MASIMO CORP
Form S-1/A
May 29, 2007
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As filed with the Securities and Exchange Commission on May 25, 2007

Registration No. 333-142171

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

AMENDMENT NO. 1

TO

FORM S-1

REGISTRATION STATEMENT

Under

The Securities Act of 1933

MASIMO CORPORATION

(Exact name of registrant as specified in its charter)

DELAWARE	**3845**	**33-0368882**
(State or other jurisdiction of incorporation or organization)	**(Primary Standard Industrial Classification Code Number)**	**(I.R.S. Employer Identification Number)**

40 Parker

Irvine, California 92618

(949) 297-7000

(Address, including zip code, and telephone number, including area code, of registrant s principal executive offices)

Joe E. Kiani

Chief Executive Officer

40 Parker

Irvine, California 92618

(949) 297-7000

(Name, address, including zip code, and telephone number, including area code, of agent for service)

Copies to:

John F. Della Grotta	**Patrick T. Seaver**
Michael G. McKinnon	**Charles K. Ruck**
Paul, Hastings, Janofsky & Walker LLP	**Latham & Watkins LLP**
695 Town Center Drive, Suite 1700	**650 Town Centre Drive, 20th Floor**
Costa Mesa, CA 92626	**Costa Mesa, CA 92626**

Approximate date of commencement of proposed sale to the public:

As soon as practicable after the effectiveness of this Registration Statement.

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act, check the following box: ¨

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective Registration Statement for the same offering. ¨

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ¨

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ¨

The Registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment that specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933, as amended, or until the Registration Statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), may determine.

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The information in this prospectus is not complete and may be changed. We and the selling stockholders may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities and it is not soliciting an offer to buy these securities in any jurisdiction where the offer or sale is not permitted.

Subject to completion, dated May 25, 2007

Shares

MASIMO CORPORATION

Common Stock

$ per share

- Masimo Corporation and the selling stockholders are offering shares of common stock, of which the selling stockholders are offering shares.
- The initial public offering price of our common stock is expected to be between $ and $ per share.
- This is our initial public offering and no public market currently exists for our shares.

Proposed trading symbol:
NASDAQ Global Market MASI

This investment involves risks. See Risk Factors beginning on page 10.

	Per Share	Total
Initial public offering price	$	$
Underwriting discount	$	$
Proceeds, before expenses, to Masimo Corporation	$	$
Proceeds, before expenses, to selling stockholders	$	$

We have granted the underwriters a 30-day option to purchase up to additional shares of our common stock at the initial public offering price, less the underwriting discount, to cover over-allotments, if any. We will not receive any proceeds from the sale of common stock by the selling stockholders.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or passed upon the adequacy or accuracy of this prospectus. Any representation to the contrary is a criminal offense.

Piper Jaffray **Deutsche Bank Securities**

Cowen and Company **Thomas Weisel Partners LLC**

The date of this prospectus is , 2007

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Proven Technology, Proven Performance, Proven Leadership.

- **The gold standard in pulse oximetry, demonstrated clinically superior in more than 100 independent and objective studies.** These objective, peer-reviewed studies demonstrate Masimo s revolutionary Signal Extraction Technology (Masimo SET) outperforms any other pulse oximeter in the marketplace.

- **Many of the world s top hospitals have made Masimo SET their primary pulse oximetry platform,** including four out of the top five hospitals in the United States as listed on the US News and World Report Honor Roll.

- **Leading patient monitoring companies around the world have adopted Masimo SET.** In addition to a complete array of Masimo-branded monitors, Masimo is integrated into more than 90 multiparameter monitors and 40 monitoring brands.

- **A continuing commitment to innovation.** From our invention of Signal Extraction Technology and the introduction of Read-Through Motion and Low Perfusion pulse oximetry, to our most recent launch of Masimo Rainbow SET Pulse CO-Oximetry capable of monitoring carboxyhemoglobin and methemoglobin continuously and noninvasively, we are committed to providing clinicians with tools to make precise and timely diagnoses that lead to better treatment decisions.

Masimo provides accurate, reliable pulse oximetry measurements under difficult

clinical conditions of motion and low peripheral perfusion.

- Masimo s Read-Through Motion and Low Perfusion technology works when conventional pulse oximetry technologies do not, virtually eliminating false alarms without missing true events maximizing efficiency by providing clinicians with meaningful alarms and alerts that they can trust to reflect patients true oxygenation status.

Demonstrated Accuracy with Adults[1]

Demonstrated Accuracy with Infants[2]

* The failure of the monitor to detect a physiological change that should trigger the monitor s alarm.

** The erroneous activation of the monitor s alarm without an appropriate triggering physiological event.

1 Shah N, Estanol L. Comparison of three new generation pulse oximeters during motion & low perfusion in volunteers. *Anesthesiology* 2006; 105: A929.

2 Hay WW, Rodden DJ, Collins SM, Melara DL, Hale KA, Fashaw LM. Reliability of conventional and new oximetry in neonatal patients. *Journal of Perinatology*. 2002; 22:360-266.

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Masimo manufactures a complete range of bedside and handheld monitors along with one of the broadest lines of sensors in the industry.

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We have not authorized anyone to provide you with information different from that contained in this prospectus and any free writing prospectus authorized by us. We and the selling stockholders are offering the securities for sale in those jurisdictions in the United States, Europe and elsewhere where it is lawful to make such offers. The distribution or possession of this prospectus or any free writing prospectus in or from certain jurisdictions may be restricted by law. This prospectus is not an offer to sell these securities and is not soliciting an offer to buy these securities in any jurisdiction where the offer or sale is not permitted or where the person making the offer or sale is not qualified to do so or to any person to whom it is not permitted to make such offer or sale. The information contained in this prospectus is accurate only as of the date of this prospectus, regardless of the time of delivery of this prospectus or of any sale of our common stock. Our business, financial condition, results of operations and prospects may have changed since that date.

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Market and Industry Data

Information contained in this prospectus concerning the medical device industry and the pulse oximetry market, including our general expectations and market position, market opportunity and market share, is based on information from independent industry analysts and third-party sources, such as Frost & Sullivan, and management estimates. Management estimates are derived from publicly available information released by independent industry analysts and third-party sources, as well as data from our internal research, and are based on assumptions made by us based on such data and our knowledge of such industry and markets, which we believe to be reasonable. Other than Frost & Sullivan, none of the sources cited in this prospectus has consented to the inclusion of any data from its reports, nor have we sought their consent. Our internal research has not been verified by any independent source, and we have not independently verified any third-party information. In addition, while we believe the market position, market opportunity and market share information included in this prospectus is generally reliable, such information is inherently imprecise. Such data involves risks and uncertainties and are subject to change based on various factors, including those discussed under the heading Risk Factors.

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SUMMARY

This summary highlights selected information contained elsewhere in this prospectus. This summary provides an overview of selected information and does not contain all of the information you should consider before investing in our common stock. You should read carefully the entire prospectus, including Risk Factors and the financial statements and related notes, before making an investment decision. Unless the context indicates otherwise, the references in this prospectus to Masimo, we, us and our refer to Masimo Corporation, together with its subsidiaries.

Our Business

We are a global medical technology company that develops, manufactures and markets non-invasive patient monitoring products that improve patient care. We invented Masimo Signal Extraction Technology, or Masimo SET, which provides the capabilities of Read-Through Motion and Low Perfusion pulse oximetry to address the primary limitations of conventional pulse oximetry. Pulse oximetry is the non-invasive measurement of the oxygen saturation level of arterial blood, or the blood that delivers oxygen to the body s tissues, and pulse rate. Our Masimo SET platform has significantly addressed many of the previous technology limitations and has been recognized as the gold standard in pulse oximetry, the benefits of which have been validated in over 100 independent clinical studies. During 2006, we generated product revenue of $155.1 million and we increased our product revenue at a compound annual growth rate, or CAGR, of approximately 41.6% for the four years ended December 31, 2006. We were profitable in 2005 and 2006, but prior to 2005, we had a history of net losses.

We market a family of patient monitoring solutions which incorporate a monitor or circuit board and consumables, including both proprietary single-patient use and reusable sensors and cables. In addition, we offer a remote-alarm/monitoring solution, software and other accessories. We sell our solutions and related products to end-users through our direct sales force and certain distributors, and certain of our products to original equipment manufacturer, or OEM, partners, for incorporation into their products. We estimate that our worldwide installed base of pulse oximeters, OEM monitors that incorporate Masimo SET and adapter cables was approximately 449,000 units as of December 31, 2006. Based on industry reports, we estimate that the worldwide pulse oximetry market is over $900 million, the largest component of which is the sale of consumables.

We believe that the reliability and accuracy of our Masimo SET platform, along with our remote-alarm and monitoring solutions, will facilitate the expansion of our pulse oximetry products into areas beyond critical care settings, including the general care areas of the hospital. Additionally, we have recently developed products that non-invasively monitor parameters beyond arterial blood oxygen saturation level and pulse rate. In 2005, we launched our Masimo Rainbow SET platform utilizing licensed Rainbow technology, which we believe includes the first and only devices cleared by the U.S. Food and Drug Administration, or FDA, to non-invasively measure carboxyhemoglobin, or carbon monoxide levels in the blood, and methemoglobin saturation levels in the blood. We believe that the use of products incorporating Rainbow technology will become widely adopted for the non-invasive monitoring of these parameters. In addition, we believe that we will develop and introduce new products to monitor additional parameters in the future based on our proprietary technology platforms.

The Masimo Solution

Our innovative and proprietary technologies and products are designed to overcome the primary limitations of pulse oximetry, which involve maintaining accuracy in the presence of motion artifact, or patient movement, and low perfusion, or low arterial blood flow. We overcame these limitations through our read-through motion and low perfusion pulse oximetry technology. Our Masimo SET platform,

which became available to hospitals in the United States in 1998, is the basis of our pulse oximetry products, and we believe it represented the first significant technological advancement in pulse oximetry since its introduction in the early 1980s. Our products have been recognized as the gold standard in pulse oximetry due to their ability to provide clinicians with reliable, continuous, real-time information even in the presence of both motion artifact and low perfusion.

To complement our Masimo SET platform, we have developed a wide range of proprietary single-patient use and reusable sensors, cables and other accessories designed specifically to work with Masimo SET software and hardware. Although our technology platforms operate solely with our proprietary sensor lines, our sensors have the capability to work with certain competitive pulse oximetry monitors through the use of our adapter cables. Our proprietary Low Noise Optical Probe, or LNOP, neonatal sensors have been clinically proven to exhibit greater durability compared to competitive products.

In 2005, we introduced our Masimo Rainbow SET platform, leveraging Masimo Signal Extraction Technology and incorporating licensed Rainbow technology to enable reliable, real-time monitoring of additional parameters beyond arterial blood oxygen saturation and pulse rate. The Masimo Rainbow SET platform has the unique ability to distinguish oxygenated hemoglobins, or hemoglobins carrying oxygen, from certain dyshemoglobins, or hemoglobins incapable of transporting oxygen, and allows for the rapid, non-invasive monitoring of carboxyhemoglobin and methemoglobin, which we refer to as Pulse CO-Oximetry. High levels of carboxyhemoglobin are indicative of carbon monoxide poisoning, which requires quick treatment to prevent long-term organ damage or death. Methemoglobin is another form of hemoglobin that is unable to carry oxygen to tissues throughout the body, and elevated levels can cause cyanosis, or bluish discoloration of the skin. This condition can also cause organ damage and, in extreme cases, death. Along with the release of our Masimo Rainbow SET Pulse CO-Oximetry products, we have developed specialized sensors that have the ability to monitor multiple parameters with a single sensor. We believe that the use of Masimo Rainbow SET Pulse CO-Oximetry products will become widely adopted for the non-invasive monitoring of these parameters.

Benefits of Our Products and Technology

We believe that our technology and products offer several key benefits, including:

Accurate, Real-Time Measurement.

Increased Quality of Patient Care.

Reduced Cost of Care.

Masimo SET Platform Allows for Expansion into Non-Critical Care Settings.

Upgradeable Platform for the Monitoring of Additional Parameters.

Our Strategy

Since inception, our mission has been to develop non-invasive patient monitoring solutions that improve patient outcomes and reduce the cost of patient care. We intend to continue to grow our business and to improve our market position by pursuing the following strategies:

Continue to expand our market share in pulse oximetry.

Expand the pulse oximetry market to other patient care settings.

Utilize our customer base and OEM relationships to market our Masimo Rainbow SET Pulse CO-Oximetry products incorporating licensed Rainbow technology.

Continue to innovate and maintain our technology leadership position.

