MASIMO CORP
Form 10-Q
November 01, 2011
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended October 1, 2011

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from to

Commission File Number 001-33642

Masimo Corporation

(Exact Name of Registrant as Specified in its Charter)

Delaware	**33-0368882**
(State or Other Jurisdiction of	**(I.R.S. Employer**
Incorporation or Organization)	**Identification Number)**
40 Parker	
Irvine, California	**92618**
(Address of Principal Executive Offices)	**(Zip Code)**

(949) 297-7000

(Registrant s Telephone Number, Including Area Code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

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

Large accelerated filer	x	Accelerated filer	¨
Non-accelerated filer	¨ (Do not check if a smaller reporting company)	Smaller reporting company	¨

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date:

Class	**Number of Shares Outstanding as of October 1, 2011**
Common stock, $0.001 par value	60,003,291

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MASIMO CORPORATION

FORM 10-Q FOR THE QUARTER ENDED OCTOBER 1, 2011

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PART 1. FINANCIAL INFORMATION

Item 1. Financial Statements

MASIMO CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

(unaudited, in thousands, except share amounts)

	October 1, 2011	January 1, 2011
ASSETS		
Current assets		
Cash and cash equivalents	$ 143,192	$ 88,305
Accounts receivable, net of allowance for doubtful accounts of $1,684 and $1,720 at October 1, 2011 and January 1, 2011, respectively	53,526	49,694
Royalties receivable	6,736	12,000
Inventories	45,523	45,028
Prepaid expenses	13,362	7,887
Deferred tax assets	12,588	12,555
Other current assets	1,703	2,136
Total current assets	276,630	217,605
Deferred cost of goods sold	51,508	47,184
Property and equipment, net	15,096	15,951
Intangible assets, net	10,992	10,497
Deferred tax assets	12,542	12,560
Other assets	7,336	6,438
Total assets	$ 374,104	$ 310,235
LIABILITIES AND EQUITY		
Current liabilities		
Accounts payable	$ 20,006	$ 22,150
Accrued compensation	18,421	21,074
Accrued liabilities	10,764	9,832
Income taxes payable	1,923	722
Deferred revenue	14,876	16,369
Current portion of capital lease obligations	48	50
Total current liabilities	66,038	70,197
Deferred revenue	1,120	1,554
Capital lease obligations, less current portion	87	122
Other liabilities	9,488	8,323
Total liabilities	76,733	80,196
Commitments and contingencies		
Equity		
Masimo Corporation stockholders equity:		
Preferred stock, $0.001 par value; 5,000,000 shares authorized; 0 shares issued and outstanding at October 1, 2011 and January 1, 2011		
	60	59

Common stock, $0.001 par value; 100,000,000 shares authorized; 60,003,291 and 59,462,969 shares outstanding at October 1, 2011 and January 1, 2011, respectively		
Treasury stock, 156,240 shares at October 1, 2011 and January 1, 2011	(1,209)	(1,209)
Additional paid-in capital	239,218	222,206
Accumulated other comprehensive income	1,294	925
Retained earnings	55,544	5,664
Total Masimo Corporation stockholders equity	294,907	227,645
Noncontrolling interest	2,464	2,394
Total equity	297,371	230,039
Total liabilities and equity	$ 374,104	$ 310,235

The accompanying notes are an integral part of these condensed consolidated financial statements.

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MASIMO CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(unaudited, in thousands, except per share amounts)

	Three Months Ended		Nine Months Ended	
	October 1, 2011	October 2, 2010	October 1, 2011	October 2, 2010
Revenue:				
Product	$ 97,639	$ 88,823	$ 301,771	$ 262,647
Royalty	6,401	12,165	24,876	37,186
Total revenue	104,040	100,988	326,647	299,833
Cost of goods sold	35,601	29,376	106,125	88,379
Gross profit	68,439	71,612	220,522	211,454
Operating expenses:				
Selling, general and administrative	40,134	39,547	125,275	129,862
Research and development	9,372	9,227	28,793	27,688
Antitrust litigation proceeds				(30,728)
Total operating expenses	49,506	48,774	154,068	126,822
Operating income	18,933	22,838	66,454	84,632
Non-operating income (expense)	(240)	1,232	482	1,194
Income before provision for income taxes	18,693	24,070	66,936	85,826
Provision for income taxes	3,869	7,376	17,049	29,052
Net income including noncontrolling interests	14,824	16,694	49,887	56,774
Net (income) loss attributable to the noncontrolling interests	5	(275)	(7)	642
Net income attributable to Masimo Corporation	$ 14,829	$ 16,419	$ 49,880	$ 57,416
Net income per share attributable to Masimo Corporation stockholders:				
Basic	$ 0.25	$ 0.28	$ 0.83	$ 0.98
Diluted	$ 0.24	$ 0.27	$ 0.82	$ 0.95
Weighted average shares used in per share calculations:				
Basic	59,971	58,866	59,804	58,644
Diluted	61,086	60,572	61,082	60,527
Cash dividend declared per share	$	$	$	$ 2.00

The accompanying notes are an integral part of these condensed consolidated financial statements.

