MACK CALI REALTY CORP
Form PRE 14A
April 12, 2019

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

SCHEDULE 14A

Proxy Statement Pursuant to Section 14(a) of
the Securities Exchange Act of 1934 (Amendment No.)

Filed by the Registrant ý

Filed by a Party other than the Registrant o

Check the appropriate box:

ý Preliminary Proxy Statement

o **Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**

o Definitive Proxy Statement

o Definitive Additional Materials

o Soliciting Material under §240.14a-12

MACK-CALI REALTY CORPORATION

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

ý No fee required.

o Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.

(1) Title of each class of securities to which transaction applies:

(2) Aggregate number of securities to which transaction applies:

(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

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(1) Amount Previously Paid:

(2) Form, Schedule or Registration Statement No.:

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(4) Date Filed:

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PRELIMINARY PROXY STATEMENT DATED APRIL [•], 2019

MACK-CALI REALTY CORPORATION

Harborside 3, 210 Hudson Street, Ste. 400
Jersey City, New Jersey 07311

Dear Stockholder:

You are cordially invited to attend the Annual Meeting of Stockholders (referred to as the "Annual Meeting") of Mack-Cali Realty Corporation, a Maryland corporation (referred to as the "Company," "we," "our" or "us"), to be held at Harborside 3, 210 Hudson Street, 7th Floor, Jersey City, New Jersey 07311, on Wednesday, June 12, 2019, at 12:00 p.m., local time, for the following purposes:

1. To elect eleven (11) persons to the Board of Directors of the Company (referred to as the "Board of Directors"), each to serve a one-year term and until their respective successors are elected and qualified.

2. To consider and vote, on an advisory basis, for the adoption of a resolution approving the compensation of our named executive officers.

3. To consider and vote upon a proposal to ratify the appointment of PricewaterhouseCoopers LLP, independent registered public accounting firm, as the Company's independent registered public accountants for the fiscal year ending December 31, 2019.

The accompanying Notice of Annual Meeting of Stockholders and proxy statement describe these matters in more detail. We urge you to read this information carefully.

The Board of Directors unanimously recommends a vote: **FOR** each of the Board of Directors' eleven (11) nominees for election to the Board of Directors named in the Company's proxy statement, **FOR** the proposal to adopt, on an advisory basis, a resolution approving the compensation of our named executive officers, and **FOR** the proposal to ratify the appointment of PricewaterhouseCoopers LLP as the Company's independent registered public accountants for the fiscal year ending December 31, 2019.

Bow Street Special Opportunities Fund XV, LP (referred to as "Bow Street") has notified the Company of its intent to nominate six (6) insurgent director candidates for election to the Board of Directors at the Annual Meeting in opposition to the nominees recommended by our Board of Directors. As a result, you may receive solicitation materials, including a [•] proxy card, from Bow Street seeking your proxy to vote for the Bow Street nominees. The Board of Directors has not approved or nominated, and does not endorse or support, any of Bow Street's insurgent director nominees. **WE URGE YOU NOT TO SIGN OR RETURN ANY [•] PROXY CARD SENT TO YOU BY BOW STREET, EVEN AS A PROTEST VOTE AGAINST BOW STREET AND ITS INSURGENT DIRECTOR CANDIDATES.** Instead, our Board of Directors recommends that you vote **FOR** each of the Board of Directors' eleven (11) director nominees named in the Company's proxy statement.

If you have already voted using a [•] proxy card sent to you by Bow Street, you can revoke that proxy by voting **FOR** the Board of Directors' nominees named in the Company's proxy statement by using the enclosed **WHITE** proxy card. Only the latest-dated and validly executed proxy that you submit will count at the Annual Meeting.

Your vote is very important. Whether or not you plan to attend the Annual Meeting in person, and regardless of the number of shares of the Company that you own, it is important that your shares be represented and voted at the Annual Meeting. Therefore, our Board of Directors urges you to vote your shares via the Internet or telephone or by mail by promptly marking, signing and dating the enclosed **WHITE** proxy card and returning it in the enclosed postage-paid envelope.

On behalf of the Board of Directors, we thank you for your support and participation.

Sincerely,
Michael J. DeMarco
Chief Executive Officer

If you have questions or need assistance voting your shares, please contact:

105 Madison Avenue
New York, New York 10016
proxy@mackenziepartners.com
Call Collect: (212) 929-5500
or
Toll-Free (800) 322-2885

MACK-CALI REALTY CORPORATION

Harborside 3, 210 Hudson Street, Ste. 400
Jersey City, New Jersey 07311

NOTICE OF ANNUAL MEETING OF STOCKHOLDERS TO BE HELD ON JUNE 12, 2019

To Our Stockholders:

Notice is hereby given that the Annual Meeting of Stockholders (referred to as the "Annual Meeting") of Mack-Cali Realty Corporation, a Maryland corporation (referred to as the "Company," "we," "our" or "us"), will be held at Harborside 3, 210 Hudson Street, 7th Floor, Jersey City, New Jersey 07311 on Wednesday, June 12, 2019, at 12:00 p.m., local time, for the following purposes:

1. To elect eleven (11) persons to the Board of Directors of the Company (referred to as the "Board of Directors"), each to serve a one-year term and until their respective successors are elected and qualified.

2. To consider and vote, on an advisory basis, for the adoption of a resolution approving the compensation of our named executive officers, as such compensation is described under the "Compensation Discussion and Analysis" and "Executive Compensation" sections of the attached proxy statement.

3. To consider and vote upon a proposal to ratify the appointment of PricewaterhouseCoopers LLP, independent registered public accounting firm, as the Company's independent registered public accountants for the fiscal year ending December 31, 2019.

The attached proxy statement (referred to as the "Proxy Statement"), which forms a part of this Notice of Annual Meeting of Stockholders and is incorporated herein by reference, includes information relating to these proposals. Additional purposes of the Annual Meeting are to receive reports of officers (without taking action thereon) and to transact such other business as may properly come before the Annual Meeting or any adjournment or postponement thereof.

All stockholders of record as of the close of business on April 16, 2019 are entitled to notice of, and to vote at, the Annual Meeting or any continuation, adjournment or postponement thereof. At least a majority of the outstanding shares of common stock of the Company present in person or by proxy at the Annual Meeting is required for a quorum. You may vote electronically via the Internet or by telephone. The instructions on your enclosed **WHITE** proxy card describe how to use these convenient services. Of course, if you prefer, you can vote by mail by promptly marking, signing and dating the enclosed **WHITE** proxy card and returning it in the enclosed postage-paid envelope. If your shares are held by a bank, broker or other agent, please follow the instructions from your bank, broker or other agent to have your shares voted.

The Board of Directors unanimously recommends a vote: **FOR** each of the Board of Directors' eleven (11) nominees for election to the Board of Directors named in the Proxy Statement, **FOR** the proposal to adopt, on an advisory basis, a resolution approving the compensation of our named executive officers, and **FOR** the proposal to ratify the appointment of PricewaterhouseCoopers LLP as the Company's independent registered public accountants for the fiscal year ending December 31, 2019.

Bow Street Special Opportunities Fund XV, LP (referred to as "Bow Street") has notified the Company of its intent to nominate six (6) insurgent director candidates for election to the Board of Directors at the Annual Meeting in opposition to the nominees recommended by our Board of

Directors. As a result, you may receive solicitation materials, including a [•] proxy card, from Bow Street seeking your proxy to vote for the Bow Street nominees. **THE BOARD OF DIRECTORS HAS NOT APPROVED OR NOMINATED, AND DOES NOT ENDORSE OR SUPPORT, ANY OF BOW STREET'S INSURGENT DIRECTOR NOMINEES. WE URGE YOU NOT TO SIGN OR RETURN ANY [•] PROXY CARD SENT TO YOU BY BOW STREET, EVEN AS A PROTEST VOTE AGAINST BOW STREET AND ITS INSURGENT DIRECTOR CANDIDATES.** Instead, our Board of Directors recommends that you vote **FOR** each of the Board of Directors' eleven (11) director nominees named in the Proxy Statement.

If you have already voted using a [•] proxy card sent to you by Bow Street, you can revoke that proxy by voting **FOR** the Board of Directors' nominees named in the Proxy Statement by using the enclosed **WHITE** proxy card. Only the latest-dated and validly executed proxy that you submit will count at the Annual Meeting.

THE BOARD OF DIRECTORS APPRECIATES AND ENCOURAGES YOUR PARTICIPATION IN THE ANNUAL MEETING. WHETHER OR NOT YOU PLAN TO ATTEND THE ANNUAL MEETING IN PERSON, IT IS IMPORTANT THAT YOUR SHARES BE REPRESENTED. ACCORDINGLY, PLEASE AUTHORIZE A PROXY TO VOTE YOUR SHARES VIA THE INTERNET OR TELEPHONE OR BY MAIL USING THE ENCLOSED WHITE PROXY CARD. IF YOU ATTEND THE ANNUAL MEETING, YOU MAY WITHDRAW YOUR PROXY, IF YOU WISH, AND VOTE IN PERSON. YOUR PROXY IS REVOCABLE IN ACCORDANCE WITH THE PROCEDURES SET FORTH IN THE PROXY STATEMENT.

By Order of the Board of Directors,

Gary T. Wagner
General Counsel and Secretary

April [•], 2019
Jersey City, New Jersey

If you have questions or need assistance voting your shares, please contact:

105 Madison Avenue
New York, New York 10016
proxy@mackenziepartners.com
Call Collect: (212) 929-5500
or
Toll-Free (800) 322-2885

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PRELIMINARY PROXY STATEMENT DATED APRIL [•], 2019

MACK-CALI REALTY CORPORATION

Harborside 3, 210 Hudson Street, Ste. 400
Jersey City, New Jersey 07311

PROXY STATEMENT FOR ANNUAL MEETING OF STOCKHOLDERS TO BE HELD ON JUNE 12, 2019

INFORMATION ABOUT THE ANNUAL MEETING

General Information

This Proxy Statement is furnished to stockholders of Mack-Cali Realty Corporation, a Maryland corporation (the "Company"), in connection with the solicitation by the Board of Directors of the Company (the "Board of Directors") of proxies in the accompanying form for use in voting at the Annual Meeting of Stockholders of the Company (the "Annual Meeting") to be held at Harborside 3, 210 Hudson Street, 7th Floor, Jersey City, New Jersey 07311 on Wednesday, June 12, 2019, at 12:00 p.m., local time, and any continuation, adjournment or postponement thereof.

We intend to mail this Proxy Statement, the Notice of Annual Meeting of Stockholders and the accompanying **WHITE** proxy card to all stockholders of record entitled to notice of, and to vote at, the Annual Meeting on or about April **[•]**, 2019.

IMPORTANT NOTICE REGARDING THE AVAILABILITY OF PROXY MATERIALS FOR THE ANNUAL MEETING OF STOCKHOLDERS TO BE HELD ON JUNE 12, 2019.