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Nellcor Patent Litigation Settlement

In October 1999, we filed a patent infringement lawsuit in the United States District Court for the Central District of California against Mallinckrodt, Inc., now part of Tyco Healthcare, and one of its subsidiaries, Nellcor Puritan Bennett, Inc., collectively referred to as Nellcor. Nellcor is one of the largest manufacturers and distributors of pulse oximetry products in the world. The lawsuit was filed for infringement of our pulse oximetry signal processing patents. Nellcor denied our claims and made counterclaims alleging infringement of its patents by us. This lawsuit resulted in a jury verdict that Nellcor had infringed several of our patents. In September 2005, the U.S. Federal Court of Appeals ruled that Nellcor infringed several Masimo patents and ordered the lower court to enjoin Nellcor s infringing products. Prior to the issuance of a permanent injunction, Nellcor entered into a settlement agreement with us on January 17, 2006, under which we agreed to settle all pending patent litigation with Nellcor. In return, Nellcor agreed to pay us $263.0 million for damages incurred through January 2006. We granted Nellcor a covenant not to sue on certain new products and Nellcor agreed to pay us royalties on its total U.S. pulse oximetry revenue at least through March 14, 2011. In addition, in January 2006, Nellcor made an advance royalty payment to us of $67.5 million for estimated sales of its products in the United States during the remainder of the calendar year 2006. Through December 31, 2006, we have received $330.5 million in cash from Nellcor pursuant to the settlement agreement.

We believe the result of this judgment was to strengthen the patents on which we prevailed, which included some patents supporting our Masimo SET platform. We intend to continue protecting our rights and pursuing additional infringement claims against other companies whose products we believe infringe our patents.

In March 2006 and February 2007, we declared dividends to holders of our common stock and preferred stock in the aggregate amount of approximately $208.9 million. In addition, in March 2006 and March 2007, we made special bonus payments in the aggregate amount of $11.7 million to our employees and directors who held vested stock options as of March 1, 2006. The funds used to pay these cash dividends and special bonus payments were made from the after-tax proceeds that we received from our patent infringement lawsuit against Nellcor and the interest on those proceeds.

We recorded the $263.0 million lump sum payment as patent lawsuit proceeds in January 2006 and we recognized approximately $68.8 million of royalty revenue in 2006. We recognize royalty revenue based on the estimated average royalty rate per the settlement agreement multiplied by our estimate of Nellcor s sales for each quarter. This estimate is adjusted when we receive the Nellcor royalty report, 60 days after the end of each quarter. Per our settlement agreement, the 2006 royalty rate will decline significantly and, as a result, we expect our future Nellcor royalties to be significantly below the levels recognized in 2006.

We do not intend to distribute any future royalties received from Nellcor under the settlement agreement to our stockholders or our option holders.

Masimo Laboratories, Inc.

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

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Under the Cross-Licensing Agreement, we granted Masimo Labs an exclusive, perpetual and worldwide license, with sublicense rights to use all Masimo SET owned by us, including all improvements on this technology, for the measurement of non-vital signs parameters and to develop and sell devices incorporating Masimo SET for monitoring non-vital signs parameters in any product market in which a product is intended to be used by a patient or pharmacist rather than a professional medical caregiver, which we refer to as the Labs Market. We also granted Masimo Labs a non-exclusive, perpetual and worldwide license, with sublicense rights to use all Masimo SET for the measurement of vital signs in the Labs Market.

Vital signs parameters include peripheral venous oxygen saturation, arterial oxygen saturation, or SpO2, mixed venous oxygen saturation, fetal oximetry, sudden infant death syndrome, electrocardiogram, or ECG, blood pressure (non-invasive blood pressure, invasive blood pressure and continuous non-invasive blood pressure), temperature, respiration rate, carbon dioxide, or CO2, pulse rate, cardiac output, electroenchephalogram, or EEG, perfusion index, depth of anesthesia, cerebral oximetry, tissue oximetry and/or electromyography, or EMG, and associated features derived from these parameters, such as 3-D alarms, Pleth Variability Index and other features. Non-vital signs parameters are body fluid constituents other than vital signs parameters, and include, but are not limited to, carbon monoxide, methemoglobin, blood glucose, total hemoglobin and bilirubin.

We exclusively license from Masimo Labs the right to make and distribute products in the professional medical caregiver markets, or the Masimo Market, that utilize Rainbow technology for the measurement of carbon monoxide, methemoglobin, fractional arterial oxygen saturation, and total hemoglobin, which includes hematocrit. To date, we have developed and commercially released devices that measure carbon monoxide and methemoglobin using licensed Rainbow technology. We also have the option to obtain the exclusive license to make and distribute products that utilize Rainbow technology for the measurement of other non-vital signs parameters, including blood glucose, in product markets where the product is intended to be used by a professional medical caregiver, which we refer to as the Masimo Market.

Risks Associated with Our Business

Our business is subject to numerous risks, as more fully described in the section entitled Risk Factors immediately following this prospectus summary. There are several risks associated with our business, such as:

- We currently derive substantially all of our revenue from our Masimo SET platform and related products.
- If the patents we own or license, or our other intellectual property rights, do not adequately protect our products, we may lose market share to our competitors and be unable to operate our business profitably.
- If third parties claim that we infringe their intellectual property rights, we may incur liabilities and costs and may have to redesign or discontinue selling certain products.
- Some of our products, including those based on licensed Rainbow technology, are in development or have been recently introduced into the market and may not achieve market acceptance, which could adversely affect our potential growth.
- Our operating results are volatile and difficult to predict and, prior to 2005, we had a history of net losses. We may experience significant fluctuations in our quarterly results and we may not maintain our recent profitability in the future.

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Corporate Information

We were incorporated in California in May 1989 and reincorporated in Delaware in May 1996. Our executive offices are located at 40 Parker, Irvine, California 92618. Our telephone number at that address is (949) 297-7000 and our website is www.masimo.com. The information contained on, or that can be accessed through, our website is not incorporated by reference into this prospectus and should not be considered to be part of this prospectus.

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The Offering

Common stock offered by us		shares
Common stock offered by the selling stockholders		shares
Common stock to be outstanding after this offering		shares
Initial public offering price	$	per share
Use of proceeds		We expect to use approximately $15.0 million of the net proceeds from this offering for capital expenditures and the placement of equipment, approximately $10.0 million for sales and marketing activities, approximately $10.0 million for research and development activities and the remaining amount for working capital and general corporate purposes. We will not receive any proceeds from the sale of common stock by the selling stockholders. See Use of Proceeds.
Proposed NASDAQ Global Market symbol		MASI

The number of shares of common stock to be outstanding upon completion of this offering is based on 17,107,346 shares of common stock outstanding as of April 30, 2007 and excludes as of that date:

- 2,539,525 shares of common stock issuable upon exercise of outstanding options with a weighted average exercise price of $16.15 per share, of which 1,121,313 options were vested;
- 560,464 shares of common stock reserved for awards available for future issuance under our current equity incentive plans; and
- 1,500,000 shares of our common stock reserved for future issuance under our 2007 Stock Incentive Plan, which will become effective in connection with this offering. Shares available for future issuance under our 2007 Stock Incentive Plan do not include shares that may become available for issuance pursuant to a provision in this plan that provides for the automatic annual increase in the number of shares reserved thereunder.

Unless otherwise indicated, the information in this prospectus assumes:

- the conversion of all outstanding shares of preferred stock into 11,537,501 shares of common stock immediately prior to the closing of this offering;

no exercise of the underwriters over-allotment option;

a -for- forward split of our common stock to be effected prior to the effectiveness of the registration statement related to this offering; and

the filing of our amended and restated certificate of incorporation, which will occur immediately prior to the closing of this offering.

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Summary Consolidated Financial Data

The following table presents summary consolidated historical and pro forma as adjusted financial data. We derived the summary statement of operations data for the years ended December 31, 2004, 2005 and 2006 and the summary balance sheet data as of December 31, 2006 from our audited consolidated financial statements and notes thereto included in this prospectus. We derived the summary statement of operations data for the three months ended March 31, 2006 and 2007 and the summary balance sheet data as of March 31, 2007 from our unaudited consolidated financial statements and notes thereto included in this prospectus. We have prepared this unaudited information on the same basis as the audited financial statements and have included all adjustments, consisting of normal recurring adjustments, that we consider necessary for a fair statement of our financial position and operating results for such periods. Our historical results are not necessarily indicative of the results that may be expected in the future. You should read this data together with our consolidated financial statements and the notes thereto, Selected Consolidated Financial Data, and Management s Discussion and Analysis of Financial Condition and Results of Operations included in this prospectus.

The pro forma basic and diluted net income per common share data in the statement of operations data for the year ended December 31, 2006 and the three months ended March 31, 2007, reflect the conversion of all of our outstanding shares of convertible preferred stock into 11,537,501 shares of common stock in connection with this offering.

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	Year ended December 31,			Three months ended March 31,	
	2004	2005	2006	2006 (unaudited)	2007 (unaudited)
	(in thousands, except share data)				
Statement of Operations Data[1]:					
Revenue:					
Product	$ 69,069	$ 107,613	$ 155,131	$ 34,679	$ 45,764
Royalty and license fee	288	277	69,207	14,627	13,190
Total revenue	69,357	107,890	224,338	49,306	58,954
Cost of goods sold	29,354	42,717	61,640	16,138	16,901
Gross profit	40,003	65,173	162,698	33,168	42,053
Operating expenses:					
Research and development	6,044	8,548	24,875	11,794	5,454
Selling, general and administrative	30,118	43,085	91,493	36,139	21,412
Patent litigation	6,204	1,736	60		
Purchased in-process research and development		2,800			
Total operating expenses	42,366	56,169	116,428	47,933	26,866
Operating income (loss)	(2,363)	9,004	46,270	(14,765)	15,187
Non-operating income (expense):					
Patent lawsuit proceeds, net			262,665	262,665	
Interest income	107	224	6,741	2,659	355
Interest expense	(1,434)	(1,851)	(1,824)	(505)	(427)
Other	8	(8)	551	99	41
Total non-operating income (expense):	(1,319)	(1,635)	268,133	264,918	(31)
Income (loss) before provision for (benefit from) income taxes	(3,682)	7,369	314,403	250,153	15,156
Provision for (benefit from) income taxes	161	(26,012)	132,577	105,456	6,059
Net income (loss)	(3,843)	33,381	181,826	144,697	9,097
Preferred stock dividend			(77,785)	(58,571)	
Accretion of preferred stock	(8,477)	(8,278)	(7,985)	(2,117)	(1,956)
Undistributed income attributable to preferred stockholders		(19,599)	(34,275)	(34,783)	(4,828)
Net income (loss) attributable to common stockholders	$ (12,320)	$ 5,504	$ 61,781	$ 49,226	$ 2,313
Net income (loss) per common share[2]:					
Basic	$ (3.94)	$ 1.70	$ 11.36	$ 9.54	$ 0.42
Diluted	$ (3.94)	$ 1.26	$ 9.13	$ 7.58	$ 0.34
Weighted-average number of common shares:					
Basic	3,126,247	3,239,294	5,439,966	5,158,407	5,530,721
Diluted	3,126,247	4,367,537	6,767,624	6,490,642	6,887,510
Pro forma net income per common share (unaudited)[2]:					
Basic			$ 10.71		$ 0.53
Diluted			$ 9.93		$ 0.49
Weighted-average number of common shares used in computing pro forma net income per common share (unaudited):					
Basic			16,977,467		17,068,222

Diluted	18,305,125	18,425,011

	As of March 31, 2007	
	Actual	Pro Forma As Adjusted[3]
	(in thousands)	
	(unaudited)	(unaudited)
Balance Sheet Data[1]:		
Cash and cash equivalents	$ 22,907	$
Working capital	44,259	
Total assets	152,137	
Long-term debt, including current portion	31,736	
Stockholders equity	66,143	

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(1) Pursuant to Financial Accounting Standards Board Interpretation No. 46(R), *Consolidation of Variable Interest Entities an Interpretation of ARB No. 51,* or FIN 46(R), Masimo Labs is consolidated within our financial statements. Accordingly, all inter-company royalties, option and licensing fees, and other charges between us and Masimo Labs have been eliminated in the consolidation. Also in accordance with FIN 46(R), all direct engineering expenses that have been incurred by us and charged to Masimo Labs have not been eliminated and are included as research and development expense in our consolidated statements of operations. For additional discussion of accounting for Masimo Labs, see Note 4 to the Notes to Consolidated Financial Statements.

(2) See Note 2 to the Notes to Consolidated Financial Statements for a description of the method used to compute basic and diluted net income (loss) per common share and basic and diluted pro forma net income per common share.

(3) On a pro forma as adjusted basis giving effect to the conversion of all outstanding shares of our convertible preferred stock into common stock and to reflect the sale of shares of our common stock in this offering at an assumed initial public offering price of $ per share, the midpoint of the range on the cover of this prospectus. A $1.00 increase (decrease) in the assumed initial public offering price of $ per share would increase (decrease) cash and cash equivalents, working capital, total assets and stockholders equity by $ million, assuming the number of shares offered by us, as set forth on the cover page of this prospectus, remains the same, and after deducting the underwriting discount and estimated offering expenses payable by us.