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MASIMO CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited, in thousands)

	Nine Months Ended October 1, 2011	Nine Months Ended October 2, 2010
Cash flows from operating activities:		
Net income including noncontrolling interests	$ 49,887	$ 56,774
Adjustments to reconcile net income including noncontrolling interests to net cash provided by operating activities:		
Depreciation and amortization	5,608	4,755
Share-based compensation	10,167	8,887
Provision for doubtful accounts	184	129
Provision for obsolete inventory	1,879	448
Provision for warranty costs	1,919	1,790
Provision for deferred income taxes		133
Income tax benefit from exercise of stock options granted prior to January 1, 2006	1,290	2,072
Excess tax benefit from share-based payment arrangements	(58)	(494)
Changes in operating assets and liabilities:		
Increase in accounts receivable	(4,016)	(10,561)
Decrease in royalties receivable	5,264	
Increase in inventories	(2,374)	(12,290)
Increase in deferred cost of goods sold	(4,321)	(7,201)
(Increase) decrease in prepaid expenses	(5,459)	522
Increase in other assets	(436)	(2,675)
Increase (decrease) in accounts payable	(2,146)	7,189
Increase (decrease) in accrued compensation	(2,744)	1,650
Decrease in accrued liabilities	(1,001)	(734)
Increase in income taxes payable	1,249	1,036
Increase (decrease) in deferred revenue	(1,927)	1,691
Increase in other liabilities	1,101	677
Net cash provided by operating activities	54,066	53,798
Cash flows from investing activities:		
Purchase of short-term investments		(75,986)
Proceeds from sale and maturities of short-term investments		132,975
Purchases of property and equipment	(3,508)	(5,942)
Increase in intangible assets	(1,719)	(1,381)
Net cash provided by (used in) investing activities	(5,227)	49,666
Cash flows from financing activities:		
Repayments of capital lease obligations	(37)	(43)
Proceeds from issuance of common stock	5,568	6,277
Excess tax benefit from share-based payment arrangements	58	494
Dividends paid		(117,506)
Net cash provided by (used in) financing activities	5,589	(110,778)
Effect of foreign currency exchange rates on cash	459	667
Net increase (decrease) in cash and cash equivalents	54,887	(6,647)

Cash and cash equivalents at beginning of period	88,305	132,054
Cash and cash equivalents at end of period	$ 143,192	$ 125,407

The accompanying notes are an integral part of these condensed consolidated financial statements.

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MASIMO CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

1. Description of the Company

Masimo Corporation, or the Company, is a global medical technology company that develops, manufactures and markets noninvasive patient monitoring products that help clinicians improve patient care. The Company invented Masimo Signal Extraction Technology, or Masimo SET, which provides the capabilities of Measure-Through Motion and Low Perfusion pulse oximetry to address the primary limitations of conventional pulse oximetry. The Company has also developed Masimo rainbow® SET products which monitor multiple blood measurements, including carboxyhemoglobin, methemoglobin, Pleth Variability Index, total hemoglobin, acoustic respiration rate and Halo Index. The Company develops, manufactures and markets a family of patient monitoring solutions which incorporate a monitor or circuit board and sensors, including both proprietary single-patient use and reusable sensors and cables. The Company considers the pulse oximetry device (monitor or circuit board), its sensors and cables and software fees to be products as defined in its condensed consolidated statements of income. The Company sells to hospitals and the alternate care market through its direct sales force and distributors, and markets its circuit boards containing the Company s proprietary algorithm and software architecture to original equipment manufacturer, or OEM, partners.

2. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission, or SEC. Certain information and note disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America, or GAAP, have been condensed or omitted pursuant to such rules and regulations. The condensed consolidated financial statements have been prepared on the same basis as the annual financial statements and, in the opinion of management, reflect all adjustments, which include only normal recurring adjustments, necessary to present fairly the Company s condensed consolidated financial statements. The condensed consolidated balance sheet as of January 1, 2011 was derived from the Company s audited consolidated financial statements at that date. The accompanying condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and related notes contained in the Company s Annual Report on Form 10-K, filed with the SEC on February 16, 2011. The results for the three and nine months ended October 1, 2011 are not necessarily indicative of the results to be expected for the year ending December 31, 2011 or for any other interim period or for any future year. Certain amounts in the condensed consolidated financial statements for prior periods have been reclassified to conform with current period presentations.

Principles of Consolidation

The condensed consolidated financial statements include the accounts of the Company, its wholly-owned subsidiaries and the variable interest entities, or VIEs, of which the Company is the primary beneficiary. All intercompany accounts and transactions have been eliminated in consolidation. In accordance with GAAP, current authoritative guidance is applied when determining whether an entity is subject to consolidation.

Fiscal Periods

The Company follows a conventional 52/53 week fiscal year. Under a conventional 52/53 week fiscal year, a 52 week year includes four quarters of 13 fiscal weeks while a 53 week fiscal year includes three 13 fiscal week quarters and one 14 fiscal week quarter. In fiscal 2010, the Company followed a 52 week fiscal calendar in which the Company s first, second and third quarters ended on Saturday, April 3, July 3 and October 2, 2010, respectively, and its fiscal year ended on Saturday, January 1, 2011. Similar to fiscal 2010, fiscal 2011 is on a 52 week fiscal calendar in which the Company s first, second and third quarters ended on Saturday April 2, 2011, July 2, 2011 and October 1, 2011, respectively, and its fiscal year will end on Saturday, December 31, 2011.

Use of Estimates

The Company prepares its financial statements in conformity with GAAP, which requires the Company to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Significant estimates include: determination of accounts receivable allowances, inventory reserves, warranty reserves, rebate reserves, valuation of the Company s stock options, distributor channel inventory, royalty revenues, deferred revenue, uncertain income tax positions and property taxes. Actual results could differ from those estimates.

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MASIMO CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(unaudited)

Fair Value Measurements

The authoritative guidance describes a fair value hierarchy based on three levels of inputs, of which the first two are considered observable and the last unobservable, that may be used to measure fair value:

Level 1 Quoted prices in active markets for *identical* assets or liabilities.

Level 2 Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for *similar* assets or liabilities; quoted prices in markets that are not active; or other inputs that can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

Pursuant to current authoritative guidance, entities are allowed an irrevocable option to elect fair value for the initial and subsequent measurement for specified financial assets and liabilities on a contract-by-contract basis. The Company did not elect the fair value option under this guidance as to specific assets or liabilities. There were no transfers between level 1, level 2 and level 3 inputs during the three and nine months ended October 1, 2011. The Company carries cash and cash equivalents at cost which approximates fair value. The following tables represent the Company s fair value hierarchy for its cash equivalents (in thousands):

	Fair Value Measurement as of October 1, 2011 using:			
	Level 1	**Level 2**	**Level 3**	**Total**
Assets:				
U.S. Treasuries	$ 96,000	$	$	$ 96,000
Money Market funds	1,373			1,373
Total	$ 97,373	$	$	$ 97,373

	Fair Value Measurement as of January 1, 2011 using:			
	Level 1	**Level 2**	**Level 3**	**Total**
Assets:				
U.S. Treasuries	$ 57,995	$	$	$ 57,995
Money Market funds	12,165			12,165
Total	$ 70,160	$	$	$ 70,160

Accounts Receivable and Allowance for Doubtful Accounts

Accounts receivable consist of trade receivables recorded upon recognition of revenue for product revenues, reduced by reserves for estimated bad debts and returns. Trade accounts receivable are recorded at the invoiced amount and do not bear interest. Credit is extended based on evaluation of the customer s financial condition. Collateral is not required. The allowance for doubtful accounts is determined based on historical write-off experience, current customer information and other relevant factors, including specific identification of past due accounts, based on the age of the receivable in excess of the contemplated or contractual due date. Accounts are charged off against the allowance when the Company believes they are uncollectible.

Intangible Assets

Costs to renew intangibles are capitalized and amortized over the remaining useful life of the intangible. For the three and nine months ended October 1, 2011, total renewal costs capitalized for patents were $125,000 and $324,000, respectively. For the three and nine months ended October 1, 2011, total renewal costs capitalized for trademarks were $27,000 and $44,000, respectively. As of October 1, 2011, the weighted average number of years until the next renewal is one year for patents and five years for trademarks.