This Proxy Statement, the Notice of Annual Meeting of Stockholders and Our Annual Report to Stockholders are available at http://investors.mack-cali.com/sec-filings.

Purpose of the Annual Meeting

At the Annual Meeting, the stockholders will consider and vote on the following matters:

1. To elect eleven (11) persons to the Board of Directors, each to serve a one-year term and until their respective successors are elected and qualified.

2. To consider and vote, on an advisory basis, for the adoption of a resolution approving the compensation of our named executive officers, as such compensation is described under the "Compensation Discussion and Analysis" and "Executive Compensation" sections of this Proxy Statement.

3. To consider and vote upon a proposal to ratify the appointment of PricewaterhouseCoopers LLP, independent registered public accounting firm, as the Company's independent registered public accountants for the fiscal year ending December 31, 2019.

YOUR VOTE IS VERY IMPORTANT. THE BOARD OF DIRECTORS UNANIMOUSLY RECOMMENDS A VOTE "FOR" THE ELECTION OF EACH OF THE BOARD OF DIRECTORS' ELEVEN (11) DIRECTOR NOMINEES NAMED IN THIS PROXY STATEMENT. THE BOARD OF DIRECTORS ALSO UNANIMOUSLY RECOMMENDS A VOTE "FOR" THE PROPOSAL TO ADOPT, ON AN ADVISORY BASIS, A RESOLUTION APPROVING THE COMPENSATION OF OUR NAMED EXECUTIVE OFFICERS, AND "FOR" THE PROPOSAL TO RATIFY THE APPOINTMENT OF PRICEWATERHOUSECOOPERS LLP AS

THE COMPANY'S INDEPENDENT REGISTERED PUBLIC ACCOUNTANTS FOR THE FISCAL YEAR ENDING DECEMBER 31, 2019. YOU CAN VOTE VIA THE INTERNET OR BY TELEPHONE OR BY MAIL BY COMPLETING, SIGNING AND DATING THE ENCLOSED *WHITE* PROXY CARD AND RETURNING IT IN THE POSTAGE-PAID ENVELOPE PROVIDED.

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Bow Street Special Opportunities Fund XV, LP ("Bow Street") has notified the Company of its intent to nominate six (6) insurgent director candidates for election to the Board of Directors at the Annual Meeting in opposition to the nominees recommended by our Board of Directors. As a result, you may receive solicitation materials, including a [•] proxy card, from Bow Street seeking your proxy to vote for the Bow Street nominees. **THE BOARD OF DIRECTORS HAS NOT APPROVED OR NOMINATED, AND DOES NOT ENDORSE OR SUPPORT, ANY OF BOW STREET'S INSURGENT DIRECTOR NOMINEES. WE URGE YOU NOT TO SIGN OR RETURN ANY [•] PROXY CARD SENT TO YOU BY BOW STREET, EVEN AS A PROTEST VOTE AGAINST BOW STREET AND ITS INSURGENT DIRECTOR CANDIDATES.** Instead, our Board of Directors recommends that you vote **FOR** each of the Board of Directors' eleven (11) director nominees named in the Proxy Statement.

If you have already voted using a [•] proxy card sent to you by Bow Street, you can revoke that proxy by voting **FOR** the Board of Directors' nominees named in the Proxy Statement by using the enclosed **WHITE** proxy card. Only the latest-dated and validly executed proxy that you submit will count at the Annual Meeting.

Solicitation and Voting Procedures

Solicitation. The Board of Directors is soliciting proxies for the Annual Meeting from our stockholders, and the Company will bear all attendant costs. These costs will include the expense of preparing and mailing proxy materials for the Annual Meeting and reimbursements paid to brokerage firms and others for their expenses incurred in forwarding solicitation material regarding the Annual Meeting to beneficial owners of the Company's common stock, par value $.01 per share (the "Common Stock"). The Company has retained MacKenzie Partners, Inc., 105 Madison Avenue, 14th Floor, New York, New York 10016 ("MacKenzie Partners"), to perform various proxy solicitation services in connection with the solicitation of proxies for the Annual Meeting. The Company will pay MacKenzie Partners a fee not to exceed $**[•]**, plus out-of-pocket expenses, for such services. MacKenzie Partners expects that approximately **[•]** of its employees will assist in the solicitation of proxies for the Annual Meeting. We may use several of our regular employees, who will not be specifically compensated, to solicit proxies from our stockholders, either personally or via the Internet or by telephone, facsimile or special delivery letter.

As a result of the proxy contest initiated by Bow Street, we may incur substantial additional costs in connection with the solicitation of proxies for the Annual Meeting. These additional solicitation costs are expected to include, among others, the fees and expenses of MacKenzie Partners, fees and expenses of our outside media and communications consulting firm, fees and expenses of outside counsel in connection with a contested election of the Company's directors, costs associated with SEC filings, increased printing and mailing costs related to additional mailings of solicitation materials to stockholders, and the costs of retaining an independent inspector of elections. Our aggregate expenses related to our solicitation of proxies for the Annual Meeting, excluding salaries and wages of our regular employees, any costs related to any litigation in connection with the Annual Meeting and expenses that we would ordinarily incur in connection with an uncontested annual meeting, are expected to be approximately $**[•]**, of which approximately $**[•]** has been incurred as of the date of this Proxy Statement.

Under applicable regulations of the Securities and Exchange Commission (the "SEC"), members of the Board of Directors and certain officers and employees of the Company may be deemed to be "participants" with respect to the Company's solicitation of proxies in connection with the Annual Meeting by reason of their positions as directors and director nominees of the Company or because they may be soliciting proxies on our behalf. Certain information concerning such persons (the "Participants") is set forth in this Proxy Statement and *Annex A* hereto.

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Householding of Proxy Materials. In accordance with a notice sent previously to beneficial owners holding shares in street name (for example, through a bank, broker or other holder of record) who share a single address with other similar holders, only one Annual Report and Proxy Statement is being sent to that address unless contrary instructions were received from any stockholder at that address. This practice, known as "householding," is designed to reduce printing and postage costs. Any of such beneficial owners may discontinue householding by writing to the address or calling the telephone number provided for such purpose by their holder of record. Any such stockholder may also request prompt delivery of a copy of the Annual Report or Proxy Statement by contacting the Company at (732) 590-1010 or by writing to Gary T. Wagner, General Counsel and Secretary, Mack-Cali Realty Corporation, Harborside 3, 210 Hudson Street, Ste. 400, Jersey City, New Jersey 07311. Other beneficial owners holding shares in street name may be able to initiate householding if their holder of record has chosen to offer such service, by following the instructions provided by the record holder.

Voting. Stockholders of record may authorize the proxies named in the enclosed **WHITE** proxy card to vote their shares of Common Stock in the following manner:

by mail, by marking the enclosed **WHITE** proxy card, signing and dating it, and returning it in the postage-paid envelope provided;

by telephone, by dialing the toll-free telephone number indicated on the proxy card that you received in the mail with this Proxy Statement, within the United States or Canada, and following the instructions. Stockholders voting by telephone need not return the proxy card; and

through the Internet, by accessing the World Wide Web site indicated on the proxy card that you received in the mail with this Proxy Statement. Stockholders voting by the internet need not return the proxy card.

Different Color Proxy Cards. Bow Street has notified the Company of its intent to nominate six (6) insurgent director candidates for election to the Board of Directors at the Annual Meeting in opposition to the nominees recommended by our Board of Directors. As a result, you may receive solicitation materials, including a [•] proxy card, from Bow Street seeking your proxy to vote for the Bow Street nominees. The Company is not responsible for the accuracy of any information provided by or relating to Bow Street contain in any proxy solicitation materials filed or disseminated by or on behalf of Bow Street or any other statements that Bow Street may otherwise make.

THE BOARD OF DIRECTORS HAS NOT APPROVED OR NOMINATED, AND DOES NOT ENDORSE OR SUPPORT, ANY OF BOW STREET'S INSURGENT DIRECTOR NOMINEES. WE URGE YOU NOT TO SIGN OR RETURN ANY [•] PROXY CARD SENT TO YOU BY BOW STREET. Instead, our Board of Directors recommends that you vote **"FOR"** each of the Board of Directors' eleven (11) director nominees named in this Proxy Statement.

Voting to "withhold authority" with respect to any of Bow Street's nominees on its [•] proxy card is not the same as voting "FOR" the Board of Directors' eleven (11) director nominees. This is because a vote to "withhold authority" with respect to any of Bow Street's nominees on its [•] proxy card will revoke any previous proxy submitted by you to vote "FOR" the Board of Directors' eleven (11) director nominees on a **WHITE** proxy card, as only your latest dated and signed proxy card will be counted at the Annual Meeting. **DO NOT RETURN ANY [•] PROXY CARD SENT TO YOU BY BOW STREET, EVEN AS A PROTEST VOTE AGAINST BOW STREET AND ITS INSURGENT DIRECTOR NOMINEES.**

The Company has provided you with the enclosed **WHITE** proxy card. The Board of Directors unanimously recommends using the enclosed **WHITE** proxy card to vote "FOR" each of the Board of Directors' eleven (11) director nominees named in this Proxy Statement. If the Company receives a validly executed **WHITE** proxy card from you, your shares will be voted by the Company proxies as

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indicated in your voting preference selection. We encourage you to cast your vote "FOR" each of the proposals, following the instructions on your **WHITE** proxy card, as promptly as possible.

If you have already voted using a [•] proxy card sent to you by Bow Street, you have every right and the ability to change your vote. We urge you to revoke that proxy by voting "FOR" the Board of Directors' eleven (11) director nominees named in this Proxy Statement by using the enclosed **WHITE** proxy card. Only the latest-dated and validly executed proxy that you submit will count at the Annual Meeting.

Revocability of Proxies. Any proxy given pursuant to this solicitation may be revoked by the person giving it at any time before it is exercised in the same manner in which it was given or by taking any of the following actions:

- by delivering to our corporate secretary a written notice of revocation, bearing a date later than the date of the proxy, stating that the proxy is revoked;

- by marking, signing and delivering a new **WHITE** proxy card, relating to the same shares and bearing a later date than the original proxy card;

- submitting another proxy via the Internet or by telephone (your latest voting instructions will be followed); or

- by attending the Annual Meeting and voting in person (although attendance at the Annual Meeting, will not, by itself, revoke a proxy, unless you vote in person at the Annual Meeting).

Written notices of revocation and other communications with respect to the revocation of proxies should be addressed to:

Mack-Cali Realty Corporation
Harborside 3, 210 Hudson Street, Ste. 400
Jersey City, New Jersey 07311
Attention: Gary T. Wagner, General Counsel and Secretary

If your shares are held in "street name," you may change your vote by submitting new voting instructions to your broker, bank or other nominee. You must contact your broker, bank or other nominee to find out how to do so.