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RISK FACTORS

Investing in our common stock involves a high degree of risk. You should consider carefully the risks described below, together with all of the other information contained in this prospectus, before making your decision to invest in shares of our common stock. The occurrence of any of the following risks, and the risks described elsewhere in this prospectus, including the section entitled Management s Discussion and Analysis of Financial Condition and Results of Operations, could materially and adversely affect our financial condition, results of operations, cash flow and per share trading price and could cause you to lose some or all of your investment.

Risks Related to Our Business

We currently derive substantially all of our revenue from our Masimo SET platform and related products. If this technology and the related products do not continue to achieve market acceptance, our business, financial condition and results of operations would be adversely affected.

We are dependent upon the success and market acceptance of our proprietary Masimo Signal Extraction Technology, or Masimo SET. Currently, our primary product offerings are based on the Masimo SET platform. Continued market acceptance of products incorporating Masimo SET will depend upon our ability to continue to provide evidence to the medical community that our products are cost-effective and provide significantly improved performance compared to conventional pulse oximeters. Health care providers that currently have significant investments in competitive pulse oximetry products may be reluctant to purchase our products. If hospitals and other health care providers do not believe our Masimo SET platform to be cost-effective, more accurate or reliable, they may not buy our products in sufficient quantities to enable us to be profitable. If we are unable to achieve additional market acceptance of our core technology or products incorporating Masimo SET, we will not generate significant revenue growth from the sale of our products.

If the patents we own or license, or our other intellectual property rights, do not adequately protect our products, we may lose market share to our competitors and be unable to operate our business profitably.

Our success depends significantly on our ability to protect our rights to the technologies used in our products, including Masimo SET and licensed Rainbow technology. We rely on patent protection, trade secrets, as well as a combination of copyright and trademark laws and nondisclosure, confidentiality and other contractual arrangements to protect our technology. However, these legal means afford only limited protection and may not adequately protect our rights or permit us to gain or keep any competitive advantage. In addition, we cannot be assured that any of our pending patent applications will result in the issuance of a patent to us. The U.S. Patent and Trademark Office, or PTO, may deny or require significant narrowing of claims in our pending patent applications, and patents issued as a result of the pending patent applications, if any, may not provide us with significant commercial protection or be issued in a form that is advantageous to us. We could also incur substantial costs in proceedings before the PTO. These proceedings could result in adverse decisions as to the claims included in our patents.

Our issued and licensed patents and those that may be issued or licensed in the future may be challenged, invalidated or circumvented, which could limit our ability to stop competitors from marketing related products. Additionally, upon expiration of our issued or licensed patents, we may lose some of our rights to exclude others from making, using, selling or importing products using the technology based on the expired patents. We also must rely on contractual rights with the third parties that license technology to us to protect our rights in the technology licensed to us. Although we have taken steps to protect our intellectual property and technology, there is no assurance that competitors will not be able to design around our patents. We also rely on unpatented proprietary technology. We cannot assure you that we

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can meaningfully protect all our rights in our unpatented proprietary technology or that others will not independently develop substantially equivalent proprietary products or processes or otherwise gain access to our unpatented proprietary technology. We seek to protect our know-how and other unpatented proprietary technology with confidentiality agreements and intellectual property assignment agreements with our employees, or OEM partners, independent distributors and consultants. However, such agreements may not be enforceable or may not provide meaningful protection for our proprietary information in the event of unauthorized use or disclosure or other breaches of the agreements or in the event that our competitors discover or independently develop similar or identical designs or other proprietary information. In addition, we rely on the use of registered and common law trademarks with respect to the brand names of some of our products. Our common law trademarks provide less protection than our registered trademarks. Loss of rights in our trademarks could adversely affect our business, financial condition and results of operations.

Furthermore, the laws of foreign countries may not protect our intellectual property rights to the same extent as the laws of the United States. If we fail to apply for intellectual property protection or if we cannot adequately protect our intellectual property rights in these foreign countries, our competitors may be able to compete more effectively against us, which could adversely affect our competitive position, as well as our business, financial condition and results of operations.

If third parties claim that we infringe their intellectual property rights, we may incur liabilities and costs and may have to redesign or discontinue selling certain products.

Companies in the medical device industry have used intellectual property litigation to gain a competitive advantage in the marketplace. Whether a product infringes a patent involves complex legal and factual issues, the determination of which is often uncertain. We face the risk of claims that we have infringed on third parties intellectual property rights. Prior to launching major new products in our key markets, we normally evaluate existing intellectual property rights. However, searching for existing intellectual property rights may not reveal important intellectual property and our competitors may also have filed for patent protection, which is not as yet a matter of public knowledge, or claimed trademark rights that have not been revealed through our availability searches. Our efforts to identify and avoid infringing on third parties intellectual property rights may not always be successful. Any claims of patent or other intellectual property infringement, even those without merit, could:

- increase the cost of our products;
- be expensive and time consuming to defend;
- result in us being required to pay significant damages to third parties;
- force us to cease making or selling products that incorporate the challenged intellectual property;
- require us to redesign, reengineer or rebrand our products;
- require us to enter into royalty or licensing agreements in order to obtain the right to use a third party s intellectual property, the terms of which may not be acceptable to us;
- require us to indemnify third parties pursuant to contracts in which we have agreed to provide indemnification to such parties for intellectual property infringement claims;
- divert the attention of our management; and

result in our customers or potential customers deferring or limiting their purchase or use of the affected products until the litigation is resolved.

In addition, new patents obtained by our competitors could threaten a product s continued life in the market even after it has already been introduced.

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We believe competitors may currently be violating and may in the future violate our proprietary rights, and we may bring additional litigation to enforce our intellectual property rights, which may result in substantial expense and may divert our attention from the implementation of our business strategy.

We believe that the success of our business depends, in significant part, on obtaining patent protection for our products and technology, defending our patents once obtained and preserving our trade secrets. We were previously involved in significant litigation to protect our patent position and may be required to engage in further litigation. In 2006, we settled a costly, six-year lawsuit against Mallinckrodt, Inc., now a part of Tyco Healthcare, and one of its subsidiaries, Nellcor Puritan Bennett, Inc., collectively referred to as Nellcor, in which we claimed that Nellcor was infringing certain of our pulse oximetry signal processing patents. See Business Nellcor Patent Litigation Settlement. We believe that other competitors of ours, including some of our OEM partners, may be infringing at least one of our patents. See Business Competition. Our failure to pursue any potential claim could result in the loss of our proprietary rights and harm our position in the marketplace. Therefore, we may be forced to pursue litigation to enforce our rights. We cannot be certain that we will have the required financial resources to pursue litigation or otherwise to protect these rights in the future. In addition, any future litigation could result in the diversion of management s attention from the implementation of our business strategy and may not be adequate to protect our intellectual property rights.

Some of our products, including those based on licensed Rainbow technology, are in development or have been recently introduced into the market and may not achieve market acceptance, which could limit our growth and adversely affect our business, financial condition and results of operations.

Our products that have been recently introduced, including those based on Rainbow technology, a technology that we license, may not be accepted in the market. Our first product incorporating licensed Rainbow technology was made commercially available in September 2005. Accordingly, we do not know to what degree the market will accept these products, if at all. Even if our customers recognize the benefits of our products, we cannot assure you that our customers will purchase them in quantities sufficient for us to be successful. We will need to invest in significant sales and marketing resources to achieve market acceptance of these products with no assurance of success. The degree of market acceptance of these products will depend on a number of factors, including:

- perceived effectiveness of our products;
- cost of our products;
- perceived advantages over competing products;
- introduction and acceptance of competing products or technologies; and
- obtaining the required domestic and international regulatory approvals for our products under development.

In order for any of these products to be accepted, we must prove that they are effective and commercially beneficial. Even if customers accept these products, this acceptance may not translate into sales if our competitors develop similar products that our customers prefer. If our products do not gain market acceptance or if our customers prefer our competitors products, our potential growth could be limited, which could adversely affect our business, financial condition and results of operations.

Our products are subject to reporting requirements and may be subject to recalls, which could be expensive, damage our reputation and result in a diversion of management resources.

After a device is placed on the market, numerous regulatory requirements apply, including medical device reporting regulations that require us to report to the FDA or similar governmental bodies in other countries if our products cause or contribute to a death or serious injury or malfunction in a way that would be reasonably likely to contribute to death or serious injury if the malfunction were to recur. The

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FDA and similar governmental bodies in other countries have the authority to require the recall of our products in the event of material deficiencies or defects in design or manufacture. A government mandated or voluntary recall by us could occur as a result of manufacturing or labeling errors or design defects. Any voluntary or government mandated recall may divert management attention and financial resources and harm our reputation with customers. Any recall involving one of our products could also harm the reputation of the product and us and would be particularly harmful to our business and financial results.

We may recall our products, either voluntarily or involuntarily, if any prove or are perceived to be defective. Much of our growth may come from the introduction and sale of new products, which may result in a greater frequency of recalls. From our inception through April 30, 2007, we initiated three voluntary recalls of our products, none of which was material. Any future recall could result in a diversion of management resources, substantial cost and negative publicity, all of which could adversely affect our business, financial condition and results of operations.

Our ability to commercialize products that incorporate Masimo SET or Rainbow technology is limited.

In May 1998, we created a newly-formed entity, Masimo Laboratories, Inc., or Masimo Labs, and provided it rights to use Masimo SET to commercialize non-vital signs monitoring applications while we retained the rights to Masimo SET to commercialize vital signs monitoring applications. On May 2, 1998, we entered into a cross-licensing agreement with Masimo Labs, which has been amended several times, most recently in an Amended and Restated Cross-Licensing Agreement, effective January 1, 2007, or the Cross-Licensing Agreement. Under the Cross-Licensing Agreement, we granted Masimo Labs:

- an exclusive, perpetual and worldwide license, with sublicense rights, to use all Masimo SET owned by us, including all improvements on this technology, for the measurement of non-vital signs parameters and to develop and sell devices incorporating Masimo SET for monitoring non-vital signs parameters in any product market in which a product is intended to be used by a patient or pharmacist rather than by a professional medical caregiver, which we refer to as the Labs Market, and

- a non-exclusive, perpetual and worldwide license, with sublicense rights, to use all Masimo SET for measurement of vital signs in the Labs Market.

Non-vital signs parameters consist of body fluid constituents other than vital signs parameters, including but not limited to carbon monoxide, methemoglobin, blood glucose, total hemoglobin, and bilirubin.

Under the Cross-Licensing Agreement, we are only permitted to sell devices utilizing Masimo SET for the measurement of non-vital signs parameters in markets where the product is intended to be used by a professional medical caregiver, including but not limited to hospital caregivers and emergency medical services, or EMS, facility caregivers, rather than by a patient or pharmacist, which we refer to as the Masimo Market. Accordingly, our ability to commercialize new products, new or improved technologies and additional applications for Masimo SET is limited. In particular, our inability to expand beyond the Masimo Market may impair our growth and adversely affect our financial condition and results of operations.

Pursuant to the Cross-Licensing Agreement, we have licensed from Masimo Labs the right to make and distribute products in the Masimo Market that utilize Rainbow technology for the measurement of carbon monoxide, methemoglobin, fractional arterial oxygen saturation, and total hemoglobin, which includes hematocrit. As a result, the opportunity to expand the market for our products incorporating Rainbow technology is limited, which could limit our revenue and impair our growth.

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We will be required to pay Masimo Labs for the right to use certain improvements to Masimo SET that we develop.

Under the Cross-Licensing Agreement, when we develop improvements to Masimo SET for the non-invasive measurement of non-vital signs parameters, we would be required to assign these developments to Masimo Labs and then license the technology back from Masimo Labs in consideration for a license fee and royalty obligations to Masimo Labs. Therefore, any improvement to this technology would be treated as if it had been developed exclusively by Masimo Labs. In addition, we will not be reimbursed by Masimo Labs for our expenses relating to the development of any such technology. As a result of these terms, we may not generate any revenue from the further development of Masimo SET for the measurement of non-vital signs parameters, which could adversely affect our business, financial condition and results of operations.

In the event that the Cross-Licensing Agreement is terminated for any reason, or Masimo Labs grants a license to Rainbow technology to a third party, our business would be materially and adversely affected.

Masimo Labs owns all of the proprietary rights to Rainbow technology developed with our proprietary Masimo SET for products intended to be used in the Labs Market, and all rights for any non-vital signs parameter for which we do not exercise an option pursuant to the Cross-Licensing Agreement. In addition, Masimo Labs has the right to terminate the Cross-Licensing Agreement or grant licenses covering Rainbow technology to third parties if we breach certain terms of the agreement, including failure to meet our minimum royalty payment obligations or failure to use commercially reasonable efforts to develop or market products incorporating licensed Rainbow technology. If we lose our exclusive license to Rainbow technology, we may not be able to develop comparable technology or license similar technology on commercially favorable terms or at all, and we would lose the ability to prevent others from making, using, selling or importing products using Rainbow technology in our market. As a result, we would likely be subject to increased competition within our market, and Masimo Labs or competitors who obtain a license to Rainbow technology from Masimo Labs would be able to offer related products.