The Company s policy is to renew its patents and trademarks. The Company continually evaluates the amortization period and carrying basis of patents and trademarks to determine whether any events or circumstances warrant a revised estimated useful life or reduction in value. Capitalized application costs are charged to operations when it is determined that the patent or trademark will not be obtained or is abandoned.

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MASIMO CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(unaudited)

Revenue Recognition

The Company follows the current authoritative guidance for revenue recognition. Based on these requirements, the Company recognizes revenue when: (i) persuasive evidence of an arrangement exists, (ii) delivery has occurred or services have been rendered, (iii) the price is fixed or determinable, and (iv) collectability is reasonably assured. The Company enters into agreements to sell pulse oximetry and related products and services as well as multiple deliverable arrangements that include various combinations of products and services. While the majority of the Company s sales transactions contain standard business terms and conditions, there are some transactions that contain non-standard business terms and conditions. As a result, contract interpretation is sometimes required to determine the appropriate accounting, including: (a) whether an arrangement exists, (b) how the arrangement consideration should be allocated among the deliverables if there are multiple deliverables, (c) when to recognize revenue on the deliverables, and (d) whether undelivered elements are essential to the functionality of the delivered elements. Changes in judgments on these assumptions and estimates could materially impact the timing of revenue recognition.

In September 2009, the Financial Accounting Standards Board, or FASB, amended the accounting standards related to revenue recognition for arrangements with multiple deliverables. The new standard changes the requirements for establishing separate units of accounting in a multiple element arrangement and requires the allocation of arrangement consideration to each deliverable to be based on relative selling prices. The FASB also amended the accounting standards for revenue recognition to exclude software that is contained in a tangible product from the scope of software revenue guidance if the software is essential to the tangible product s functionality. The Company adopted these new standards on a prospective basis. Therefore, the new standards apply only to revenue arrangements entered into or materially modified on or after January 2, 2011. For revenue arrangements that were entered into or materially modified after the adoption of these standards, implementation of this new authoritative guidance had no significant impact on the Company s reported revenue in either the three or nine months ended October 1, 2011 as compared to revenue if the related arrangements entered into or materially modified on or after January 2, 2011 were subject to the accounting requirements in effect in the same prior year periods.

The new standards establish a hierarchy to determine the selling price to be used for allocating revenue to deliverables as follows: (i) vendor-specific objective evidence of fair value, or VSOE, (ii) third-party evidence of selling price, or TPE, and (iii) best estimate of the selling price, or ESP. VSOE is defined as the price charged when the same element is sold separately. VSOE generally exists only when the deliverable is sold separately and is the price actually charged for that deliverable. TPE generally does not exist for the majority of the Company s products because of their uniqueness. The objective of ESP is to determine the price at which the Company would transact a sale if the product was sold on a stand-alone basis. In the absence of VSOE and TPE, the Company determines ESP for its products by considering multiple factors including, but not limited to, features and functionality of the product, geographies, type of customer, contractual prices pursuant to Group Purchasing Organization, or GPO, contracts, the Company s pricing and discount practices and market conditions.

A deliverable in an arrangement qualifies as a separate unit of accounting if the delivered item has value to the customer on a stand-alone basis. Most of the Company s products in a multiple deliverable arrangement qualify as separate units of accounting. In the case of the Company s monitoring equipment products containing embedded Masimo SET software, the Company has determined that the hardware and software components function together to deliver the products essential functionality, and therefore, represent a single deliverable. In accordance with the new guidance, the revenue from the sale of these products no longer falls within the scope of the software revenue recognition guidance. Software deliverables, such as rainbow® parameter software, which do not function together with hardware components to provide the products essential functionality, continue to be accounted for under software revenue recognition guidance. The Company s multiple deliverable arrangements may therefore have software deliverables that are subject to the existing software revenue recognition guidance. The revenue for these multiple-element arrangements is allocated to the software deliverables and the non-software deliverables based on the relative selling prices of all of the deliverables in the arrangement using the hierarchy in the new revenue recognition accounting guidance for arrangements with multiple deliverables. The Company s sales under long-term sensor purchase contracts are generally structured such that the Company agrees to provide up-front and at no initial charge certain monitoring equipment, software, installation, training and ongoing warranty support in exchange for the hospital s agreement to purchase sensors over the term of the agreement, which ranges from three to six years. The sensors are essential to the functionality of the monitoring equipment and, therefore, represent a substantive performance obligation. The Company does not recognize any revenue when the monitoring and related equipment and software are delivered to the hospitals and installation and training is complete. The Company recognizes revenue for these delivered elements, on a pro-rata basis, as the sensors are delivered under the long-term purchase commitment. The adoption of the new guidance for revenue recognition did not change this pattern of revenue recognition for long-term sensor purchase contracts. The cost of the monitoring equipment initially placed at the hospitals is deferred and amortized to cost of goods sold over the life of the underlying long-term sensor purchase contract.