If you have previously signed a [•] proxy card sent to you by Bow Street or otherwise voted according to instructions provided by Bow Street, you may change your vote and revoke your prior proxy by signing, dating and returning the enclosed **WHITE** proxy card in the accompanying envelope or by voting by telephone or via the Internet by following the instructions on the **WHITE** proxy card. **DO NOT RETURN ANY [•] PROXY CARD SENT TO YOU BY BOW STREET, EVEN AS A PROTEST VOTE AGAINST BOW STREET AND ITS INSURGENT DIRECTOR NOMINEES.** Submitting a [•] proxy card sent to you by Bow Street (even if you withhold your vote on the Bow Street nominees) will revoke votes you have previously made via our **WHITE** proxy card.

Voting in Person. If you plan to attend the Annual Meeting and wish to vote in person, you will be given a ballot at the Annual Meeting. Stockholders who wish to attend the Annual Meeting will be required to present verification of ownership of our common stock, such as a bank or brokerage firm account statement, and will be required to present a valid government-issued picture identification, such as a driver's license or passport, to gain admittance to the Annual Meeting. No cameras, recording equipment, electronic devices, large bags, briefcases or packages will be permitted in the Annual Meeting.

Record Date; Outstanding Shares. The close of business on April 16, 2019 has been fixed as the record date (the "Record Date") for determining the holders of shares of Common Stock entitled to notice of, and to vote at, the Annual Meeting. Each share of Common Stock outstanding on the Record Date is entitled to one vote on all matters, and there are no cumulative voting rights. As of the Record Date, there were [•] shares of Common Stock issued and outstanding.

Voting Procedures; Quorum and Votes Required. Stockholder votes will be tabulated by the persons appointed by the Board of Directors to act as inspectors of election for the Annual Meeting. The inspectors of election will also determine whether a quorum is present. The presence at the Annual Meeting of a majority of the outstanding shares of Common Stock, represented either in person or by proxy, will constitute a quorum for the transaction of business at the Annual Meeting.

Shares represented by a properly executed and delivered proxy will be voted at the Annual Meeting and, when instructions have been given by the stockholder, will be voted in accordance with those instructions. If a properly executed and delivered **WHITE** proxy card does not provide instructions, then the shares represented by that proxy will be voted "FOR" the election of each of the Board of Directors' eleven (11) nominees for director named below, "FOR" the advisory approval of executive compensation, and "FOR" the ratification of the appointment of PricewaterhouseCoopers LLP as the Company's independent registered public accounting firm.

If your shares are held in the name of a bank, broker or other nominees, you will receive instructions from such nominee that you must follow in order to vote your shares. If your shares are not registered in your own name and you plan to vote your shares in person at the Annual Meeting, you should contact your broker or agent to obtain a broker's proxy card and bring it with you to the Annual Meeting in order to vote. Under New York Stock Exchange (the "NYSE") Rules, only the ratification of the appointment of PricewaterhouseCoopers LLP as the Company's independent auditors, as set forth in Proposal No. 3, is considered a "discretionary" item. This means that brokerage firms may vote in their discretion on Proposal No. 3 on behalf of beneficial owners who have not furnished a properly executed proxy card or delivered voting instructions to their broker at least ten days before the date of the Annual Meeting. In contrast, the election of directors as set forth in Proposal No. 1 and the advisory vote to approve executive compensation as set forth in Proposal No. 2 are considered non-discretionary items. This means that brokerage firms that have not received a properly executed proxy card or voting instructions from their clients may not vote on behalf of their clients with respect to Proposals Nos. 1 and 2. These so called "broker non-votes" will be included in the calculation of the number of shares considered to be present at the Annual Meeting for purposes of determining a quorum, but will not be included in the total of votes cast for the election of directors or the advisory vote for approval of executive compensation.

Proposal No. 1: Election of Directors. A plurality of the votes cast by the holders of shares of Common Stock present in person or by proxy at the Annual Meeting and entitled to vote in the election of directors is required for the election of directors. Accordingly, the eleven (11) director nominees that receive the greatest number of "FOR" votes will be elected to the Board of Directors. Abstentions, failures to vote and broker non-votes are not considered votes cast and, therefore, will have no effect on the outcome of the election of directors.

Proposal No. 2: Advisory Vote to Approve Executive Compensation. The affirmative vote of a majority of the votes cast by the holders of shares of our Common Stock present in person or by proxy at the Annual Meeting and entitled to vote on the proposal is required for the approval, on an advisory basis, of the compensation of the Company's named executive officers. Abstentions, failures to vote and broker non-votes are not considered votes cast and, therefore, will have no effect on this proposal.

Proposal No. 3: Ratification of the Appointment of Independent Auditors. The affirmative vote of a majority of the votes cast by the holders of shares of our Common Stock present in person or by proxy at the Annual Meeting and entitled to vote on the proposal is required for the ratification of the appointment of PricewaterhouseCoopers LLP as the Company's independent auditors. Abstentions and

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failures to vote are not considered votes cast and, therefore, will have no effect on this proposal. Because the ratification of the independent auditors is a discretionary item, we do not anticipate receiving any broker non-votes with respect to this proposal.

No Appraisal Rights. Under Maryland law, stockholders will not have appraisal or similar rights in connection with any proposal set forth in this Proxy Statement.

If you have questions or need assistance voting your shares, please contact:

105 Madison Avenue
New York, New York 10016
proxy@mackenziepartners.com
Call Collect: (212) 929-5500
or
Toll-Free (800) 322-2885

Forward-Looking Statements

Statements made in this Proxy Statement may be forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements can be identified by the use of words such as "may," "will," "plan," "potential," "projected," "should," "expect," "anticipate," "estimate," "target," "continue," or comparable terminology. Such forward-looking statements are inherently subject to certain risks, trends and uncertainties, many of which the Company cannot predict with accuracy and some of which the Company might not even anticipate and involve factors that may cause actual results to differ materially from those projected or suggested. Readers are cautioned not to place undue reliance on these forward-looking statements and are advised to consider the factors listed above together with the additional factors under the heading "Disclosure Regarding Forward-Looking Statements" and "Risk Factors" in the Company's Annual Report on Form 10-K, as may be supplemented or amended by the Company's Quarterly Reports on Form 10-Q, which are incorporated herein by reference. The Company assumes no obligation to update or supplement forward-looking statements that become untrue because of subsequent events, new information or otherwise, except as required under applicable law.

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BACKGROUND OF THE SOLICITATION

The following is a chronology of the material events leading up to the filing of this Proxy Statement:

The Board of Directors regularly evaluates the Company's strategic direction and reviews alternatives for maximizing stockholder value, including potential strategic transactions.

On January 28, 2019, representatives of Bow Street and David Werner Real Estate Investments ("DWREI") contacted David J. Smetana, the Company's Chief Financial Officer, by telephone to request a meeting to discuss a potential transaction involving the Company.

On February 25, 2019, Michael J. DeMarco, the Company's Chief Executive Officer, Mr. Smetana, and Gary T. Wagner, the Company's General Counsel and Secretary, held an in-person meeting with representatives of Bow Street and DWREI. During the meeting, the Bow Street and DWREI representatives presented an unsolicited proposal (the "Proposal") to acquire the Company's suburban and waterfront office assets for $2.4 billion to $2.6 billion in cash, in a complex transaction in which the Company's Roseland Residential Trust subsidiary ("Roseland") and other residential assets of the Company would be spun-off to the Company's stockholders as a newly-formed, publicly-traded residential REIT (the "Proposed Transaction"). At the conclusion of the meeting, Mr. DeMarco informed the Bow Street and DWREI representatives that the Company's management would review the Proposal with the Company's financial and legal advisors, inform the Board of Directors of the receipt of the Proposal and review the Proposal at the upcoming Board of Directors meeting on March 13, 2019.

During the period from February 26, 2019 to March 8, 2019, the Company, in consultation with its financial and legal advisors, conducted a thorough review of the Proposal.

On February 26, 2018, as part of the Company's review process, Mr. Smetana held a telephonic conference with representatives of Bow Street and DWREI to review Bow Street's financial model and assumptions with respect to the newly-formed, publicly-traded residential REIT that would be created as part of the Proposed Transaction ("ResiCo"). Mr. Smetana also discussed with the representatives of Bow Street and DWREI the Company's commercial asset portfolio to clarify which of the Company's properties would be included in the suburban and waterfront office assets that Bow Street and DWREI were proposing to acquire, and which assets would remain in ResiCo following the completion of the Proposed Transaction. At the conclusion of the telephone conference, Mr. Smetana requested that Bow Street and DWREI provide back-up information for their financial model and assumptions relating to ResiCo.

On February 27, 2019, a representative of Bow Street sent an email to Mr. Smetana with certain financial information relating to the Proposal, including back-up information for Bow Street's financial model and assumptions with respect to ResiCo. On the same day, Mr. DeMarco also received a call from David Werner reiterating his interest in the Proposed Transaction.

On February 28, 2019, a representative of Bow Street sent an email to Mr. DeMarco suggesting that the parties hold another in-person meeting to discuss the Proposal on March 11, 2019 or another mutually convenient date.

On March 8, 2019, the Company informed Bow Street that the Board of Directors would review and consider the Proposal at its regularly scheduled quarterly meeting on March 13, 2019, as part of the Board of Directors' regular evaluation of the Company's strategic direction.

On March 10, 2019, Bow Street informed the Company of its intent to nominate a slate of candidates for election to the Board of Directors at the Annual Meeting prior to the March 15, 2019 deadline for submitting director nominations under the Company's bylaws, unless the Company agreed to extend such deadline to continue private discussions with Bow Street regarding the Proposal.

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On March 13, 2019, the Board of Directors, at its regularly scheduled quarterly meeting, after careful evaluation of the Proposal, in consultation with its financial and legal advisors, unanimously determined that the Proposal substantially undervalued the Company's core office portfolio, was based on unrealistic assumptions regarding ResiCo's trading multiples, was unworkable and, if consummated, would likely result in materially adverse tax consequences to the Company and its stockholders and would leave the Company and its stockholders without the wherewithal to capitalize on its residential assets and with shares of a small, undercapitalized company unlikely to achieve an attractive valuation in the public market. Accordingly, the Board of Directors determined that the Proposed Transaction was inadequate and not in the best interests of the Company's stockholders.

On March 14, 2019, the Company sent a letter to Bow Street and DWREI informing them of the Board of Directors' decision to reject the Proposal and explaining the reasons for the Board of Directors' decision.

Also on March 14, 2019, Bow Street delivered to the Company a formal notice of its intent to nominate a majority slate of six (6) candidates to stand for election to the Board of Directors at the Annual Meeting.

On March 18, 2019, the Company issued a press release and filed with the SEC a Current Report on Form 8-K disclosing the receipt of the notice of director nominations from Bow Street. In the press release, the Company announced that Bow Street delivered its notice of director nominations following the Board of Directors' unanimous decision to reject the Proposal, and explained the reasons for the Board of Directors' decision.

On March 21, 2019, Bow Street delivered to the Company a request to inspect the books and records of the Company under Section 1315(a) of the New York Business Corporation Law.