We may not be able to commercialize our products incorporating licensed Rainbow technology cost-effectively or successfully.

It costs us more to make products that incorporate Rainbow technology than products without Rainbow technology due to increased production costs in addition to the royalties that we must pay to Masimo Labs. In order to successfully commercialize these products, we must be able to pass these higher costs on to the market. We cannot assure you that we will be able to sell products incorporating Rainbow technology at a price the market is willing to accept. If we cannot commercialize our products incorporating licensed Rainbow technology successfully, we may not be able to generate sufficient product revenue to be profitable, which could adversely affect our business, financial condition and results of operations.

We are required to pay royalties to Masimo Labs for all products sold that contain Rainbow technology, including certain annual minimum royalty payments and this may impact our gross margins.

The Cross-Licensing Agreement requires us to pay Masimo Labs a royalty for all products that we sell which include their proprietary Rainbow technology. This includes hand-held, table-top and multi-parameter products that incorporate licensed Rainbow technology. Beginning in 2009, for hospital contracts where we place equipment and enter into a sensor contract, we will pay a royalty to Masimo Labs on the total sensor contract revenues based on the ratio of Rainbow enabled devices to total devices. The agreement also requires that we provide to Masimo Labs, at its request, up to 10% of our annual board and sensor production volume at our total manufactured cost. In addition to these specific royalty and product obligations, our Cross-Licensing Agreement requires that we pay Masimo Labs specific annual minimum royalty payments.

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While the payment of royalties for enabled Rainbow parameters should not have a negative impact on our overall margins, the minimum annual royalties will have a negative impact to the extent that we do not generate sufficient Rainbow product revenues to offset the minimum royalties owed to Masimo Labs. In addition, the requirement for us to provide Masimo Labs with up to 10% of our board and sensor production at our manufactured cost will, if requested by Masimo Labs, have a negative impact on our gross margins.

Rights provided to Masimo Labs in the Cross-Licensing Agreement may impede a change in control of our company.

In the event we undergo a change in control, which, as defined in the Cross-Licensing Agreement, includes the resignation or termination of Joe E. Kiani from his position of Chief Executive Officer of either Masimo or Masimo Labs, we are required to immediately pay a $2.5 million fee to exercise an option to license technology developed by Masimo Labs for use in blood glucose monitoring. Additionally, our per product royalties payable to Masimo Labs will become subject to specified minimums, and the minimum aggregate annual royalties for all licensed Rainbow parameters payable to Masimo Labs will increase to up to $15.0 million for carbon monoxide, methemoglobin, fractional arterial oxygen saturation, total hemoglobin and blood glucose, plus up to $2.0 million per other Rainbow parameters. Also, if the surviving or acquiring entity ceases to use Masimo as a company name and trademark following a change in control, all rights to the Masimo trademark will automatically be assigned to Masimo Labs. This could delay or discourage transactions involving an actual or potential change in control of us, including transactions in which our stockholders might otherwise receive a premium for their shares over then current prices. In addition, our requirement to assign all future improvements for non-vital signs to Masimo Labs could impede a change in control.

Masimo Labs has conducted most of the research and development of Rainbow technology and we are dependent upon Masimo Labs to develop improvements to Rainbow technology.

Masimo Labs has conducted the research and development of Rainbow technology. Although we expect Masimo Labs to continue its research and development activities related to Rainbow technology and specific non-invasive monitoring parameters, including blood glucose and total hemoglobin, no assurance can be given that it will do so. In the event Masimo Labs does not continue to develop and improve Rainbow technology, our business, financial condition and results of operations could be adversely affected.

We will experience conflicts of interest with Masimo Labs with respect to business opportunities and other matters. Investors in this offering will not receive an equity interest in Masimo Labs.

As of April 30, 2007, our stockholders owned approximately 99.9% of the outstanding shares of capital stock of Masimo Labs. In addition, Joe E. Kiani and Jack Lasersohn, members of our board of directors, are also members of the board of directors of Masimo Labs. Joe E. Kiani, our Chairman and Chief Executive Officer, is also the Chairman and Chief Executive Officer of Masimo Labs. Due to the interrelated nature of Masimo Labs with us, conflicts of interest will arise with respect to transactions involving business dealings between us and Masimo Labs, potential acquisitions of businesses or products, development of products and technology, the sale of products, markets and other matters in which our best interests and the best interests of our stockholders may conflict with the best interests of the stockholders of Masimo Labs. We cannot assure you that any conflict of interest will be resolved in our favor, or that with respect to our transactions with Masimo Labs we will negotiate terms that are as favorable to us as if such transactions were with an unaffiliated third party. Investors in this offering are not receiving an equity interest in Masimo Labs.

Our operating results are volatile and difficult to predict and, prior to 2005, we had a history of net losses. We may experience significant fluctuations in our quarterly results and we may not maintain our recent profitability in the future.

We incurred net losses attributable to common stockholders in each year from our inception through 2004. Our net losses attributable to common stockholders were approximately $8.6 million,

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$15.4 million and $12.3 million in 2002, 2003 and 2004, respectively. We expect our expenses to increase as we expand our research and development and sales and marketing activities. As a result, if we are unable to maintain or increase our revenue, we may incur net losses and negative cash flows in the future.

Our operating results have fluctuated in the past and are likely to fluctuate significantly in the future. We may experience fluctuations in our quarterly results of operations as a result of:

- delays or interruptions in manufacturing and shipping of our products;
- varying demand for and market acceptance of our technology and products;
- the effect of competing technological and market developments resulting in lower selling prices or significant promotional costs;
- changes in the timing of product orders and the volume of sales to our OEM partners;
- actions taken by group purchasing organizations, or GPOs;
- delays in hospital conversions to our products;
- our legal expenses, particularly those related to litigation matters;
- changes in our product or customer mix;
- unanticipated delays or problems in the introduction of new products, including delays in obtaining clearance or approval from the FDA;
- product recalls; and
- high levels of returns and repairs.

These factors, some of which are not within our control, may cause the price of our stock to fluctuate substantially. To respond to these and other factors, we may need to make business decisions that could result in failure to meet financial expectations. If our quarterly operating results fail to meet or exceed the expectations of securities analysts or investors, our stock price could drop suddenly and significantly. Most of our expenses, such as employee compensation, inventory and debt repayment obligations, are relatively fixed in the short term. Moreover, our expense levels are based, in part, on our expectations regarding future revenue levels. As a result, if our revenue for a particular period were below our expectations, we would not be able to proportionately reduce our operating expenses for that period. Any revenue shortfall would have a disproportionately negative effect on our operating results for the period.

Due to these and other factors, we believe that quarter-to-quarter comparisons of our operating results may not be meaningful. You should not rely on our results for any one quarter as an indication of our future performance. In future quarters, our operating results may be below the expectations of securities analysts or investors.

We depend on our OEM partners for a portion of our revenue. If they do not devote sufficient resources to the promotion of products that use Masimo SET and licensed Rainbow technology, our business would be harmed.

We are, and will continue to be, dependent upon our OEM partners for a portion of our revenue through their marketing, selling and distribution of certain of their products that incorporate Masimo SET and licensed Rainbow technology. Although we expect that our OEM partners will accept and actively market, sell and distribute products that incorporate licensed Rainbow technology, they may elect not to do so in the near future or at all. The failure of our OEM partners to successfully market, sell or distribute products incorporating these technologies, the termination of OEM agreements, the loss of OEM partners or the inability to enter into future OEM partnership agreements would have a material

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adverse effect on our business, financial condition and results of operations. Our success will depend in part upon whether our OEM partners devote sufficient resources to the promotion of products that incorporate these technologies. These products may represent a relatively small percentage of business for some of our OEM partners. In addition, some of our OEM partners offer products that compete with ours. Therefore, we cannot guarantee that our OEM partners will vigorously promote products incorporating Masimo SET and licensed Rainbow technology. If any of our OEM partners were to be acquired, we cannot assure you that an acquiring company would devote sufficient resources to promote products that incorporate technology we own or license.

The loss of any large customer or any cancellation or delay of a significant purchase by a large customer could reduce our net sales and harm our operating results.

For the year ended December 31, 2006, we did not have any customers who accounted for over 10.0% of our total revenues. However, we have a concentration of OEM, distribution and direct customers. If, for any reason, we were to lose our ability to sell to a specific group or class of customers, we would experience a significant reduction in revenues. This would, in turn, adversely impact our operating results because we may not be able to react quickly enough to reduce our operating expenses. Also, we cannot assure you that we will retain our current customers or groups of customers or that we will be able to attract and retain additional customers.

Our royalty agreement with Nellcor provides for a declining royalty rate schedule over the term of the settlement agreement which, if not offset by other revenues and sources of income, could significantly harm our total sales and operating results.

In fiscal 2006, our royalties from the Nellcor settlement totaled $68.8 million. Because these royalty payments do not carry any significant cost, they result in significant improvements to our reported gross profit and operating income levels. As a result, any decline in royalties that we earn under this agreement will have a significant impact on our revenues, gross margins and operating income. Under terms of the agreement, we earn royalties on Nellcor s total U.S. based pulse oximetry sales. The royalty rate in 2006 was nearly 20% if averaged over the entire year. The royalty rates in 2007 will decline to a range of 12% to 15% depending on Nellcor s ability to re-design their products in a manner that would avoid some of our patent coverage in the settlement agreement. In 2008 and through the term of the royalty agreement, at least through March 14, 2011, the royalty rates will decline to a range of 10% to 12%, also subject to Nellcor s ability to develop new products that avoid the current patent coverage as negotiated in the settlement agreement. As a result of these declining royalty rates in 2007 and beyond, there is a significant financial risk to our operating income if we are unable to generate sufficient revenues and gross margins to offset the impact of declining royalty rates on sales of Nellcor s U.S. pulse oximetry products.

If we fail to maintain relationships with GPOs, sales of our products would decline.

Our ability to sell our products to U.S. hospitals depends in part on our relationships with GPOs. Many existing and potential customers for our products become members of GPOs. GPOs negotiate pricing arrangements and contracts, sometimes exclusive, with medical supply manufacturers and distributors, and these negotiated prices are made available to a GPO s affiliated hospitals and other members. If we are not one of the providers selected by a GPO, affiliated hospitals and other members may be less likely to purchase our products, and if the GPO has negotiated a strict sole source, market share compliance or bundling contract for another manufacturer s products, we may be precluded from making sales to members of the GPO for the duration of the contractual arrangement. Our failure to renew contracts with GPOs may cause us to lose market share and could have a material adverse effect on our sales, financial condition and results of operations. In 2006, revenue from the sale of our pulse oximetry products related to GPOs amounted to $66.6 million, representing 80.7% of our revenue from sales to U.S. hospitals. We do not have any contracts expiring in 2007. In the future, if we are unable to keep our relationships and develop new relationships with GPOs, our competitive position would likely suffer.

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In addition, some GPOs have tested the use of new internet bidding which has resulted in business shifting from one vendor to another vendor. We cannot assure you that continued movement to these internet bidding procedures will not increase and that this may result in our failure to secure contracts with these organizations.

If we do not successfully develop and commercialize enhanced or new products that remain competitive with new products or alternative techniques developed by others, we could lose revenue opportunities and customers, and our ability to achieve growth would be impaired.

The medical device industry is characterized by rapid product development and technological advances, which places our products at risk of obsolescence. Our long-term success depends upon the development and successful commercialization of new products, new or improved technologies and additional applications for Masimo SET and licensed Rainbow technology. The research and development process is time-consuming and costly and may not result in products or applications that we can successfully commercialize. In particular, we may not be able to successfully commercialize our products for applications other than arterial blood oxygen saturation and pulse rate monitoring, including carboxyhemoglobin and methemoglobin monitoring. If we do not successfully adapt our products and applications both within and outside these parameters, we could lose revenue opportunities and customers. In addition, we may not be able to improve our products or develop new products or technologies quickly enough to maintain a competitive position in our markets and continue to grow our business. Furthermore, one or more of our competitors may develop products that are substantially equivalent to our FDA-cleared products, or those of our OEM partners, whereby they may be able to use our products or those of our OEM partners, as predicate devices to more quickly obtain FDA clearance of their competing products.

We face competition from other companies, many of which have substantially greater resources than we do and may be able to develop products perceived as more effective or easier to use than ours or are more readily accepted, or offer their products at lower prices than we can, which could adversely affect our business, financial condition and results of operations.

We face substantial competition from companies developing products that compete with our Masimo SET platform for use with third-party monitoring systems. We also face competition from companies currently marketing pulse oximetry monitors. One company in particular, Nellcor, a subsidiary of Tyco Healthcare, currently holds a substantial share of the pulse oximetry market. Our revenues and profit are significantly smaller than our primary competitors. A number of the companies in the pulse oximetry market have substantially greater capital resources, larger customer bases, larger sales forces, greater marketing and management resources, larger research and development staffs and larger facilities than ours, and have established reputations with our target customers, as well as worldwide distribution channels that are more effective than ours. Competition could result in price reductions, fewer orders, reduced gross margins and loss of market share.

