaging modality is developed,” responds Toomey. And primary-care doctors may be slow to adopt this new technology. SonoSite has focused on them from Day 1, and yet, notes Toomey, “penetration is still not all that great.” Stay tuned._