On March 27, 2019, William L. Mack, Chairman of the Board of Directors, and Mr. DeMarco held an in-person meeting with representatives of Bow Street and DWREI, at their request. At the meeting, the Bow Street and DWREI representatives asked the Company's representatives if the Company and its financial advisors had reconsidered their position with respect to the Proposal. The Company's representatives responded that the Board of Directors continued to believe that the Proposal was inadequate, for the reasons described in the press release issued by the Company on March 18, 2019. The Bow Street and DWREI representatives also indicated that Bow Street would be willing to withdraw its director nomination notice if the Company agreed to sell to Bow Street and DWREI certain of the Company's office properties at a discount to their current fair market value. The Company's representatives informed the Bow Street and DWREI representatives that the Company is not interested in selling any of these office properties at this time and, in any event, would not be willing to sell any of its assets or properties at a price that does not reflect their fair market value. The Company's representatives also stated, however, that the Company expected to continue to sell additional office assets in a tax efficient manner pursuant to the Company's strategic plan after completing the Flex portfolio sale and that Bow Street and DWREI were welcome to bid on such assets in a competitive manner.

On April 2, 2019, Mr. DeMarco held an in-person meeting with a representative of Bow Street, at the Bow Street representative's request. At the meeting, the Bow Street representative indicated that Bow Street would be willing to withdraw its director nomination notice if the Board of Directors agreed to (1) nominate three of Bow Street's insurgent director candidates (including at least one director candidate affiliated with Bow Street) for election to the Board of Directors at the Annual Meeting and (2) form a special committee of the Board of Directors to review and evaluate potential acquisition proposals involving the Company. Mr. DeMarco responded that in light of Bow Street's approximately 4.3% ownership of the Company's common stock, three directors would give Bow Street disproportionate representation on the Board of Directors. However, in order to avoid a costly and distracting proxy contest, the Board of Directors would consider nominating two independent candidates to be mutually identified by Bow Street and the Company (which candidates would not include any of Bow Street's nominees affiliated with Bow Street or DWREI) for election to the Board of Directors at the Annual Meeting. Mr. DeMarco also informed the Bow Street representative that the Board of Directors does not believe that the formation of a special committee to review and evaluate potential acquisition proposals would be warranted at this time, because the Company is not currently conducting a sale process and any potential unsolicited acquisition proposals can be reviewed and evaluated by the full Board of Directors, as part of its regular evaluation of the Company's strategic direction.

On April 3, 2019, a representative of Bow Street sent an email to Mr. DeMarco with certain financial information relating to Bow Street's calculation of the net cash proceeds that would be available for distribution to the Company's stockholders under the Proposal as well as Bow Street's projections with respect to ResiCo's NAV following the completion of the Proposed Transaction. Upon review of these materials, the Company's management and financial advisors concluded that they did not include any new information that could lead the Company to reconsider its previous determination that the Proposal substantially undervalued the Company's core office portfolio, was based on unrealistic assumptions regarding ResiCo's trading multiples and failed to address the materially adverse tax consequences to the Company and its stockholders that would likely result from the Proposed Transaction.

On April 9, 2019, Mr. DeMarco held a telephone conversation with a representative of Bow Street, during which they discussed matters relating to the Proposal and Bow Street's director nominations. During the telephone conversation, the Bow Street representative indicated that Bow Street and DWREI disagreed with the Company's determination that the amount of net cash proceeds from the Proposed Transaction that would be available for distribution to Mack-Cali stockholders would likely be materially lower than $8.00 to $10.00 per share, as suggested in the Proposal. However, the Bow Street representative did not explain how Bow Street and DWREI proposed to finance the Proposed Transactions, including the additional amount of cash that would be required to address the materially adverse tax consequences, frictional costs and structuring constraints that would likely be associated with the Proposed Transaction. The Bow Street representative also acknowledged that the Proposed Transaction and the cash purchase price of $2.4 billion to $2.6 billion for the Company's suburban and waterfront office assets, as suggested in the Proposal, were subject to due diligence.

Mr. DeMarco responded that the Board of Directors continues to believe that the Proposed Transaction is inadequate and not in the best interests of the Company's stockholders. However, in order to avoid a costly and distracting proxy contest, the Board of Directors would consider nominating one independent candidate from Bow Street's slate of nominees for election to the Board of Directors at the Annual Meeting and subsequently nominating an additional independent candidate to be mutually identified by Bow Street and the Company for election to the Board of Directors at the Company's 2020 annual meeting of stockholders. Mr. DeMarco emphasized that these director candidates must be independent and would not include any of Bow Street's nominees affiliated with Bow Street or DWREI. Mr. DeMarco also reiterated that the Board of Directors continues to believe that the formation of a special committee to review and evaluate potential acquisition proposals involving the Company, as suggested by the Bow Street representative during the April 2, 2019 in-person meeting, would not be warranted at this time, because the Company is not currently conducting a sale process and any potential unsolicited acquisition proposals can be reviewed and evaluated by the full Board of Directors, as part of its regular evaluation of the Company's strategic direction. Mr. DeMarco also stated that, as discussed by the parties during the March 27, 2019 in-person meeting, while the Company was not willing to sell any of its assets or properties to Bow Street or DWREI at a price that does not reflect their fair market value, the Company expected to continue to sell additional office assets in the fourth quarter of 2019, in a tax efficient manner pursuant to the Company's strategic plan, and would be willing to discuss such sales with Bow Street and

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DWREI at such time, if they are interested in purchasing such assets at a fair price. Mr. DeMarco also informed the Bow Street representative that the Company needed to receive a response to its offer from Bow Street by Thursday, April 11, 2019, as the Company intended to file its preliminary proxy statement with the SEC no later than Friday, April 12, 2019.

On April 12, 2019, a representative of Bow Street sent an email to Mr. DeMarco stating that, as previously indicated by the Bow Street representative during the April 9, 2019 telephone conversation with Mr. DeMarco, the $8.00 to $10.00 per share was the amount of cash proceeds from the Proposed Transaction that Bow Street and DWREI intended to deliver to Mack-Cali stockholders, net of frictional costs. However, the email did not specify whether Bow Street and DWREI were proposing to increase the $2.4 billion to $2.6 billion cash price for the Company's suburban and waterfront office assets, as indicated in the Proposal, or otherwise explain how they proposed to finance the Proposed Transaction, including the additional amount of cash that would be required to address the materially adverse tax consequences, frictional costs and structuring constraints that would likely be associated with the Proposed Transaction. The email also stated that, in response to the Company's offer to nominate two of Bow Street's independent director candidates for election to the Board of Directors, Bow Street proposed that the Company add two of Bow Street's director nominees to the Board of Directors in 2019 and an additional Bow Street nominee in 2020, for a total of three directors. While the email stated that Bow Street was generally open to the Company's input on its director candidates, it did not indicate Bow Street's willingness to accept the Company's requirement that its director candidates must be independent and not affiliated with Bow Street or DWREI. In addition, the email stated that Bow Street requested that the Board of Directors announce the exploration of strategic alternatives to maximize stockholder value, and indicated that Bow Street and DWREI expected their Proposal to be a part of that process, despite the previous indications by the Company's representatives that the Company is not currently engaged in a process to sell or break up itself.

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VOTING SECURITIES AND PRINCIPAL HOLDERS

Unless otherwise indicated, the following table sets forth information as of February 16, 2019 with respect to each person or group who is known by the Company, in reliance on Schedules 13D and 13G reporting beneficial ownership and filed with the SEC, to beneficially own more than 5% of the Company's outstanding shares of Common Stock. Except as otherwise noted below, all shares of Common Stock are owned beneficially by the individual or group listed with sole voting and/or investment power.

Name of Beneficial Owner	Amount and Nature of Beneficial Ownership	Percent of Class(%)(1)
BlackRock, Inc.(2)	13,220,528	14.6%
The Vanguard Group, Inc.(3)	12,982,558	14.4%
The Mack Group(4)	7,436,066	7.6%
Morgan Stanley(5)	5,794,257	6.4%
CenterSquare Investment Management LLC(6)	4,906,783	5.4%
Madison International Realty Holdings, LLC(7)	4,516,012	5.0%

1,058

Net change in cash and cash equivalents

11,147

3,952

Cash and cash equivalents at beginning of period

26,809

17,272

Cash and cash equivalents at end of period

$

37,956

$

21,224

Supplemental disclosure of cash flow information:

Cash paid for income taxes

$

102

$

276

See accompanying notes to condensed consolidated financial statements.

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

Interim Financial Information

Basis of Presentation

The information contained herein has been prepared in accordance with instructions for Form 10-Q and Article 10 of Regulation S-X. The information reflects, in the opinion of SonoSite, Inc. management, all adjustments necessary (which are of a normal and recurring nature) for a fair presentation of the results for the interim periods presented. The results of operations for the three and nine months ended September 30, 2006 are not necessarily indicative of expected results for the entire year ending December 31, 2006 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, 2005, included in our Annual Report on Form 10-K.

Reclassification of prior period balances

Certain amounts reported in previous periods have been reclassified to conform to current period presentation.

Inventories

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

Inventories consisted of the following (in thousands):

	As of	
	September 30, 2006	December 31, 2005
Raw material	$ 8,876	$ 8,856
Work-in-process	23	58
Demonstration inventory	5,199	4,532
Finished goods	10,663	7,289
Total	$24,761	$ 20,735

Warranty expense

We accrue estimated warranty expense at the time of sale for costs expected to be incurred under our product warranties. This provision for warranty expense is made based upon our historical product failure rates and service repair costs as well as management's judgment. Our typical warranty period is one year except for the MicroMaxx system, which has, with certain exceptions, a five-year warranty period. We have classified amounts as non-current based upon our estimated timing of repair costs. The current portion of our warranty liability, amounting to $602,000 and $209,000 at September 30, 2006 and December 31, 2005, respectively, is classified in accrued expenses in the accompanying condensed consolidated balance sheet. The warranty is included with the original purchase. In addition to our standard warranty, we sell extended warranty and service agreements for coverage beyond the standard warranty period or coverage above what is covered by the standard warranty. Revenue from sales of extended warranty and service agreements are deferred and recognized over the extended period and such deferred amounts are recorded in Deferred Revenue. The warranty liability is summarized as follows (in thousands):

	Balance at Beginning of Period	Charged to cost of Revenue	Applied to Liability	Balance at end of Period
Three months ended September 30, 2006	$ 1,494	$ 620	$ (277)	$ 1,837
Three months ended September 30, 2005	$ 573	$ 365	$ (141)	$ 797
Nine months ended September 30, 2006	$ 995	$ 1,600	$ (758)	$ 1,837
Nine months ended September 30, 2005	$ 561	$ 678	$ (442)	$ 797

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Income taxes

The income tax provision for the three and nine months ended September 30, 2006 was computed in accordance with Accounting Principles Bulletin ("APB") Opinion No. 28, "Interim Financial Reporting," and Financial Accounting Standards Board ("FASB") Interpretation No. 18, "Accounting for Income Taxes in Interim Periods," and was based on projections of total year pre-tax income and the projected total year tax provision computed in accordance with FASB Statement (" SFAS") No. 109, "Accounting for Income Taxes." Deferred income taxes are provided based on the estimated future tax effects of temporary differences between financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards arising since our inception. Deferred tax assets and liabilities are measured using enacted tax rates that are expected to apply to taxable income in the years in which those temporary differences and carryforwards are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance is established when necessary to reduce deferred tax assets to the amount, if any, expected to be realized. The decrease in our consolidated effective tax rate for the nine months ended September 30, 2006, as compared to 2005, results from income tax deductions related to employee dispositions of stock purchased through our employee stock purchase plan prior to the minimum holding period required under the Internal Revenue Code and the transitioning of our foreign subsidiaries to profitability.