Our suppliers may not supply us with a sufficient amount of materials and components or materials and components of adequate quality.

We depend on sole or limited source suppliers for key materials and components of our products, and if we are unable to obtain these components on a timely basis, we will not be able to deliver our products to customers. Also, we cannot guarantee that any of the materials or components that we purchase, if available at all, will be of adequate quality or that the prices we pay for these materials or components will not increase. From time to time, there are industry-wide shortages of several electronic components that we use in our products. We may experience delays in production of our products if we fail to identify alternate vendors, or any parts supply is interrupted or reduced or there is a significant increase in production costs, each of which could adversely affect our business, financial condition and results of operations.

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We are dependent upon a third party for our remote-alarm and monitoring solutions and any adverse change in this relationship may have a significant negative impact on our revenue and the growth of our business.

One of our OEM partners, Welch Allyn, supplies us with the RadNet and PPO+ products pursuant to an OEM purchase agreement. We expect to rely in part on RadNet and PPO+ for the expansion of our products beyond critical care settings into the general care areas of the hospital. If our relationship with Welch Allyn is impaired, or if Welch Allyn does not successfully perform its contractual duties or meet expected deadlines, the use of our products in the general care areas of hospitals could be limited, which could result in an adverse effect on our business, financial condition and results of operations.

We may be subject to damages resulting from claims that we or our employees have wrongfully used or disclosed alleged trade secrets of their former employers.

Many of our employees were previously employed at other medical device companies. We may be subject to claims that employees have disclosed, or that we have used, trade secrets or other proprietary information of their former employers. Defending against these claims could result in substantial costs and be a distraction to management. If we fail in defending such claims, in addition to paying monetary damages, we may lose valuable intellectual property rights or personnel. A loss of key research and development or sales personnel could limit our ability to sell our existing products, which could adversely affect our business, financial condition and results of operations.

If product liability claims are brought against us, we could face substantial liability and costs.

The manufacture and sale of products using Masimo SET and licensed Rainbow technology expose us to product liability claims and product recalls, including those that may arise from misuse or malfunction of, or design flaws in, our products or the use of our products with incompatible components or systems. Any losses that we may suffer from future liability claims, and the effect that any product liability litigation may have upon the reputation and marketability of our technology and products, together with the corresponding diversion of the attention of our key employees, could adversely affect our business, financial condition and results of operations. Any product liability claims could require significant cost and management resources and may subject us to significant damages. We currently have product liability insurance that we believe to be adequate, but we cannot be certain that it will be sufficient to cover damages or claims. Furthermore, we may not be able to obtain or maintain insurance in the future at satisfactory rates or in adequate amounts to protect us against any product liability claims.

Our failure to obtain and maintain FDA clearances or approvals on a timely basis, or at all, would prevent us from commercializing our current or upgraded products in the United States, which could severely harm our business.

Each medical device that we wish to market in the United States generally must first receive either 510(k) clearance, by filing a 510(k) pre-market notification, or PMA approval, by filing a PMA application, from the FDA pursuant to the Federal Food, Drug, and Cosmetic Act. Even if regulatory approval of a product is granted, the approval may be subject to limitations on the indicated uses for which the product may be marketed. We cannot assure you that the FDA will grant 510(k) clearance on a timely basis, if at all, for new products or uses that we propose for the Masimo SET or licensed Rainbow technology. The FDA s 510(k) clearance process usually takes from four to twelve months, although it can last longer. The process of obtaining PMA approval is much more costly, lengthy and uncertain and generally takes from one to three years or even longer. See Business Government Regulation for more detailed information about 510(k) clearances and PMA approvals.

To date, the FDA has regulated pulse oximeters incorporating Masimo SET and licensed Rainbow technology, and our sensors, cables and other products incorporating Masimo SET and licensed Rainbow technology for pulse oximetry under the 510(k) process. Although 510(k) clearances have been obtained for all of our current products, these clearances may be revoked by the FDA if safety or effectiveness problems develop with our devices. Any modifications to an FDA-cleared device that could

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significantly affect its safety or effectiveness or that would constitute a major change in its intended use would require a new 510(k) clearance. Furthermore, our new products or significantly modified marketed products could be denied 510(k) clearance and be required to undergo the more burdensome PMA approval process. If so, our ability to upgrade our products in a timely fashion could be limited. The withdrawal of existing 510(k) clearances or the inability to obtain new ones on a timely basis, or at all, could severely harm our business.

The failure of our OEM partners to obtain FDA clearances or approvals could have a negative impact on our revenue.

Our OEM partners will be required to obtain their own FDA clearances for products incorporating Masimo SET and licensed Rainbow technology to market these products in the United States. We cannot assure you that the FDA clearances we have obtained will make it easier for our OEM partners to obtain clearances of products incorporating these technologies, or that the FDA will ever grant clearances on a timely basis, if at all, for any future product incorporating Masimo SET and licensed Rainbow technology that our OEM partners propose to market.

If we or our suppliers fail to comply with ongoing regulatory requirements, or if we experience unanticipated problems with our products, these products could be subject to restrictions or withdrawal from the market.

Our products, along with the manufacturing processes and promotional activities for such products, are subject to continual review and periodic inspections by the FDA and other regulatory bodies. In particular we and our suppliers are required to comply with the quality system regulation, or QSR, which covers the methods and documentation of the design, testing, production, control, quality assurance, labeling, packaging, storage and shipping of our products. The FDA enforces the QSR through unannounced inspections. We are also subject to similar state requirements and licenses. Failure by us or one of our suppliers to comply with statutes and regulations administered by the FDA and other regulatory bodies, discovery of previously unknown problems with our products (including unanticipated adverse events or adverse events of unanticipated severity or frequency), manufacturing problems, or failure to comply with regulatory requirements, or failure to adequately respond to any FDA observations concerning these issues, could result in, among other things, any of the following actions:

- issuance of public warning letters;
- a shut-down or interruption of our manufacturing operations;
- withdrawal or suspension of clearance or approval by the FDA or other regulatory bodies;
- product recall, detention or seizure;
- fines and civil penalties;
- unanticipated expenditures;
- operating restrictions;
- injunctions; and
- criminal prosecution.

If any of these actions were to occur, it would harm our reputation and adversely affect our business, financial condition and results of operations. Furthermore, our key component suppliers may not currently be, or may not continue to be, in compliance with applicable regulatory

requirements.

Failure to obtain regulatory approval in foreign jurisdictions will prevent us from marketing our products abroad.

We currently market, and intend to continue to market, our products internationally. Outside the United States, we can market a product only if we receive a marketing authorization and, in some cases, pricing

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approval, from the appropriate regulatory authorities. The approval procedure varies among countries and can involve additional testing, and the time required to obtain approval may differ from that required to obtain FDA approval. The foreign regulatory approval process may include all of the risks associated with obtaining FDA approval in addition to other risks. We may not obtain foreign regulatory approvals on a timely basis, if at all. Approval by the FDA does not ensure approval by regulatory authorities in other countries, and approval by one foreign regulatory authority does not ensure approval by regulatory authorities in other foreign countries or by the FDA. If we fail to receive necessary approvals to commercialize our products in foreign jurisdictions on a timely basis, or at all, our business, financial condition and results of operations could be adversely affected.

Modifications to our marketed devices may require new regulatory clearances or premarket approvals, or may require us to cease marketing or recall the modified devices until clearances or approval is obtained.

Any modifications to an FDA-cleared device that would significantly affect its safety or effectiveness or that would constitute a major change in its intended use would require a new 510(k) clearance or possibly a PMA approval. We may not be able to obtain such clearances or approvals in a timely fashion, or at all. Delays in obtaining future clearances would adversely affect our ability to introduce new or enhanced products in a timely manner, which in turn would have an adverse effect on our business, financial condition and results of operations. We have made modifications to our devices in the past and we may make additional modifications in the future, some of which we may believe do not or will not require additional clearances or approvals. If the FDA disagrees and requires new clearances or approvals for the modifications, we may be required to recall and to stop marketing the modified devices, which could have an adverse effect on our business, financial conditions and results of operations.

Off-label promotion of our products or promotional claims deemed false or misleading could subject us to substantial penalties.

Obtaining 510(k) clearance only permits us to promote our products for the uses cleared by the FDA. Although we may request additional cleared indications for our current products, the FDA may deny those requests, require additional expensive clinical data to support any additional indications or impose limitations on the intended use of any cleared product as a condition of clearance. We must have adequate substantiation for our product performance claims. If the FDA determines that we or our OEM partners have promoted our products for off-label use, or have made false or misleading or inadequately substantiated promotional claims, we could be subject to fines, injunctions or other significant penalties or restrictions.

If we are unable to increase our sales, marketing and distribution capabilities or maintain or establish arrangements with third parties to sell, market, manufacture and distribute our pulse oximetry and Rainbow technology products, our business, financial condition and results of operations could be adversely affected.

We have limited sales and marketing experience both in the United States and internationally and may not be successful in developing and implementing our business strategy. In addition, we currently have a small sales organization compared to many of our competitors. To increase our commercial success, we need to:

- increase our sales and marketing force;
- continue to maintain domestic and international OEM partners;
- ensure that distributors and OEM partners provide the technical and educational support customers need to use products incorporating Masimo SET and Rainbow technology successfully;
- promote monitoring systems using Masimo SET and Rainbow technology so that sales of those systems and, in turn, sales of our consumable products increase; and
- be prepared to provide services, as necessary, to geographically dispersed users of monitoring systems using Masimo SET and Rainbow technology.

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We currently plan to increase the size of our direct sales force to further market our products in the United States and internationally. Our sales force will be competing with the experienced and well-funded sales and marketing operations of our competitors. Increasing our direct sales capabilities is expensive and time consuming. We may not be able to further develop this capacity on a timely basis or at all. If we are unable to expand our sales and marketing capabilities, we will need to continue to contract with third parties to market and sell our approved products in the United States and internationally. To the extent that we enter into arrangements with third parties to perform sales, marketing and distribution services, our product revenue could be lower than if we directly marketed and sold our products. Furthermore, to the extent that we enter into co-promotion or other sales and marketing arrangements with other companies, any revenue received will depend on the skills and efforts of others, and we do not know whether these efforts will be successful. If we are unable to maintain adequate sales, marketing, manufacturing and distribution capabilities, independently or with others, we may not be able to generate sufficient product revenue to be profitable.

If we are unable to manufacture an adequate supply of our products, we could lose customers and our revenue and growth could be limited.

Our anticipated growth may strain our ability to manufacture an increasingly large supply of our products. Manufacturing facilities often experience difficulties in scaling up production, including problems with production yields and quality control and assurance. If we cannot scale our manufacturing operations appropriately, maintain control over expenses or otherwise adapt to anticipated growth, or if we have underestimated our future growth, we may not have the capability to satisfy market demand, which would have an adverse effect on our business, financial condition and results of operations.

We anticipate and plan for significant growth, which we may not be able to effectively manage.

We expect to rapidly expand our operations and our research and development, product development, sales, marketing and administrative organizations. This growth and activity will likely result in new and increased responsibilities for management personnel and place significant strain upon our operating and financial systems and resources. To accommodate our expected growth and compete effectively, we will be required to improve our information systems, create additional procedures and controls and expand, train, motivate and manage our work force. We also may need to expand our manufacturing resources.

We cannot be certain that our personnel, systems, procedures, facilities and controls will be adequate to support our future operations. Any failure to effectively manage our growth could impede our ability to successfully develop, market and sell our products, our anticipated growth may be impaired and our business, financial condition and results of operations would be adversely affected.

We manufacture our products at two locations. Any disruption in these manufacturing facilities could adversely affect our business, financial condition and results of operations.

We have relied, to date, on our manufacturing facilities in Irvine, California and Mexicali, Mexico. These facilities and the manufacturing equipment we use to produce our products would be difficult to replace and could require substantial lead-time to repair or replace. Our facilities may be affected by natural or man-made disasters. In the event that one of our facilities was affected by a disaster, we would be forced to rely on third-party manufacturers if we could not shift production to another of our manufacturing facilities. Although we believe we possess adequate insurance for damage to our property and the disruption of our business from casualties, such insurance may not be sufficient to cover all of our potential losses and may not continue to be available to us on acceptable terms, or at all. If we are forced to seek alternative facilities, we may incur additional costs and we may experience a disruption in the supply of our products until those facilities are available. Any disruption in our manufacturing capacity could have an adverse impact on our ability to produce sufficient inventory of our products or may require us to incur additional expenses in order to produce sufficient inventory, and, therefore, may

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adversely affect our revenue, gross margins and results of operations. Any disruption or delay at our manufacturing facilities could impair our ability to meet the demand of our customers and our customers may cancel orders or purchase products from our competitors, which could adversely affect our business, financial condition and results of operations.

In the future, we may choose to add new manufacturing capabilities in either our existing facilities or in new facilities throughout the world. If we expand our worldwide manufacturing locations, there can be no assurance that this expansion will occur without implementation difficulties or that such expansion will ultimately lower our overall cost of production.