MASIMO CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(unaudited)

The Company s distributors purchase primarily sensor products which they then resell to hospitals that are typically fulfilling their purchase obligations to the Company under the end-user hospitals long-term sensor purchase commitments. Upon shipment to the distributor, revenue is deferred until the Company s commitment to its end-user hospital is fulfilled, which occurs when the sensors are sold by the distributor to the end-user hospital. The Company also provides certain end-user hospitals with the ability to purchase sensors under rebate programs. Under these programs, the end-user hospitals may earn rebates based on their purchasing activity. The Company estimates and provides allowances for these programs at the time of sale as a reduction to revenue.

The Company also earns revenue from the sale of integrated circuit boards that use the Company s software technology and license fees for allowing certain OEMs the right to use the Company s technology in their products. The license fee is recognized upon shipment of the OEM s product to its customers, as represented to the Company by the OEM.

Product Warranty

The Company provides a warranty against defects in material and workmanship for a period ranging from six months to one year, depending on the product type. In the case of long-term sales agreements, the Company typically warranties the products for the term of the agreement, which ranges from three to six years. In traditional sales activities, including direct and OEM sales, the Company establishes an accrual for the estimated costs of warranty at the time of revenue recognition. Estimated warranty expenses are recorded as an accrued liability, with a corresponding provision to cost of sales. In long-term sales agreements, revenue related to extended warranty is recognized over the term of the extended warranty pursuant to its revenue recognition policy, while the product warranty costs related to the long-term sales agreements are expensed as incurred.

Changes in the product warranty accrual were as follows (in thousands):

	Nine Months Ended	
	October 1, 2011	**October 2, 2010**
Warranty accrual, beginning of period	$ 544	$ 354
Provision for warranty costs	1,919	1,790
Warranty expenditures	(1,823)	(1,650)
Warranty accrual, end of period	$ 640	$ 494

Comprehensive Income

Authoritative accounting guidance establishes requirements for reporting and disclosure of comprehensive income and its components. Comprehensive income includes foreign currency translation adjustments that have been excluded from net income including noncontrolling interests and reflected in Masimo Corporation stockholders equity.

Net Income Per Share

Basic net income per share attributable to Masimo Corporation for the three and nine months ended October 1, 2011 and October 2, 2010 is computed by dividing net income attributable to Masimo Corporation by the weighted average number of shares outstanding during each period. The diluted net income per share attributable to Masimo Corporation for the three and nine months ended October 1, 2011 and October 2, 2010 is computed by dividing the net income attributable to Masimo Corporation by the weighted average number of shares and potential shares outstanding during each period, if the effect of potential shares is dilutive. Potential shares include incremental shares of stock issuable upon the exercise of stock options. For the three and nine months ended October 1, 2011, options to purchase 3,708,900 and 2,516,475 shares of common stock, respectively, were not included in the computation of diluted share equivalent because the options exercise prices were greater than the average market price for the period. For the three and nine months ended October 2, 2010, options to purchase 3,643,020 and 3,189,620 shares of common stock, respectively, were not included in the computation of diluted share equivalent because the options exercise prices were greater than the average market price for the period.

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MASIMO CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(unaudited)

The Company reduced its net income including noncontrolling interests by the amount of net (income) loss attributable to noncontrolling interests for the three and nine months ended October 1, 2011 and October 2, 2010. A reconciliation of basic and diluted net income per share attributable to Masimo Corporation is as follows (in thousands, except per share amounts):

	Three Months Ended		Nine Months Ended	
	October 1, 2011	October 2, 2010	October 1, 2011	October 2, 2010
Net income attributable to stockholders of Masimo Corporation:				
Net income including noncontrolling interests	$ 14,824	$ 16,694	$ 49,887	$ 56,774
Net (income) loss attributable to the noncontrolling interests	5	(275)	(7)	642
Net income attributable to Masimo Corporation	$ 14,829	$ 16,419	$ 49,880	$ 57,416
Basic net income per share attributable to Masimo Corporation:				
Net income attributable to Masimo Corporation	$ 14,829	$ 16,419	$ 49,880	$ 57,416
Weighted average shares outstanding - basic	59,971	58,866	59,804	58,644
Basic net income per share attributable to Masimo Corporation	**$ 0.25**	**$ 0.28**	**$ 0.83**	**$ 0.98**
Diluted net income per share attributable to Masimo Corporation:				
Weighted average shares outstanding - basic	59,971	58,866	59,804	58,644
Diluted share equivalent: stock options	1,115	1,706	1,278	1,883
Weighted average shares outstanding - diluted	61,086	60,572	61,082	60,527
Diluted net income per share attributable to Masimo Corporation	**$ 0.24**	**$ 0.27**	**$ 0.82**	**$ 0.95**