Stock-based compensation

As of September 30, 2006, we had the following stock compensation plans: the 1998 Nonofficer Employee Stock Option Plan ("1998 NOE Plan"), the 1998 Stock Option Plan ("1998 Plan"), the Nonemployee Director Stock Option Plan ("Director Plan"), the Management Incentive Compensation Plan ("MIC Plan"), the Adjustment Plan, the 2005 Stock Incentive Plan ("2005 Plan") and the 2005 Employee Stock Purchase Plan ("2005 ESPP Plan"). Additionally, through 2004, we granted a total of 165,000 options outside of these plans to corporate officers, which are included within the information presented herein and contain similar provisions to our 1998 Plan.

Prior to adoption of FASB Statement No. 123R, "Share-Based Payment" ("SFAS 123R"), we accounted for those plans under the intrinsic value method in accordance with the provisions of APB Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25"). Accordingly, compensation cost related to stock option grants to employees had been recognized only to the extent that the fair market value of the stock exceeded the exercise price of the stock option at the date of the grant. We recognized compensation expense for the fair value of restricted stock unit ("RSU") grants ratably over the applicable vesting period. The fair value was based on the market price of our stock on the date of grant. We recorded share-based compensation related to stock options in accordance with the accelerated methodology described in FASB Interpretation No. 28, "Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans" ("FIN 28").

On January 1, 2006, we adopted the fair value recognition provisions of SFAS 123R using the modified prospective transition method. SFAS 123R focuses primarily on accounting for transactions in which an entity obtains employee services in share-based payment transactions and requires entities to recognize compensation expense for awards of equity instruments to employees based on the grant-date fair value of those awards (with limited exceptions). Prior to the adoption of SFAS 123R, we presented all tax benefits resulting from the exercise of stock options as operating cash inflows in our consolidated statement of cash flows, in accordance with the provision of the Emerging Issues Task Force

("EITF") Issue No.00-15, "Classification in the Statement of Cash Flows of the Income Tax Benefit Received by a Company upon Exercise of a Nonqualified Employee Stock Option." SFAS 123R requires the benefits of tax deductions in excess of recognized compensation expense to be reported as a financing cash flow, rather than as an operating cash flow on a prospective basis, and therefore reduces net operating cash flows and increases net financing cash flows. This amount is shown as "Excess tax benefit from exercise of stock options" on our condensed consolidated statement of cash flows. We use a tax law ordering methodology for determining when tax benefits from stock option exercises are realized. Total cash flows remain unchanged from what have been reported under prior accounting rules.

Total stock-based compensation expense recognized in our consolidated statement of operations for the three and nine months ended September 30, 2006 was $2.3 million and $5.7 million before income taxes and consisted of expense related to stock options of $1.1 million and $3.1 million, RSU awards of $1.0 million and $2.1 million and the employee stock purchase plan of $0.2 million and $0.5 million, respectively. The related deferred tax benefit was $0.8 million and $2.1 million for the three and nine months ended September 30, 2006. The amount of stock-based compensation capitalized to inventory was not material as of September 30, 2006.

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The following table illustrates the impact of our adoption of SFAS 123R on selected line items from our consolidated financial statements for the three months and nine months ended September 30, 2006 (in thousands, except per share data):

	Three Months Ended September 30, 2006		Nine Months Ended September 30, 2006	
	As Reported	Under APB 25	As Reported	Under APB 25
Income before income taxes	$ 534	$ 1,809	$ 1,903	$ 5,513
Net income	$ 475	$ 1,355	$ 1,406	$ 3,881
Net income per share:				
Basic	$ 0.03	$ 0.08	$ 0.09	$ 0.24
Diluted	$ 0.03	$ 0.08	$ 0.08	$ 0.23
Cash flows from operating activities			$ 8,454	$ 10,449
Cash flows from financing activities			$ 10,890	$ 8,895

The following table illustrates the effect on net income (loss) and net income (loss) per share if we had applied the fair value recognition provisions of SFAS No. 123, "Accounting for Stock-Based Compensation," to stock-based employee compensation in 2005 (in thousands, except per share data):

	Three Months Ended September 30, 2005	Nine Months Ended September 30, 2005
Net income, as reported	$ 1,446	$ 119
Add: Stock-based compensation expense, as reported, net of related tax effects	76	110
Deduct: Stock-based compensation expense determined under fair value method for all awards, net of tax	(804)	(2,207)
Pro forma net income (loss)	$ 718	$ (1,978)
Basic net income (loss) per share:		
As reported	$ 0.09	$ 0.01
Pro forma	$ 0.05	$ (0.13)
Diluted net income (loss) per share:		
As reported	$ 0.09	$ 0.01
Pro forma	$ 0.04	$ (0.13)

Our results for prior years have not been restated.

The fair value for stock awards was estimated at the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions for the three and nine months ended September 30, 2006 and 2005:

Three Months Ended	Stock Options		ESPP
	September 30, 2006	September 30, 2005 (Pro forma)	September 30, 2006
Expected term (in years)	--	6.5	--
Expected stock price volatility	--%	53%	--%
Risk-free interest rate	--%	4.0%	--%
Expected dividend yield	--%	0.0%	--%
Weighted average fair value of options granted	$ --	$ 17.92	$ --

There were no grants of stock options or issuance from the employee stock purchase plan during the three months ended September 30, 2006.

Nine Months Ended	Stock Options		ESPP
	September 30, 2006	September 30, 2005 (Pro forma)	September 30, 2006
Expected term (in years)	4.6	5.4	0.5
Expected stock price volatility	41 %	54 %	26 %
Risk-free interest rate	4.6 %	3.9 %	5.0 %
Expected dividend yield	0.0 %	0.0 %	0.0 %
Weighted average fair value of options granted	$ 16.44	$ 15.59	$ 8.74

The expected term of the options represents the estimated period of time until exercise and is based on historical experience of similar awards, giving consideration to the contractual terms, vesting schedules and expectations of future employee behavior. Expected stock price volatility is based on historical volatility of our stock over the historical period commensurate with the expected term assumptions. The risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of grant with an equivalent remaining term. The Company has not paid dividends in the past and does not plan to pay any dividends in the near future.

The assumptions used to calculate the fair value of options granted are evaluated and revised, as necessary, to reflect market conditions and our experience. In conjunction with the adoption of SFAS 123R, we changed our method of attributing the value of stock-based compensation expense from the accelerated multiple-option approach to the straight-line single-option method. Compensation expense for all stock-based awards granted on or prior to December 31, 2005 will continue to be recognized using the accelerated multiple-option approach, while compensation expense for all stock-based awards granted subsequent to December 31, 2005 will be recognized using the straight-line single-option method. Compensation expense is recognized only for those options expected to vest, with forfeitures estimated at the date of grant based on the Company's historical experience and future expectations. Prior to the adoption of SFAS 123R, the effect of forfeitures on the pro forma expense amounts was recognized as the forfeitures occurred.

Stock compensation plans

Under the 1998 NOE Plan, 1998 Plan, MIC Plan, 2005 Plan and option grants outside our stock option plans, as of September 30, 2006, 473,000 shares were available for grant under these stock option plans. In most cases, stock options issued prior to October 22, 2002 are exercisable at 25% each year over a four-year vesting period and have a ten-year contractual term from the grant date. In October 2002, our Board of Directors approved a change in the vesting schedule for employee option grants made after October 22, 2002 so that first-time grants issued to new employees vest 25% after one year of employment and then monthly over the next three years, and grants made to employees after their first year of employment vest monthly over four years. Option grants made under the 2005 Plan to employees during the nine months ended September 30, 2006 vest monthly over three years and grants made to directors vest in full one year following their grant date provided the optionee has continued to serve as our director. Additionally, option grants under the 2005 Plan generally have a seven-year contractual term from the date of grant.

Under the Director Plan, 100,000 shares of common stock were authorized for issuance of stock options at prices equal to the fair market value of our common shares at the date of grant. At September 30, 2006, there were no shares available for grant under this Plan. Stock options are exercisable and vest in full one year following their grant date provided the optionee has continued to serve as our director. Each option expires on the earlier of ten years from the grant date or 90 days following the termination of a director's service as our director.

The 2005 ESPP Plan, which qualifies under Section 423 of the Internal Revenue Code, permits substantially all employees to purchase shares of our common stock. Participating employees may purchase common stock through payroll deductions at the end of each participation period at a purchase price equal to 85% of the lower of the fair market value of the common stock at the beginning or the end of the participation period. As of September 30, 2006, 931,000 shares of common stock were available for issuance under the 2005 ESPP Plan. During the nine months ended September 30, 2006, 41,000 shares of common stock were issued under this plan.

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We also have an Adjustment Plan, which includes options granted in connection with the dividend distribution occurring on April 6, 1998. As part of this distribution, existing ATL Ultrasound, Inc. ("ATL") option holders received one of our options for every six ATL options held. There was no change to the intrinsic value of the option grant, ratio of exercise price to market value, vesting provisions or option period as a result of the distribution. As of September 30, 2006, 7,000 shares of common stock were authorized primarily for issuance upon exercise of stock options at prices equal to the fair market value of our common shares at the date of grant.

Summary of stock option activity

The following table presents summary stock option activity for the nine months ended September 30, 2006 (shares presented in thousands):

	Nine Months Ended September 30, 2006			
	Shares	**Weighted average exercise price**	**Weighted Average Remaining Contractual Life**	**Aggregate Intrinsic Value (in thousands)**
Outstanding, beginning of period	1,830	$ 18.95		
Granted	437	$ 39.95		
Exercised	(458)	$ 17.16		
Forfeited	(103)	$ 29.60		
Expired	(12)	$ 18.31		
Outstanding, end of period	1,694	$ 24.21	5.74	$ 12,155
Exercisable, end of period	1,205	$ 19.75	5.32	$ 11,358

The aggregate intrinsic value in the table above is based on our closing stock price of $28.40 as of September 30, 2006, which would have been received by the optionees, excluding applicable income taxes, had all options been exercised on that date. As of September 30, 2006, total unrecognized stock-based compensation expense related to nonvested stock options was $6.3 million, which is expected to be recognized over a weighted average period of approximately 1.9 years. During the three and nine months ended September 30, 2006, the total intrinsic value of stock options exercised was $0.2 million and $10.4 million.