If we lose the services of our key personnel, or if we are unable to attract and retain other key personnel, we may not be able to manage our operations or meet our growth objectives.

We are highly dependent on our senior management, especially Joe E. Kiani, our Chief Executive Officer, and other key officers. We are also heavily dependent on our engineers and field sales team, including sales representatives and clinical specialists. Our success will depend on our ability to retain our current management, engineers and field sales team, and to attract and retain qualified personnel in the future, including scientists, clinicians, engineers and other highly skilled personnel. Competition for senior management, engineers and field sales personnel is intense and we may not be able to retain our personnel. The loss of the services of members of our key personnel could prevent the implementation and completion of our objectives, including the development and introduction of our products. Each of our officers may terminate their employment at any time without notice and without cause or good reason. We carry key person life insurance on only Mr. Kiani, who is also the Chief Executive Officer of Masimo Labs. Mr. Kiani devotes substantially all of his time to us.

Existing or future acquisitions of businesses could negatively affect our business, financial condition and results of operations if we fail to integrate the acquired businesses successfully into our existing operations or if we discover previously undisclosed liabilities.

In order to expand our products and technology platform, we have acquired four businesses since our inception and we may acquire additional businesses in the future. Successful acquisitions depend upon our ability to identify, negotiate, complete and integrate suitable acquisitions and to obtain any necessary financing. Even if we complete acquisitions, we may experience:

- difficulties in integrating any acquired companies, personnel and products into our existing business;
- delays in realizing the benefits of the acquired company or products;
- diversion of our management s time and attention from other business concerns;
- limited or no direct prior experience in new markets or countries we may enter;
- higher costs of integration than we anticipated; and
- difficulties in retaining key employees of the acquired business who are necessary to manage these acquisitions.

In addition, an acquisition could materially impair our operating results by causing us to incur debt or requiring us to amortize acquisition expenses and acquired assets. We may also discover deficiencies in internal controls, data adequacy and integrity, product quality, regulatory compliance and product liabilities that we did not uncover prior to our acquisition of such businesses, which could result in us becoming subject to penalties or other liabilities. Any difficulties in the integration of acquired businesses or unexpected penalties or liabilities in connection with such businesses could have a material adverse effect on our business, financial condition and results of operations.

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We may be subject to or otherwise affected by federal and state health care laws, including fraud and abuse and health information privacy and security laws, and could face substantial penalties if we are unable to fully comply with such laws.

Although we do not provide health care services, nor receive payments directly from Medicare, Medicaid, or other third-party payers for our products or the procedures in which our products are used, health care regulation by federal and state governments will impact our business. Health care fraud and abuse and health information privacy and security laws potentially applicable to our operations include, but are not limited to:

- the Federal Health Care Programs Anti-Kickback Law, which prohibits, among other things, soliciting, receiving, offering or providing remuneration, intended to induce the purchase or recommendation of an item or service reimbursable under a federal health care program (such as the Medicare or Medicaid programs);
- federal false claims laws which prohibit, among other things, knowingly presenting, or causing to be presented, claims for payment from Medicare, Medicaid, or other third-party payers that are false or fraudulent;
- the federal Health Insurance Portability and Accountability Act of 1996, or HIPAA, and its implementing regulations, which impose regulatory and contractual requirements regarding the privacy and security of certain health information; and
- state laws analogous to each of the above federal laws, such as anti-kickback and false claims laws that may apply to items or services reimbursed by non-governmental third-party payers, including commercial insurers, and state laws governing the privacy of certain health information.

We have certain arrangements with hospitals that may be affected by these laws. For instance, under our standard customer arrangements, we provide hospitals with free pulse oximetry monitoring devices in exchange for their agreement to purchase future pulse oximetry sensor requirements from us. In addition, we occasionally provide our customers with rebates in connection with their annual purchases. While we believe that we are currently in compliance with applicable federal and state health care laws, certain of these arrangements may not meet the Anti-Kickback Law s safe harbor requirements, which may result in increased scrutiny by government authorities having responsibility for enforcing these laws.

There can be no assurance that we will not be found to be in violation of any of such laws or other similar governmental regulations to which we are directly or indirectly subject, and as a result we may be subject to penalties, including civil and criminal penalties, damages, fines, exclusion of our products from reimbursement under Medicare and Medicaid, and the curtailment or restructuring of our operations. Any penalties could adversely affect our ability to operate our business and our financial results. Any action against us for violation of these laws, even if we successfully defend against them, could cause us to incur significant legal expenses and divert our management s attention from the operation of our business.

We face environmental liabilities related to certain hazardous materials used in our operations.

Our manufacturing processes involve the use, generation and disposal of certain hazardous materials and wastes, including silicone adhesives, solder and solder paste, sealants, epoxies and various solvents such as methyl ethyl ketone, acetone and isopropyl alcohol. As such, we are subject to stringent federal, state and local laws relating to the protection of the environment, including those governing the use, handling and disposal of hazardous materials and wastes. We may incur significant costs to comply with environmental regulations. Future environmental laws may significantly affect our operations because, for instance, our manufacturing processes may be required to be altered, thereby increasing our manufacturing costs. In our research and manufacturing activities, we use materials that are hazardous to

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human health, safety or the environment. These materials and various wastes resulting from their use are stored at our facility pending ultimate use and disposal. The risk of accidental injury or contamination from these materials cannot be eliminated. In the event of such an accident, we could be held liable for any resulting damages, and any such liability could exceed our reserves. Although we maintain general liability insurance, we do not specifically insure against environmental liabilities. If an enforcement action were to occur, our reputation and our business and financial condition may be harmed, even if we were to prevail or settle the action. Similarly, if the physicians or other providers or entities with which we do business are found to be non-compliant with applicable laws, they may be subject to sanctions, which could also have a negative impact on our business.

The risks inherent in operating internationally and the risks of selling and shipping our products and of purchasing our components and products internationally may adversely impact our business, financial conditions and results of operations.

We derive a portion of our net sales from operations in international markets. In 2005 and 2006, 19.2% and 22.6%, respectively, of our product revenue was derived from our international operations. In addition, we purchase a portion of our raw materials and components on the international market. The sale and shipping of our products across international borders, as well as the purchase of materials and components from international sources, subject us to extensive U.S. and foreign governmental trade regulations. Compliance with such regulations is costly and we would be exposed to potentially significant penalties for non-compliance. Any failure to comply with applicable legal and regulatory obligations could impact us in a variety of ways that include, but are not limited to, significant criminal, civil and administrative penalties, including imprisonment of individuals, fines and penalties, denial of export privileges, seizure of shipments, restrictions on certain business activities, and exclusion or debarment from government contracting. Also, the failure to comply with applicable legal and regulatory obligations could result in the disruption of our shipping and sales activities.

In addition, our international sales operations expose us and our representatives, agents and distributors to risks inherent in operating in foreign jurisdictions. These risks include:

- the imposition of additional U.S. and foreign governmental controls or regulations;
- the imposition of costly and lengthy new export licensing requirements;
- a shortage of high-quality sales people and distributors;
- loss of any key personnel that possess proprietary knowledge, or who are otherwise important to our success in certain international markets;
- changes in duties and tariffs, license obligations and other non-tariff barriers to trade;
- the imposition of new trade restrictions;
- the imposition of restrictions on the activities of foreign agents, representatives and distributors;
- scrutiny of foreign tax authorities which could result in significant fines, penalties and additional taxes being imposed on us;
- pricing pressure that we may experience internationally;

laws and business practices favoring local companies;

longer payment cycles; and

difficulties in enforcing or defending intellectual property rights.

We cannot assure you that one or more of these factors will not harm our business. Any material decrease in our international sales would adversely affect our business, financial condition and results of operations.

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We are subject to fluctuations in foreign currency exchange rates.

We market our products in certain foreign markets through our subsidiaries and other international distributors. The related distribution agreements may provide for payments in a foreign currency. Accordingly, if the U.S. dollar strengthens against international currencies, our U.S. dollar payments from such distributors, if any, will decrease.

Inadequate levels of coverage or reimbursement from governmental or other third-party payers for our products, or for procedures using our products, may cause our revenues to decline.

Sales of our products depend in part on the reimbursement and coverage policies of governmental and private health care payers. The ability of our health care provider customers, including hospitals, to obtain adequate coverage and reimbursement for our products, or for the procedures in which our products are used, may impact our customers purchasing decisions and, therefore, could have a material adverse effect on our business.

Third-party payers have adopted, and are continuing to adopt, health care policies intended to curb rising health care costs. These policies include:

- controls on government-funded reimbursement for health care services and price controls on medical products and services;
- limitations on coverage and reimbursement for new medical technologies and procedures; and
- the introduction of managed care and prospective payment systems in which health care providers contract to provide comprehensive health care for a fixed reimbursement amount per person or per procedure.

These trends could lead to pressure to reduce prices for our current products and product candidates and could cause a decrease in the size of the market or a potential increase in competition that could adversely affect our business, financial condition and results of operations.

Legislative and regulatory changes in the health care industry could have a negative impact on our financial performance.

Changes in the health care industry in the United States and elsewhere could adversely affect the demand for our products as well as the way in which we conduct business. Additionally, there have been, and we expect there will continue to be, federal, state or local legislative and regulatory changes and proposals to change the health care system, which could affect our business. For instance, in the United States, on December 8, 2003, President George W. Bush signed into law the Medicare Prescription Drug Improvement and Modernization Act of 2003, which, among other things, changed reimbursement methodologies for devices used in the hospital outpatient department and in the home. In addition, certain federal regulatory changes to Medicare coverage and reimbursement policies that potentially affect our business occur at least annually. For instance, the Centers for Medicare and Medicaid Services, or CMS, the federal agency that administers the Medicare and Medicaid programs, has determined that, beginning in 2007, certain uses of pulse oximetry monitoring are eligible for separate payment and are no longer bundled into payments for other services provided in certain settings. The result of this change could be an increase in Medicare payments to hospitals for use of our products. Overall, we are unable to predict when legislation or regulation that affects our business may be proposed or enacted in the future or what effect any such legislation or regulation would have on our business. Any such legislation, regulation or policies that affect the coverage and reimbursement of our current or future products, or the procedures utilizing our current or future products, could cause our sales to decrease and, as a result, our revenues to decline.

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Further, our success in international markets also depends upon the eligibility of reimbursement for our products through government-sponsored health care payment systems and other third-party payers. Outside of the United States, reimbursement systems vary by country. These systems are often subject to the same pressures to curb rising health care costs and control health care expenditures as those in the United States. In addition, as economies of emerging markets develop, these countries may implement changes in their health care delivery and payment systems. If adequate levels of reimbursement from third-party payers outside of the United States are not obtained, sales of our products outside of the United States may be adversely affected.

Our ongoing antitrust litigation against Tyco Healthcare could result in significant additional costs and further divert the attention of our management and key personnel from our business operations.

In May 2002, we filed a lawsuit against Tyco Healthcare, parent company of Nellcor, in the United States District Court for the Central District of California, alleging damage to our business as a result of the anti-competitive business practices of Tyco Healthcare in connection with its Nellcor pulse oximetry brand in violation of federal antitrust laws. Specifically, we alleged that we had incurred damages as a result of a series of illegal exclusionary and anti-competitive acts by Tyco Healthcare that were designed to maintain its monopoly in the pulse oximetry market.

In March 2005, a jury found that Tyco Healthcare s use of sole-source contracts, product bundling, market share-based compliance pricing contracts and co-marketing agreements with OEM patient monitoring companies were unlawful restraints of trade and exclusionary dealing arrangements and, as a result, violated federal antitrust laws. The jury awarded us $140.0 million in damages. Tyco Healthcare filed post-trial motions requesting that the District Court either override the jury decision or grant a new trial. In March 2006, the District Court upheld a portion of the jury verdict and vacated the remaining verdict. In addition, the District Court vacated the jury s damages award and granted Tyco Healthcare a new trial on damages. The District Court held an evidentiary hearing in October 2006 to re-try the damages. On January 25, 2007, the District Court issued a preliminary ruling which did not set damages, but resolved some issues of dispute about damages, and ordered another evidentiary hearing on issues still undecided by the District Court. The District Court held this evidentiary hearing in March 2007. No final ruling from the District Court on the issue of damages has been rendered; however, the effect of the post trial orders from the District Court is to substantially reduce the damages to be awarded, if any damages are ultimately awarded to us by the District Court. Even if we are ultimately awarded damages in this litigation, the amount will be subject to a 50% legal fee contingency agreement, in which case we would receive 50% of the net (of costs) proceeds from the award.

We believe that Nellcor continues to enter into sole-source contracts, product bundling agreements, market share-based agreements, and co-marketing agreements. In bundling agreements, the customer is able to obtain discounts on unrelated products when they purchase Nellcor pulse oximeters for most of their pulse oximetry needs. Co-marketing agreements also provide significant impediments to competition in that Nellcor pays large patient monitoring companies to integrate Nellcor pulse oximetry products into their products.