New Accounting Pronouncements

In May 2011, the FASB issued Accounting Standards Update No. 2011-04, or ASU 11-04, *Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs.* ASU 11-04 provides a consistent definition of fair value and ensures that the fair value measurement and disclosure requirements are similar between U.S. GAAP and International Financial Reporting Standards. ASU 11-04 changes certain fair value measurement principles and enhances the disclosure requirements particularly for level 3 fair value measurements. This update is effective for interim and annual periods beginning after December 15, 2011 and should be applied prospectively. The Company does not expect the adoption of this update to have a material impact on its condensed consolidated financial statements.

In June 2011, the FASB issued Accounting Standards Update No. 2011-05, or ASU 11-05, *Comprehensive Income (Topic 220)*: *Presentation of Comprehensive Income.* ASU 11-05 requires an entity to present the total of comprehensive income, the components of net income and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. ASU 11-05 eliminates the option to present the components of other comprehensive income as part of the statement of equity. ASU 11-05 is effective for interim and annual periods beginning after December 15, 2011, and should be applied retrospectively. Early adoption of this update is permitted. The Company does not expect the adoption of this update to have a material impact on its condensed consolidated financial statements, as it only requires a change in the format of presentation.

In September 2011, the FASB issued Accounting Standards Update No. 2011-08, or ASU 11-08, *Intangibles Goodwill and Other (Topic 350): Testing Goodwill for Impairment*, to allow entities to use a qualitative approach to test goodwill for impairment. ASU 11-08 permits an entity to first perform a qualitative assessment to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying value. If it is concluded that this is the case, it is necessary to perform the currently prescribed two-step goodwill impairment test. Otherwise, the two-step goodwill impairment test is not required. ASU 11-08 is effective for interim and annual periods beginning after December 15, 2011. Early adoption of this update is permitted. The Company does not expect the adoption of this update to have a material impact on its condensed consolidated financial statements.

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MASIMO CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(unaudited)

3. Comprehensive Income

The Company s total comprehensive income attributable to Masimo Corporation is as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	October 1, 2011	October 2, 2010	October 1, 2011	October 2, 2010
Net income including noncontrolling interests	$ 14,824	$ 16,694	$ 49,887	$ 56,774
Other comprehensive income:				
Foreign currency translation gain	202	258	369	712
Total comprehensive income before noncontrolling interests	15,026	16,952	50,256	57,486
Net (income) loss attributable to the noncontrolling interests	5	(275)	(7)	642
Other comprehensive income attributable to noncontrolling interests				
Comprehensive income attributable to Masimo Corporation	$ 15,031	$ 16,677	$ 50,249	$ 58,128

4. Variable Interest Entities (VIEs)

The Company follows authoritative guidance for the consolidation of VIEs, which requires an enterprise to determine whether its variable interest gives it a controlling financial interest in a VIE. This consolidation guidance for VIEs replaced the prior *quantitative* approach for identifying whether an enterprise should consolidate a VIE with a *qualitative* approach. Determination about whether an enterprise should consolidate a VIE is required to be evaluated continuously as changes to existing relationships or future transactions may result in consolidating or deconsolidating the VIE.

Cercacor Laboratories, Inc.

Cercacor Laboratories, Inc., or Cercacor, is an independent entity spun off from the Company to its stockholders in 1998. Joe Kiani and Jack Lasersohn, members of the Company s board of directors, or the Board, are also members of the board of directors of Cercacor. Joe Kiani, the Company s Chairman and Chief Executive Officer, is also the Chairman and Chief Executive Officer of Cercacor. The Company is a party to a Cross-Licensing Agreement with Cercacor, which was most recently amended and restated effective January 1, 2007, that governs each party s rights to certain intellectual property held by the two companies.

Under the Cross-Licensing Agreement, the Company granted Cercacor an exclusive, perpetual and worldwide license, with sublicense rights, to use all Masimo SET owned by the Company, including al