The Company issues new shares of common stock upon exercise of stock options.

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The following is a summary of stock options outstanding as of September 30, 2006 (shares presented in thousands):

	Options outstanding			Options exercisable	
Range of exercise prices	**Number outstanding**	**Weighted average remaining contractual life**	**Weighted average exercise price**	**Number exercisable**	**Weighted average exercise price**
$ 6.35 -- $ 15.24	337	3.58	$ 11.25	326	$ 11.24
$ 15.47 -- $ 18.51	359	5.52	$ 16.65	334	$ 16.70
$ 18.60 -- $ 27.00	364	7.10	$ 22.50	311	$ 22.46
$ 28.19 -- $ 38.97	338	6.05	$ 32.68	184	$ 30.19
$ 40.58	296	6.41	$ 40.58	50	$ 40.58
	1,694	5.74	$ 24.21	1,205	$ 19.75

Restricted stock units

We have granted RSU awards to employees under the 1998 Plan and the 2005 Plan. Generally, the vesting period for our RSU awards is three years from the date of grant. As of September 30, 2006, total unrecognized stock-based compensation expense related to nonvested RSU awards was $10.7 million, which is expected to be recognized over a weighted average period of approximately 2.5 years. During the three and nine months ended September 30, 2006, we recorded stock-based compensation expense related to these RSU awards of $1.0 million and $2.1 million, including $0.1 million of cumulative catch up adjustment that reduced the expense for the effect of forfeitures.

The following table presents summary RSU award activity for the nine months ended September 30, 2006 (shares presented in thousands):

	Nine Months Ended September 30, 2006	
	Shares	**Weighted average grant date fair value**
Non-vested, beginning of period	93	$ 33.05
Granted	365	$ 36.83
Vested	--	$ --
Forfeited	(35)	$ 37.70
Non-vested, end of period	423	$ 35.93

The total fair value of RSU awards vested during the nine months ended September 30, 2006 was zero.

Net income per share

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	**2005**	**2006**	**2005**
Net income	$ 475	$ 1,446	$ 1,406	$ 119
Weighted average common shares outstanding used in computing basic net income per share	16,366	15,630	16,229	15,461
Effect of dilutive stock options and restricted stock units	537	655	628	639
Weighted average common shares outstanding used in computing diluted net income per share	16,903	16,285	16,857	16,100
Net income per share:				
Basic	$ 0.03	$ 0.09	$ 0.09	$ 0.01
Diluted	$ 0.03	$ 0.09	$ 0.08	$ 0.01

We exclude equity instruments from the calculation of diluted weighted average shares outstanding if the effect of including such instruments is anti-dilutive to net income per share. Accordingly, certain equity instruments totaling 617,000 and 322,000 shares for the three and nine months ended September 30, 2006 and 10,000 and 148,000 shares for the three and nine months ended September 30, 2005 have been excluded from the calculation of diluted weighted average shares.

Accumulated other comprehensive income

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	**2005**	**2006**	**2005**
Net income	$ 475	$ 1,446	$ 1,406	$ 119
Other comprehensive income (loss):				
Foreign currency translation adjustment	(17)	(44)	235	(381)
Unrealized holding gains (losses) arising during the period	208	(92)	180	(71)

Less reclassification adjustment for losses included in net income	9	3	6	13
Comprehensive income (loss)	$ 675	$ 1,313	$ 1,827	$ (320)

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Indemnification Obligations and Guarantees (excluding product warranty)

We apply the disclosure provisions of FIN 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" ("FIN 45") to our agreements that contain guarantee or indemnification clauses. We provide (i) indemnifications of varying scope and size to our customers and distributors against claims of intellectual property infringement made by third parties arising from the use of our products; (ii) indemnifications of varying scope and size to our customers against third party claims arising as a result of defects in our products; (iii) indemnifications of varying scope and size to consultants against third party claims arising from the services they provide to us; and (iv) guarantees to support obligations of some of our subsidiaries such as lease payments. These indemnifications and guarantees give rise only to the disclosure provisions of FIN 45.

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

Contingencies

In March 2006, we prevailed in a patent infringement suit that had been pending against us in federal court in Texas since 2001. Following is a chronology of this lawsuit. On July 24, 2001, Neutrino Development Corporation ("Neutrino") filed a complaint against us in U.S. District Court, Southern District of Texas, Houston Division, alleging infringement of U.S. Patent 6,221,021, or the '021 patent, by SonoSite as a result of our use, sale and manufacture of the SonoSite 180, SonoSite 180PLUS, SonoHeart and SonoHeart Plus devices (the "Original Products"). Subsequently, the SonoHeart ELITE, iLook, TITAN and MicroMaxx systems were also added to the lawsuit (the "New Products"). The complaint asserted 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.

In October 2001, Neutrino's motion for preliminary injunction was denied. In February 2002, the district court held a Markman hearing to interpret certain claims in the '021 patent and issued its claim construction in August 2003. In September 2004, the district court granted Neutrino's motion for summary judgment of infringement, finding that SonoSite's Original Products infringe the '021 patent as the district court construed the claims in the Markman hearing. Following this decision, the parties prepared for a jury trial on the issues of infringement by SonoSite's New Products and validity of the '021 patent, filing various motions, including motions for summary judgment. On March 21, 2006, the district court granted SonoSite's motion for summary judgment of patent invalidity based on new matter. The district court found that Neutrino improperly amended the '021 patent in violation of the U.S. patent laws to include a description of a component being handheld which was not disclosed in the original patent application. In a final judgment, the district court declared that the claims being asserted against SonoSite in the '021 patent are invalid for new matter, vacated and set aside its September 2004 ruling on infringement, and dismissed Neutrino's claims and causes of action "with prejudice".

The plaintiff has filed a notice of appeal to the U.S. Court of Appeals for the Federal Circuit in Washington, D.C. Both parties have filed their appellate briefs and oral argument will take place on December 5, 2006. We expect that a decision by the appellate court would not issue until mid-to-late 2007. Our motions to declare the case "exceptional," and to recover our attorneys' fees and costs are pending in the district court. We believe that the appellate court will uphold the district court's decision. If we are not successful in the appeal, and the case is reversed and remanded to the district court for a jury trial, and we are not successful in defending these claims in a jury trial, we could be forced to pay damages related to past product sales, modify or discontinue selling our products or may enter into royalty or licensing agreements for future product sales, which may not be available on terms acceptable to us, if at all, and which could adversely affect our financial condition, results of operations and cash flow. Sales of the allegedly infringing products represent the majority of our revenue.

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

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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 for the three months and nine months ended September 30, 2006 and 2005 are as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
United States	$ 23,406	$ 20,390	$ 61,781	$ 53,282
Europe, Africa and the Middle East	9,286	7,672	32,799	28,972
Japan	3,003	3,103	8,769	9,369
Canada, South and Latin America	2,536	1,754	8,360	7,233
Asia Pacific	2,115	1,890	5,021	3,433
Total revenue	$ 40,346	$ 34,809	$ 116,730	$ 102,289

Recent accounting pronouncements

In July 2006, the FASB issued Financial Accounting Standards Board Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" ("FIN 48"). FIN 48 clarifies the recognition threshold and measurement of a tax position taken on a tax return. FIN 48 is effective for fiscal years beginning after December 15, 2006. FIN 48 also requires expanded disclosure with respect to the uncertainty in income taxes. We are currently evaluating the requirements of FIN 48 and the impact this interpretation may have on our consolidated financial statements.

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements" ("SAB 108"), which provides interpretive guidance on the consideration of the effects of prior year misstatements in quantifying current year misstatements for the purpose of a materiality assessment. SAB 108 is effective as of the end of our 2006 fiscal year, allowing a one-time transitional cumulative effect adjustment to beginning retained earnings as of January 1, 2006 for errors that were not previously deemed material, but are material under the dual method guidance in SAB 108. We are currently evaluating the impact of adopting SAB 108 on our financial statements.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measures" ("SFAS 157"), which defines fair value, establishes a framework for measuring fair value and enhances disclosures about fair value measures required under other accounting pronouncements, but does not change existing guidance as to whether or not an instrument is carried at fair value. SFAS 157 is effective for fiscal years beginning after November 15, 2007. We are currently reviewing the provisions of SFAS 157 to determine the impact on our consolidated financial statements.

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

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

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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.

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

We undertake no obligation to publicly update any forward-looking statement, whether as a result of new information, future events or otherwise. You are advised, however, to consult any further disclosures we make on related subjects in our future quarterly reports on Form 10-Q, current reports on Form 8-K and annual reports on Form 10-K. Also note that we provide a cautionary discussion of risks, uncertainties and possibly inaccurate assumptions relevant to our business in Item 1A. "Risk Factors" sections of our Annual Report on Form 10-K for the year ended December 31, 2005. 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 the world leader in hand-carried ultrasound ("HCU"). We specialize in the development of HCU systems for use in a variety of medical specialties and a range of clinical settings. Our proprietary technologies have enabled us to design hand-carried ultrasound systems that combine high-resolution, all-digital, broadband imaging with advanced features and capabilities typically found on cart-based ultrasound systems. We believe that the performance, size, durability, ease of use and cost-effectiveness of our products are expanding existing ultrasound markets, and are opening new markets by bringing ultrasound out of the imaging lab to the point-of-care such as the patient's bedside or the physician's examining table.

The large size, weight and complexity of traditional cart-based ultrasound systems typically require a physician or highly trained clinician to perform the examination in a centralized imaging department, such as a hospital's radiology department. Our strategic intent is to enable clinicians to use ultrasound in a variety of clinical settings by developing each potential market based on three fundamental tenets: (i) the design of high performance system hardware, software and transducers with application-specific settings and capabilities; (ii) the provision of educational training that ensures appropriate use of the equipment in the clinical setting; and (iii) the support of professional institutions and ultrasound thought leaders in the completion of use protocols and clinical research that accelerates the adoption of HCU to improve patient outcomes. By providing ultrasound at the primary point-of-care, our systems can eliminate delays associated with the outpatient referral process or moving heavy, cart-based systems across hospital departments to scan patients. This increased accessibility is changing clinical practice, improving patient care and safety and has the potential to reduce healthcare costs through earlier and more rapid diagnosis of diseases and conditions.

We design our products for applications where ultrasound has not typically been used such as emergency medicine, anesthesiology, surgery, critical care, internal medicine and vascular access procedures as well as for imaging in traditional applications, such as radiology, cardiology, vascular medicine and obstetrics and gynecology ("OB/Gyn"). In addition, the U.S. military has successfully deployed our systems in both traditional hospital settings, field hospitals and forward surgical teams in Iraq and other areas of conflict. We began shipping our first products in September 1999 and today have an installed based of more than 25,000 systems worldwide.