Continued litigation could result in substantial costs and diversion of resources that would harm our business. In addition, there can be no assurance that we will receive any cash award or any equitable relief from the litigation. See Business Legal Proceedings for more information regarding our antitrust litigation against Tyco Healthcare.

We may issue additional securities in the future, including shares, debt or equity-linked debt, which may depress our stock price.

Our issuance of additional securities could:

cause substantial dilution of the percentage ownership of our stockholders at the time of the issuance;

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cause substantial dilution of our earnings per share;

subject us to the risks associated with increased leverage, including a reduction in our ability to obtain financing or an increase in the cost of any financing we obtain;

subject us to restrictive covenants that could limit our flexibility in conducting future business activities; and

adversely affect the prevailing market price for our outstanding securities.

We do not intend to seek stockholder approval for any such acquisition or security issuance unless required by applicable law or regulation or the terms of existing securities. If these securities are issued, such issuances may cause the trading price of our stock to decline.

We may require additional capital in the future, which may not be available on favorable terms, if at all.

To the extent that our existing capital is insufficient to meet our requirements and cover any losses, we will need to raise additional funds through financings or borrowings or curtail our growth and reduce our assets. Any equity or debt financing, if available at all, may be on terms that are not favorable to us. Equity financings could result in dilution to our stockholders, and the securities issued in future financings may have rights, preferences and privileges that are senior to those of our common stock. If our need for capital arises because of significant losses, the occurrence of these losses may make it more difficult for us to raise the necessary capital. If we cannot raise funds on acceptable terms, if and when needed, we may not be able to develop or enhance our products, take advantage of future opportunities, grow our business or respond to competitive pressures or unanticipated requirements.

If we fail to comply with the reporting obligations of the Securities Exchange Act of 1934 and Section 404 of the Sarbanes-Oxley Act, or if we fail to achieve and maintain adequate internal controls over financial reporting, our business results of operations and financial condition and investors confidence in us could be materially affected.

As a public company, we will be required to comply with the periodic reporting obligations of the Securities Exchange Act of 1934, as amended, or the Exchange Act, including preparing annual reports, quarterly reports and current reports. Our failure to prepare and disclose this information in a timely manner could subject us to penalties under federal securities laws, expose us to lawsuits and restrict our ability to access financing. In addition, we will be required under applicable law and regulations to integrate our systems of internal controls over financial reporting. We plan to evaluate our existing internal controls with respect to the standards adopted by the Public Company Accounting Oversight Board. During the course of our evaluation, we may identify areas requiring improvement and may be required to design enhanced processes and controls to address issues identified through this review. This could result in significant delays and costs to us and require us to divert substantial resources, including management time from other activities.

We expect to dedicate significant management, financial and other resources in connection with our compliance with Section 404 of the Sarbanes-Oxley Act in 2007. We expect these efforts to include a review of our existing internal control structure. As a result of this review, we may either hire or outsource additional personnel to expand and strengthen our finance function. We cannot be certain at this time that we will be able to comply with all of our reporting obligations and successfully complete the certification and attestation requirements of Section 404 of the Sarbanes-Oxley Act by the time that we are required to file our annual report on Form 10-K for the year ending December 31, 2008. If we fail to achieve and maintain the adequacy of our internal control and do not address the deficiencies identified by our auditors, we may not be able to ensure that we can conclude on an ongoing basis that we have effective internal controls over financial reporting in accordance with the Sarbanes-Oxley Act. Moreover, effective internal controls are necessary for us to produce reliable financial reports and are important to help prevent fraud. As a result, our failure to satisfy the requirements of Section 404 of the

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Sarbanes-Oxley Act on a timely basis could result in the loss of investor confidence in the reliability of our financial statements, which in turn could harm our business and negatively impact the trading price of our common stock.

Risks Related to Our Common Stock and this Offering

There is no existing market for our common stock, and we do not know if one will develop to provide you with adequate liquidity.

Prior to this offering, there has not been a public market for our common stock. We cannot predict the extent to which investor interest in our company will lead to the development of an active trading market on the NASDAQ Global Market or otherwise or how liquid that market might become. If an active trading market does not develop, you may have difficulty selling any of our common stock that you buy. The initial public offering price for our common stock will be determined by negotiations between representatives of the underwriters and us and may not be indicative of prices that will prevail in the open market following this offering. Consequently, you may not be able to sell our common stock at prices equal to or greater than the price you paid in this offering.

Our stock price may be volatile, and your investment in our common stock could suffer a decline in value.

There has been significant volatility in the market price and trading volume of equity securities, which is unrelated to the financial performance of the companies issuing the securities. These broad market fluctuations may negatively affect the market price of our common stock. You may not be able to resell your shares at or above the initial public offering price due to fluctuations in the market price of our common stock caused by changes in our operating performance or prospects and other factors.

Some specific factors that may have a significant effect on our common stock market price include:

- actual or anticipated fluctuations in our operating results or future prospects;
- our announcements or our competitors announcements of new products;
- the public s reaction to our press releases, our other public announcements and our filings with the Securities and Exchange Commission, or SEC;
- strategic actions by us or our competitors, such as acquisitions or restructurings;
- new laws or regulations or new interpretations of existing laws or regulations applicable to our business;
- changes in accounting standards, policies, guidance, interpretations or principles;
- changes in our growth rates or our competitors growth rates;
- developments regarding our patents or proprietary rights or those of our competitors;
- our inability to raise additional capital as needed;

concern as to the efficacy of our products;

changes in financial markets or general economic conditions;

sales of common stock by us or members of our management team; and

changes in stock market analyst recommendations or earnings estimates regarding our common stock, other comparable companies or our industry generally.

This offering will cause immediate and substantial dilution in pro forma net tangible book value.

The initial public offering price of our common stock is substantially higher than what the pro forma net tangible book value per share of our outstanding common stock will be after giving effect to the stock

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split and this offering. Pro forma net tangible book value per share represents the amount of total tangible assets less total liabilities after giving effect to the stock split of our common stock, divided by the number of shares outstanding after giving effect to the stock split. If you purchase our common stock in this offering, you will incur an immediate dilution of approximately $ in the pro forma net tangible book value per share of common stock after giving effect to the stock split.

We will also have a significant number of outstanding options to purchase our common stock with exercise prices significantly below the initial public offering price of the common stock. To the extent these options are exercised, you will experience further dilution. Upon consummation of this offering, there will be options to purchase shares of our common stock outstanding, of which would have been immediately exercisable as of , 2007.

We have broad discretion in how we use the net proceeds from this offering and we may not use these proceeds in a manner desired by our public stockholders.

While we expect to use the funds from this offering for those purposes outlined in the Use of Proceeds section of this prospectus, there can be no assurance that we will ultimately deploy the proceeds in the manner we anticipate. Accordingly, our management will have broad discretion with respect to the use of this portion of our net proceeds and investors will be relying on the judgment of our management regarding the application of these proceeds. Our management could spend these proceeds in ways that our public stockholders may not desire or that do not yield a favorable return. You will not have the opportunity, as part of your investment in our common stock, to influence the manner in which the net proceeds of the offering are used. We also may use a portion of these proceeds to acquire complementary businesses, but we currently do not have any specific acquisition plans. Any investment may not yield a favorable return. Our financial performance may differ from our current expectations or our business needs may change as our business evolves. As a result, a substantial portion of the proceeds we receive in the offering may be used in a manner significantly different from our current expectations.

Concentration of ownership among our existing directors, executive officers and principal stockholders may prevent new investors from influencing significant corporate decisions.

Upon closing of this offering, based upon beneficial ownership as of , 2007, our current directors, executive officers, holders of more than five percent of our common stock, and their affiliates will, in the aggregate, beneficially own approximately % of our outstanding common stock. As a result, these stockholders, subject to any fiduciary duties owed to our other stockholders under Delaware law, will be able to exercise a controlling influence over matters requiring stockholder approval, including the election of directors and approval of significant corporate transactions, and will have significant control over our management and policies. Some of these persons or entities may have interests that are different from yours. For example, these stockholders may support proposals and actions with which you may disagree or which are not in your interests. The concentration of ownership could delay or prevent a change in control of us or otherwise discourage a potential acquirer from attempting to obtain control of us, which in turn could reduce the price of our common stock. In addition, these stockholders, some of whom have representatives sitting on our board of directors, could use their voting influence to maintain our existing management and directors in office, delay or prevent changes in control of us, or support or reject other management and board proposals that are subject to stockholder approval, such as amendments to our employee stock plans and approvals of significant financing transactions.

If there are substantial sales of our common stock, our stock price could decline.

If our existing stockholders sell a large number of shares of our common stock or the public market perceives that these sales may occur, the market price of our common stock could decline. Based on shares outstanding on , upon the closing of this offering, assuming no outstanding options are exercised prior to the closing of this offering, we will have approximately shares of common

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stock outstanding. All of the shares offered under this prospectus will be freely tradable without restriction or further registration under the federal securities laws, unless purchased by our affiliates. Taking into consideration the effect of lock-up agreements entered into by our stockholders, the remaining shares outstanding upon the closing of this offering will be available for sale pursuant to Rules 144 and 701, and the volume, manner of sale and other limitations under these rules, as follows:

shares of common stock will be eligible for sale in the public market, beginning 180 days after the effective date of this prospectus, unless the lock-up period is otherwise extended pursuant to its terms; and

the remaining shares of common stock will become eligible for sale in the public market beginning .

Piper Jaffray & Co. may waive the restrictions set forth in the lock-up agreements in their sole discretion at any time.

Existing stockholders holding an aggregate of 10,037,501 shares of common stock, based on shares outstanding as of April 30, 2007, have rights with respect to the registration of these shares of common stock with the SEC. See Description of Capital Stock Registration Rights. If we register their shares of common stock following the expiration of the lock-up agreements, they can immediately sell those shares in the public market.

Promptly following this offering, we intend to register up to approximately shares of common stock that are authorized for issuance under our stock incentive plans, including our 2007 Stock Incentive Plan, which will become effective in connection with this offering. As of April 30, 2007, 2,539,525 shares were subject to outstanding options, of which 1,121,313 options were vested and exercisable as of that date. Once we register these shares, they can be freely sold in the public market upon issuance, subject to the lock-up agreements referred to above and restrictions on our affiliates.

Our corporate documents and Delaware law contain provisions that could discourage, delay or prevent a change in control of our company.

Prior to the consummation of this offering, we will amend and restate our certificate of incorporation and bylaws. Provisions in our amended and restated certificate of incorporation and amended and restated bylaws may discourage, delay or prevent a merger or acquisition involving us that our stockholders may consider favorable. For example, our amended and restated certificate of incorporation authorizes our board of directors to issue up to million shares of blank check preferred stock. As a result, without further stockholder approval, the board of directors has the authority to attach special rights, including voting and dividend rights, to this preferred stock. With these rights, preferred stockholders could make it more difficult for a third party to acquire us. In addition, our amended and restated certificate of incorporation provides for a staggered board of directors, whereby directors serve for three year terms, with approximately one third of the directors coming up for reelection each year. A staggered board will make it more difficult for a third party to obtain control of our board of directors through a proxy contest, which may be a necessary step in an acquisition of us that is not favored by our board of directors.

We are also subject to the anti-takeover provisions of the Delaware General Corporation Law. Under these provisions, if anyone becomes an interested stockholder, we may not enter into a business combination with that person for three years without special approval, which could discourage a third party from making a takeover offer and could delay or prevent a change in control of us. An interested stockholder means, generally, someone owning 15% or more of our outstanding voting stock or an affiliate of ours that owned 15% or more of our outstanding voting stock during the past three years, subject to certain exceptions as described in the Delaware General Corporation Law.

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In addition, prior to the consummation of this offering, we will adopt a stockholder rights plan, which will grant all of our stockholders other than the acquiring person the right to purchase common stock at % of market price if any person becomes the beneficial owner of % or more of the outstanding shares of common stock, subject to a number of exceptions set forth in the plan. Our stockholder rights plan could discourage a takeover attempt and make an unsolicited takeover of our company more difficult. As a result, you may not have the opportunity to sell your shares to a potential acquirer of us at a premium over prevailing market prices. This could reduce the market price of our common stock.

We will incur significant increased costs as a result of operating as a public company, and our management and key employees will be required to devote substantial time to new compliance initiatives.

We have never operated as a public company. As a public company, we will incur significant legal, accounting and other expenses that we did not incur as a private company. In addition, we will be subject to the reporting requirements of the Exchange Act and the Sarbanes-Oxley Act. These requirements may place a strain on our people, systems and resources. The Exchange Act will require that we file annual, quarterly and current reports with respect to our business and financial condition. The Sarbanes-Oxley Act will require that we maintain effective disclosure controls and procedures and internal controls over financial reporting. In order to maintain and improve the effectiveness of our disclosure controls and procedures and internal controls over financial reporting, significant resources and management oversight will be required. In addition, changing laws, regulations and standards relating to corporate governance and public disclosure, including regulations implemented by the SEC and the NASDAQ Global Market, are creating uncertainty for public companies, increasing legal and financial compliance costs and making some activities more time-consuming. This may divert management s attention from other business concerns, which could have a material adverse effect on our business, financial condition, results of operations and cash flows.