On April 18, 2005, we introduced our newest product, the SonoSite MicroMaxx (R) system ("MicroMaxx system"). This system is our third generation product and is based on our proprietary Application Specific Integrated Circuit ("ASIC") technology for high-resolution ultrasound imaging and offers image resolution comparable to costly, conventional cart-based ultrasound systems weighing over 200 pounds. Our first shipments of the MicroMaxx system occurred in June 2005. The system addresses both traditional and emerging ultrasound markets and includes a standard five-year warranty on the system and most of the transducers, a first in the ultrasound industry.

Our first generation of products includes the 180 (TM) and iLook (R) series. The SonoSite 180PLUS (TM) system was designed for general ultrasound imaging and the SonoHeart (R) ELITE is specifically configured for cardiovascular applications. The iLook 25 imaging tool is designed to provide visual guidance for physicians and nurses while performing vascular access procedures, and the iLook 15 imaging tool is designed to provide imaging of the chest and abdomen. Our second generation product, the TITAN (R) system, began shipping in June 2003.

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Critical Accounting Policies and Estimates

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

As discussed in Item 7, "Management Discussion and Analysis of Financial Condition and Results of Operations" of our annual report on Form 10-K for the year ended December 31, 2005, our critical accounting policies and estimates include accounts receivable, revenue recognition, valuation of inventories, goodwill, intangible assets, warranty expense, income taxes and stock-based compensation. With the adoption of SFAS 123R as of January 1, 2006, we are replacing "Stock-Based Compensation" with the following.

Stock-Based Compensation. On January 1, 2006, we adopted FAS 123R, which requires the measurement and recognition of compensation for all stock-based awards made to employees and directors including restricted stock units, stock options and employee stock purchases under a stock purchase plan based on estimated fair values. Under FAS 123R, we use the Black-Scholes option pricing model as our method of valuation for stock-based awards. Our determination of the fair value of stock-based awards on the date of grant using an option pricing model is affected by our stock price as well as assumptions regarding a number of highly complex and subjective variables. These variables include, but are not limited to the expected life of the award, our expected stock price volatility over the expected life of the award and actual and projected exercise and forfeiture behaviors. Although the fair value of stock-based awards is determined in accordance with FAS 123R, the Black-Scholes option pricing model requires the input of various subjective assumptions, and other reasonable assumptions could provide differing results.

Results of Operations

Revenue

Revenue increased to $40.3 million for the three months ended September 30, 2006 from $34.8 million for the three months ended September 30, 2005. Revenue increased to $116.7 million for the nine months ended September 30, 2006 from $102.3 million for the nine months ended September 30, 2005. The increase in 2006 compared to 2005 was due to increased direct sales offset by decreased U.S. enterprise sales and lower sales in some of our international markets. Sales of the MicroMaxx system, which has a higher average selling price than previous systems and began shipping in June 2005, accounted for 53.4% of total system revenues during the three months ended September 30, 2006.

United States

U.S. revenue increased to $23.4 million for the three months ended September 30, 2006 from $20.4 million for the three months ended September 30, 2005. U.S. revenue increased to $61.8 million for the nine months ended September 30, 2006 from $53.3 million for the nine months ended September 30, 2005. U.S. revenue was lower than expected due to the integration of our sales channel partner addressing the physician office market and the redeployment of our core direct sales to the hospital point-of-care markets. The increase in the third quarter 2006 compared to 2005 was primarily attributable to increased direct sales. The increase during the nine months of 2006 compared to 2005 was due to increased direct sales offset by a decrease in U.S. government and enterprise sales. Revenues to U.S. government declined in comparison to the prior year due to large project orders included in the first quarter of 2005.

International

Revenue from Europe, Africa, India and the Middle East increased to $9.3 million for the three months ended September 30, 2006 from $7.7 million for the three months ended September 30, 2005, primarily due to an increase in revenue from Europe offset by decreases in sales to our distributors in Italy, Middle East and Africa. Revenue from Europe, Africa, India and the Middle East increased to $32.8 million for the nine months ended September 30, 2006 from $29.0 million for the nine months ended September 30, 2005. The increases were primarily due to increased sales in Europe, offset by decreases in Italy. Revenue from Canada, South and Latin America and Asia Pacific (excluding Japan) increased to $4.7 million for the three months ended September 30, 2006 from $3.6 million for the three months ended September 30, 2005. Revenue from Canada, South and Latin America and Asia Pacific (excluding Japan) increased to $13.4 million for the nine months ended September 30, 2006 from $10.7 million for the nine months ended September 30, 2005. The increase during the three and nine months of 2006 compared to 2005 was primarily due to increased sales in Canada, Australia and Latin America.

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Revenue from Japan decreased to $3.0 million for the three months ended September 30, 2006 from $3.1 million for the three months ended September 30, 2005. Revenue from Japan decreased to $8.8 million for the nine months ended September 30, 2006 from $9.4 million for the nine months ended September 30, 2005. The decrease was primarily due to reduced TITAN system sales to a distributor as we introduced the MicroMaxx system into our distribution network. During the second quarter we began distribution to our new partner, Fukuda Denshi, for distribution of certain of our products into office physician markets and hospital point of care markets.

We anticipate that overall revenue will increase in 2006 compared to 2005 due to continued expansion of our direct selling efforts in the U.S., Europe, Canada and Australia, as well as our international distributors in Europe, Middle East, and India, the expansion of our sales operations in China, improvement in the sales operations in Germany, introduction of new product features, and the overall expansion of market awareness and acceptance of our products. In the U.S. we recently launched an alternate sales channel focused on the physician office market. However, the expansion of our sales operations in China, India, Japan and into the U.S. office market may not be as successful as anticipated and may take longer than expected. We may encounter regulatory and other issues in selling our products in these markets. Our revenue may also be impacted by fluctuations in foreign exchange rates in the countries in which we sell our products in currencies other than the USD. Increased competition may also impact the extent of the increase in our anticipated growth in revenue. We currently face competition from larger companies, such as General Electric Healthcare, that manufacture cart-based and portable ultrasound systems and have greater financial and other resources. Some of these competitors have introduced HCU products, including GE Healthcare.

Gross margin

Gross margin was 71.0% for the three months ended September 30, 2006 and 70.4% for the three months ended September 30, 2005. Gross margin was 71.3% for the nine months ended September 30, 2006 and 69.9% for the nine months ended September 30, 2005. The gross margin increased over the prior year quarter and prior year-to-date as a result of increased sales of MicroMaxx systems which generate a higher margin than our earlier generation products and manufacturing efficiencies due to higher volume and lower costs for MicroMaxx components.

We expect our gross margin percentage in 2006 to increase slightly from 2005 due to increased average selling prices, which result from changes in product mix, and due to increased manufacturing efficiencies. Nevertheless, increased competition from existing and new competitors in the portable ultrasound system market could result in lower average realized prices and could lower our gross margin. Our gross margin can be expected to fluctuate in future periods based on the mix of business between direct, government and distributor sales and our product and accessories sales mixes. Changes in our cost of inventory also may impact our gross margin. Adjustments to reduce carrying costs are recorded for obsolete material, earlier generation products and used or refurbished products held either as saleable inventory or as demonstration product. If market conditions change or the introduction of new products by us impacts the market for our previously released products, we may be required to write down the carrying value of our inventory, resulting in a negative impact on gross margins. Additionally, we rely on our sales forecasts by product to determine production volume. To the extent our sales forecasts or product mix estimates are inaccurate, we may produce excess inventory or experience inventory shortages, which may result in an increase in our costs of revenue, a decrease in our gross margin or lost sales. Our gross margin may also be impacted by fluctuations in foreign exchange rates in the countries in which we sell our products in currencies other than the USD.

Operating expenses

Research and development expenses were $5.4 million for the three months ended September 30, 2006, compared to $3.8 million for the three months ended September 30, 2005. Research and development expenses were $14.1 million for the nine months ended September 30, 2006, compared to $11.0 million for the nine months ended September 30, 2005. The increase was primarily due to increased stock-based compensation expenses recorded following the adoption of SFAS 123R on January 1, 2006 of $0.5 million and $1.3 million for the three and nine months ended September 30, 2006 and increased headcount to support further development of our ASIC technology and the MicroMaxx system.

We anticipate that research and development expenses will increase in 2006 compared to 2005 due to stock-based compensation, development related to our next generation of hand-carried technology and further development related to the MicroMaxx system. Also, we may incur higher than anticipated research and development costs in order to accelerate existing programs.

Sales and marketing expenses were $20.0 million for the three months ended September 30, 2006, compared to $15.5 million for the three months ended September 30, 2005. Sales and marketing expenses were $58.9 million for the nine months ended September 30, 2006, compared to $50.3 million for the nine months ended September 30, 2005. The increase was attributable to increased stock-based compensation of $0.7 million and $2.2 million for the three and nine months ended September 30, 2006, increased emphasis on education, and expansion of our U.S. sales force and international operations offset by the reduction in costs associated with the launch of MicroMaxx in 2005.

We anticipate that sales and marketing expenses will increase in 2006 compared to 2005 primarily due to stock-based compensation, marketing expenses for education and brand awareness, increased compensation for commissions related to the anticipated increase in revenue, and continued expansion of direct sales operations in Japan, Canada, Australia and in our European subsidiaries. Additionally, we may incur significant expenses in the expansion of our operations in China and India.

General and administrative expenses were $3.9 million for the three months ended September 30, 2006, compared to $3.2 million for the three months ended September 30, 2005. General and administrative expenses were $11.3 million for the nine months ended September 30, 2006, compared to $9.7 million for the nine months ended September 30, 2005. The increase was attributable to increased stock-based compensation of $1.0 million and $2.4 million for the three and nine months ended September 30, 2006 and increased headcount to support business growth, offset by a reduction in legal expenses.

We anticipate that general and administrative expenses, other than stock-based compensation, will not increase in 2006 compared to 2005 due to decreased legal expenses.

Other income (expense)

Total other income (expense) was $1.1 million for the three months ended September 30, 2006 compared to $0.5 million for the three months ended September 30, 2005. Total other income (expense) was $2.9 million for the nine months ended September 30, 2006 compared to $0.4 million for the nine months ended September 30, 2005. The increase was due to an increase in interest income, which was caused by higher cash balances and higher average interest rates, and a reduction in the foreign currency transaction loss from 2005.

Income tax expense

Income tax expense was $0.1 million for the three months ended September 30, 2006, compared to $1.1 million for the three months ended September 30, 2005. Income tax expense was $0.5 million for the nine months ended September 30, 2006, compared to $0.8 million for the nine months ended September 30, 2005. The decrease in our consolidated effective tax rate for the nine months ended September 30, 2006, as compared to 2005, results from income tax deductions related to employee dispositions of stock purchased through our employee stock purchase plan prior to the minimum holding period required under the Internal Revenue Code and the transitioning of our foreign subsidiaries to profitability. We anticipate that our annual consolidated effective tax rate will be 31%, excluding income tax deductions related to dispositions of stock purchased through the employee stock purchase plan and any impact of a reduction to our valuation allowance for foreign deferred tax assets based on an evaluation of the weight of all positive and negative evidence.

Liquidity and Capital Resources

Our cash and cash equivalents balance was $38.0 million as of September 30, 2006, compared to $26.8 million as of December 31, 2005. Cash and cash equivalents were primarily invested in money market accounts. Our short-term and long-term investment securities totaled $48.0 million as of September 30, 2006, compared to $44.0 million as of December 31, 2005. Our short-term investments increased to $40.7 million as of September 30, 2006 from $25.4 million as of December 31, 2005 due to the ability to achieve returns on short-term investments that are comparable with returns on long-term investment and at the same time provide greater investment flexibility. Investment securities consist of high-grade U.S. government or corporate debt and high-grade asset-backed securities. We have the ability to hold our securities until maturity, however, we classify all securities as available-for-sale, as the sale of such securities may be required prior to maturity to implement management strategies.

Operating activities provided cash of $8.5 million for the nine months ended September 30, 2006, compared to cash used of $5.5 million for the nine months ended September 30, 2005. Net income for the nine months ended September 30, 2006 was adjusted by non-cash stock-based compensation expense of $5.7 million, depreciation and amortization of $2.5 million and deferred income taxes of $0.5 million. Changes in operating assets used $2.9 million and changes in operating liabilities provided $3.4 million. Additionally, as of September 30, 2006, inventory had increased by $4.0 million from December 31, 2006 to support higher planned sales levels for the seasonally strong fourth quarter and an increase in demo inventory to support our education initiatives and international expansion. Also, as of September 30, 2006, our days sales outstanding ("DSO") increased by nine days with DSOs for U.S. based receivables decreasing and DSOs for international based receivables increasing due to longer payment cycles of international sales. SFAS 123R requires the non-cash benefits for tax deductions in excess of compensation expense calculated based on the fair value of the award to be reported as a financing cash flow and thus adjusted out of operating cash flows. Accordingly, cash from operating activities for the nine months ended September 30, 2006 was reduced by $2.0 million.

We anticipate that cash provided by operations will increase in 2006 compared to a use of cash in 2005 primarily due to anticipated continued profitable operations. This increase will depend on our ability to successfully sell our products, collect our receivables, control our inventories and manage our expenses. Our cash flow from operations will also be impacted by excess income tax benefits from the exercise of stock options, however, the amounts and timing of option exercising cannot be predicted.

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Investing activities used cash of $7.6 million for the nine months ended September 30, 2006, compared to cash provided of $1.0 million for the nine months ended September 30, 2005. The cash used in 2006 was primarily due to net purchases of investment securities of $3.7 million compared to net proceeds of $3.5 million in 2005.

Financing activities provided cash of $10.9 million for the nine months ended September 30, 2006, compared to $7.5 million for the nine months ended September 30, 2005. Cash provided by financing activities was due to proceeds from the exercise of stock options and employee stock purchase plan totaling $8.9 million in 2006 compared to $7.5 million in 2005. Additionally, SFAS 123R requires the non-cash benefits of $2.0 million for tax deductions in excess of recognized compensation expense, calculated based on the fair value of the award, to be reported as a source of cash from financing activities.

We believe that our existing cash and cash generated from operations will be sufficient to fund our operations and planned capital expenditures in 2006. Nevertheless, we may experience an increased need for additional cash due to:

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

Risk Factors

A complete listing of our risk factors is contained in the Item 1A. "Risk Factors" section of our Annual Report on Form 10-K for the year ended December 31, 2005. Updates are as follows:

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 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, in March 2006, we prevailed in a patent infringement suit that had been pending against us in federal court in Texas since 2001. Following is a chronology of this lawsuit. On July 24, 2001, Neutrino Development Corporation ("Neutrino") filed a complaint against us in U.S. District Court, Southern District of Texas, Houston Division, alleging infringement of U.S. Patent 6,221,021, or the '021 patent, by SonoSite as a result of our use, sale and manufacture of the SonoSite 180, SonoSite 180PLUS, SonoHeart and SonoHeart Plus devices (the "Original Products"). Subsequently, the SonoHeart ELITE, iLook, TITAN and MicroMaxx systems were also added to the lawsuit (the "New Products"). The complaint asserted 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.

In October 2001, Neutrino's motion for preliminary injunction was denied. In February 2002, the district court held a Markman hearing to interpret certain claims in the '021 patent and issued its claim construction in August 2003. In September 2004, the district court granted Neutrino's motion for summary judgment of infringement, finding that SonoSite's Original Products infringe the '021 patent as the district court construed the claims in the Markman hearing. Following this decision, the parties prepared for a jury trial on the issues of infringement by SonoSite's New Products and validity of the '021 patent, filing various motions, including motions for summary judgment. On March 21, 2006, the district court granted SonoSite's motion for summary judgment of patent invalidity based on new matter. The district court found that Neutrino improperly amended the '021 patent in violation of the U.S. patent laws to include a description of a component being handheld which was not disclosed in the original patent application. In a final judgment, the district court declared that the claims being asserted against SonoSite in the '021 patent are invalid for new matter, vacated and set aside its September 2004 ruling on infringement, and dismissed Neutrino's claims and causes of action "with prejudice".

The plaintiff has filed a notice of appeal to the U.S. Court of Appeals for the Federal Circuit in Washington, D.C. Both parties have filed their appellate briefs and oral argument will take place on December 5, 2006. We expect that a decision by the appellate court would not issue until mid-to-late 2007. Our motions to declare the case "exceptional," and to recover our attorneys' fees and costs are pending in the district court. We believe that the appellate court will uphold the district court's decision. If we are not successful in the appeal, and the case is reversed and remanded to the district court for a jury trial, and we are not successful in defending these claims in a jury trial, we could be forced to pay damages related to past product sales, modify or discontinue selling our products or may enter into royalty or licensing agreements for future product sales, which may not be available on terms acceptable to us, if at all, and which could adversely affect our financial condition, results of operations and cash flow. Sales of the allegedly infringing products represent the majority of our revenue.

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

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.

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

We have eight wholly-owned sales subsidiaries located in the United Kingdom, France, Germany, Spain, Japan, Canada, Australia and China. Establishing, maintaining and expanding these operations will require us to:

- substantially increase our costs of operations;
- establish an efficient and self-reliant local infrastructure;
- attract, hire, train and retain 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 international markets 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 international revenue, which would impair our operating results.

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In addition, the expansion of sales channels in the U.S. and overseas may cause short-term disruptions. In May 2006, we commenced integration of a channel partner to provide expanded sales capacity for the U.S. physician office market. During the third quarter of 2006, revenue in the U.S. was lower than expected due to this ongoing sales force transition, as we integrated 18 new sales representatives for the office market and re-deployed our core sales team into the hospital market. We anticipate this channel partner will be fully deployed in the fourth quarter of 2006. In addition, our sales force experienced some turnover. As a result, some sales territories with new sales representatives experienced a decrease in revenue in Q3. Despite our introduction of this channel partner, and our recruitment and training of highly skilled sales personnel, we may not be able generate an increase in revenues from the office market and we may experience a decrease in revenues in the short term due to disruptions to our direct sales force.

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 September 30, 2006, our portfolio consisted of $40.7 million of interest-bearing debt securities with maturities of less than one year and $7.4 million of interest-bearing debt securities with maturities of more than one year. We have the ability to hold these securities until maturity, however, we have classified them as available-for-sale in the event of unanticipated cash needs. The interest bearing securities are subject to interest rate risk and will fall in value if market interest rates increase. We believe that the impact on the fair market value of our securities and related earnings for 2006 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 substantially all our sales in USDs; therefore, the obligations of many of our international customers are in USDs. Our exposure to risk from fluctuations in foreign currencies relates to revenues and expenses transacted by subsidiaries in foreign currencies. Additionally, we have exposure related to the strengthening of the USD against the local currency of our international subsidiaries, which may result in foreign exchange losses on transactions with them, and our international customers, which may impact our ability to collect amounts owed by them.

As of September 30, 2006, 56% of our outstanding accounts receivable balance was from international customers, of which 58%, or $13.7 million, was denominated in a currency other than USDs. Total sales for the three months ended September 30, 2006 denominated in a currency other than USDs were $11.1 million, or 27.4% of total consolidated revenues. Total sales for the nine months ended September 30, 2006 denominated in a currency other than USDs were $33.2 million, or 28.4% of total consolidated revenues. The British pound, the euro and the Japanese yen represented the majority of financial transactions executed in a currency not denominated in USDs. We regularly review our receivable positions in foreign countries for any indication that collection may be at risk. In addition, we utilize letters of credit where they are warranted in order to mitigate our collection risk.

We periodically enter into foreign currency forward contracts to reduce the impact of adverse fluctuations on earnings associated with foreign currency exchange rate changes. As of September 30, 2006, we had $26.9 million in notional amount of foreign currency forward contracts.

These contracts expire on December 29, 2006 and serve as hedges of a substantial portion of our intercompany balances denominated in a currency other than the USD, but are not designated as hedges for accounting purposes. These foreign currencies primarily include the British pound, the euro and the Japanese yen. A sensitivity analysis of a change in the fair value of these contracts indicates that if the USD weakened by 10% against the applicable foreign currency, the fair value of these contracts would decrease by $2.7 million. Conversely, if the USD strengthened by 10% against the applicable foreign currency, the fair value of these contracts would increase by $2.7 million. Any gains and losses on the fair value of these contracts would be largely mitigated by offsetting losses and gains on the underlying transactions. These offsetting gains and losses are not reflected in the sensitivity analysis above. The fair value loss of these contracts as of September 30, 2006 was $0.1 million. Changes in fair value of our derivative instruments are recorded in our consolidated statements of operations.

Item 4. Controls and Procedures

Evaluation of disclosure controls and procedures

As of September 30, 2006, our chief executive officer and our chief financial officer have evaluated the effectiveness of our disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934 (the Exchange Act), and they have concluded that our disclosure controls and procedures were effective to ensure that the information required to be disclosed by us in reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission.

Changes in internal control over financial reporting

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

PART II: OTHER INFORMATION

Item 1. Legal Proceedings

A complete description of our legal proceedings in contained in Item 1. "Legal Proceedings" section of our Form 10-Q for the period ended March 31, 2006.

Item 5. Other Information

At its October 24, 2006 meeting, the Compensation Committee of the Board of Directors approved the purchase by the company of new life and disability insurance policies to provide individual coverage for the company's senior executives, including its Named Executive Officers. These benefits are expected to come into effect for each covered individual after January 1, 2007.

Item 7. Exhibits

Exhibit No.	Description
31.1	Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of Principal Executive Officer pursuant to 18 U.S.C. Section 1350 (Section 906 of the Sarbanes-Oxley Act of 2002)
32.2	Certification of Principal Financial Officer pursuant to 18 U.S.C. Section 1350 (Section 906 of the Sarbanes-Oxley Act of 2002)

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SIGNATURE

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

SONOSITE, INC.

(Registrant)

Dated: November 03, 2006

By: /s/ MICHAEL J. SCHUH

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

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