We will be exposed to risks relating to evaluations of controls required by Section 404 of the Sarbanes-Oxley Act.

We will be evaluating our internal controls systems to allow management to report on, and our independent registered public accounting firm to attest to, our internal controls over financial reporting. We will be performing the system and process evaluation and testing (and any necessary remediation) required to comply with the management certification and auditor attestation requirements of Section 404 of the Sarbanes-Oxley Act. While we anticipate being able to fully implement the requirements relating to internal controls and all other aspects of Section 404 by our compliance deadlines, we cannot be certain as to the timing of completion of our evaluation, testing and remediation actions or the impact of the same on our operations because there is presently no precedent available by which to measure compliance adequacy. If we are unable to implement the requirements of Section 404 in a timely manner or with adequate compliance, we may be subject to sanctions or investigation by regulatory authorities, including the SEC or the NASDAQ Global Market. This type of action could adversely affect our financial results or investors confidence in our company and our ability to access capital markets, and could cause our stock price to decline. In addition, the controls and procedures that we will implement may not comply with all of the relevant rules and regulations of the SEC and the NASDAQ Global Market. If we fail to develop and maintain effective controls and procedures, we may be unable to provide the required financial information in a timely and reliable manner.

We do not intend to declare cash dividends on our stock after this offering, and any return on investment may be limited to the value of our stock.

We currently intend to retain all future earnings for the operation and expansion of our business and, therefore, do not anticipate declaring or paying cash dividends on our common stock in the foreseeable future. Any payment of cash dividends on our common stock will be at the discretion of our board of directors and will depend upon our results of operations, earnings, capital requirements, financial

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condition, business prospects, contractual restrictions and other factors deemed relevant by our board of directors. Therefore, you should not expect to receive dividend income from shares of our common stock.

Securities analysts may not initiate coverage of our common stock or may issue negative reports, which may have a negative impact on the market price of our common stock.

Securities analysts may elect not to provide research coverage of our common stock after the completion of this offering. If securities analysts do not cover our common stock after the completion of this offering, the lack of research coverage may cause the market price of our common stock to decline. The trading market for our common stock may be affected in part by the research and reports that industry or financial analysts publish about our business or the pulse oximetry market. If one or more of the analysts who elects to cover us downgrades our stock, our stock price could decline rapidly. If one or more of these analysts ceases coverage of us, we could lose visibility in the market, which in turn could cause our stock price to decline. In addition, recently-adopted rules mandated by the Sarbanes-Oxley Act, and a global settlement reached in 2003 between the SEC, other regulatory agencies and a number of investment banks, has led to a number of fundamental changes in how analysts are reviewed and compensated. In particular, many investment banking firms are required to contract with independent financial analysts for their stock research. As long as we have a smaller market capitalization, it may be difficult for us to attract independent financial analysts that will cover our common stock, which could have a negative effect on the market price of our stock.

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This prospectus includes forward-looking statements. All statements other than statements of historical facts included in this prospectus that address activities, events or developments that we expect, believe or anticipate will or may occur in the future are forward-looking statements including, in particular, the statements about our plans, objectives, strategies and prospects regarding, among other things, the financial condition, results of operations and business of ours and our subsidiaries. We have identified some of these forward-looking statements with words like believe, may, could, might, forecast, possible, potential, project, will, should, expect, intend, plan, predi approximate or continue and other words and terms of similar meaning. These forward-looking statements may be contained under the captions Prospectus Summary, Risk Factors, Selected Combined Consolidated Financial Data, Management s Discussion and Analysis of Financial Condition and Results of Operations and Business or elsewhere in this prospectus. These forward-looking statements are based on current expectations about future events affecting us and are subject to uncertainties and factors relating to our operations and business environment, all of which are difficult to predict and many of which are beyond our control. Many factors mentioned in our discussion in this prospectus, including the risks outlined under Risk Factors, will be important in determining future results. Although we believe that the expectations reflected in our forward-looking statements are reasonable, we do not know whether our expectations will prove correct. They can be affected by inaccurate assumptions we might make or by known or unknown risks and uncertainties, including, with respect to us or Masimo Labs, the following, among others:

- our reliance on Masimo SET and related products for substantially all of our revenue;
- the failure in protecting our intellectual property;
- exposure to competitors assertions of intellectual property claims;
- the highly competitive nature of the markets in which we sell our products;
- the failure to continue developing innovative products;
- introduction of competing products;
- lack of acceptance of new products;
- the loss of our customers;
- increases in prices for raw materials or the loss of key supplier contracts;
- product liability claims exposure;
- risks in connection with our operations outside the United States;

conditions and changes in the medical device industry generally;

the failure to retain senior management or replace lost senior management;

changes in generally accepted accounting principles;

changes in general economic and business conditions;

changes in currency exchange rates and interest rates;

employee slowdowns, strikes or similar actions;

the vertical integration by our customers of the production of our products into their own manufacturing process;

our inability to meet performance enhancement objectives, including efficiency and cost-reduction strategies;

adverse changes in applicable laws or regulations;

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conflicts of interest due to our ownership structure;

the incurrence of additional debt, contingent liabilities and expenses in connection of future acquisitions;

the failure to effectively integrate newly acquired operations;

the absence of expected returns from the amount of intangible assets we have recorded; and

shares of common stock will be eligible for sale in the public market, beginning 180 days after the effective date of this prospectus, unless the lock-up period is otherwise extended pursuant to its terms.

The factors identified above are believed to be important factors, but not necessarily all of the important factors, that could cause our actual results to differ materially from those expressed in any forward-looking statement. Unpredictable or unknown factors could also have material adverse effects on us. Since our actual results, performance or achievements could differ materially from those expressed in, or implied by, these forward-looking statements, we cannot give any assurance that any of the events anticipated by the forward-looking statements will occur or, if any of them do, what impact they will have on our results of operations and financial condition. All forward-looking statements included in this prospectus are expressly qualified in their entirety by the foregoing cautionary statements. You are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this prospectus. We do not undertake any obligation to update, amend or clarify these forward-looking statements or the risk factors contained in this prospectus, whether as a result of new information, future events or otherwise, except as may be required under the federal securities laws.

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USE OF PROCEEDS

We estimate that the net proceeds from the sale of the shares of common stock that we are offering will be approximately $ million, after deducting the underwriting discount and estimated offering expenses payable by us, and assuming an initial public offering price of $ per share, the midpoint of the range on the cover of this prospectus. We will not receive any proceeds from the sale of common stock by the selling stockholders. If the underwriters exercise their over-allotment option in full, we estimate that our net proceeds from this offering will be approximately $ million, after deducting the underwriting discount and estimated offering expenses payable by us. A $1.00 increase (decrease) in the assumed initial public offering price of $ per share would increase (decrease) the net proceeds to us from this offering by $ million, assuming the number of shares offered by us, as set forth on the cover page of this prospectus, remains the same and after deducting the underwriting discount and estimated offering expenses payable by us.

The principal purposes of this offering are to obtain additional capital and to create a public market for our common stock. Of the net proceeds we will receive from this offering, we expect to use:

- approximately $15.0 million for capital expenditures and the placement of equipment;
- approximately $10.0 million for sales and marketing activities to support the ongoing commercialization of the Masimo SET and Masimo Rainbow SET products, including, but not limited to, expansion of our sales force, additional participation in trade shows and symposia, and expanding our international sales;
- approximately $10.0 million for research and development activities, including support of hardware and software product development and clinical study initiatives; and
- a portion of the remaining amount for increased working capital and general corporate purposes.

We may also use a portion of the net proceeds for the acquisition of, or investment in, companies, technologies, products or assets that complement our business. We have no present understandings, commitments or agreements to enter into any material acquisitions or investments. Pending these uses, we intend to invest the net proceeds of this offering in short-term, investment-grade interest-bearing securities or guaranteed obligations of the U.S. government.

The amounts we actually expend in these areas may vary significantly from our expectations and will depend on a number of factors, including operating costs, capital expenditures and any expenses related to our product development and commercialization efforts, the amount of proceeds actually raised in this offering, competition, manufacturing, any strategic partnerships arrangements we may enter into and enforcing our intellectual property rights. Accordingly, management will retain broad discretion in the allocation of the net proceeds of this offering. We may also use a portion of the proceeds for the potential acquisition of, or investment in, products, technologies or companies that complement our business, although we have no current understandings, commitments or agreements to do so.

We believe that the net proceeds from this offering, together with our cash and cash equivalent balances will be sufficient to meet our anticipated cash requirements for at least the next 12 months.

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DIVIDEND POLICY

In March 2006, we paid a cash dividend of $10.096 per share, in the aggregate amount of approximately $171.8 million, to holders of our common and preferred stock. In February 2007, we paid additional cash dividends of $1.404 per share and $0.77 per share, in the aggregate amount of approximately $37.1 million, to holders of our common and preferred stock. The majority of the funds used to pay these cash dividends were paid to our stockholders from the after-tax proceeds that we received from our patent infringement lawsuit against Nellcor and the interest thereon.

We anticipate that we will retain all of our future earnings, if any, for use in the expansion and operation of our business and do not anticipate paying cash dividends in the foreseeable future. Any future determination relating to our dividend policy will be made at the discretion of our board of directors, based on our financial condition, results of operations, earnings, contractual restrictions, capital requirements, business prospects and other factors our board of directors may deem relevant. We do not intend to distribute any future royalties received from Nellcor under the settlement agreement to our stockholders.

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CAPITALIZATION

The following table sets forth our capitalization as of March 31, 2007:

on an actual basis; and

on a pro forma as adjusted basis to give effect to the conversion of our outstanding preferred stock into 11,537,501 shares of our common stock in connection with this offering and the sale of shares of our common stock in this offering at an assumed public offering price of $ per share, the midpoint of the range on the cover of this prospectus, after deducting the underwriting discount and estimated offering expenses payable by us.

The pro forma as adjusted information below is illustrative only, and our capitalization following the completion of this offering will be adjusted based on the actual initial public offering price and other terms of this offering determined at pricing. You should read this table in conjunction with Selected Consolidated Financial Data, Management s Discussion and Analysis of Financial Condition and Results of Operations, and the consolidated financial statements and related notes included in this prospectus.

	As of March 31, 2007	
		Pro Forma
	Actual	As Adjusted[1]
	(in thousands, except share data)	
Stockholders equity		
Convertible preferred stock, $0.001 par value per share; 12,500,000 shares authorized, 11,537,501 shares issued and outstanding, actual; no shares authorized, issued and outstanding, pro forma as adjusted	$ 90,284	$
Preferred stock, par value $0.001 per share; no shares authorized, issued or outstanding, actual; shares authorized, no shares issued and outstanding, pro forma as adjusted.		
Common stock, $0.001 par value per share; 23,500,000 shares authorized, 5,552,145 shares issued and outstanding, actual; shares authorized, shares issued and outstanding, pro forma as adjusted	6	
Treasury stock, 42,080 shares, at fair market value	(786)	
Additional paid-in capital		
Accumulated other comprehensive loss	(321)	
Accumulated deficit	(23,040)	
Total stockholders equity	$ 66,143	$

(1) A $1.00 increase (decrease) in the assumed initial public offering price of $ per share would increase (decrease) additional paid-in capital and total stockholders equity by $ million, assuming the number of shares offered by us, as set forth on the cover page of this prospectus, remains the same, and after deducting the underwriting discount payable by us.

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The outstanding share information in the table above excludes as of March 31, 2007:

- 2,487,695 shares of our common stock issuable upon exercise of outstanding options, with a weighted average exercise price of $15.14 per share, of which 1,112,443 options were vested and exercisable as of that date;
- 629,994 shares of common stock reserved for awards available for future issuance under our current equity incentive plans;
- 1,500,000 shares of our common stock reserved for future issuance under our 2007 Stock Incentive Plan, which will become effective in connection with this offering; and
- shares of our common stock that may be purchased by the underwriters to cover over-allotments.

Shares available for future issuance under our 2007 Stock Incentive Plan do not include shares that may become available for issuance pursuant to a provision in this plan that provides for the automatic annual increase in the number of shares reserved thereunder. See Compensation Employee Benefit Plans 2007 Stock Incentive Plan.

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DILUTION

If you invest in our common stock, your interest will be diluted to the extent of the difference between the initial public offering price per share of our common stock and the pro forma as adjusted net tangible book value per share of our common stock after this offering.

Our pro forma net tangible book value at March 31, 2007 was $ million, or $ per share of common stock. Pro forma net tangible book value per share represents total tangible assets less total liabilities, divided by the number of outstanding shares of common stock on December 31, 2006, after giving effect to the conversion of all outstanding shares of preferred stock into shares of common stock as if the conversion occurred on March 31, 2007. Our pro forma as adjusted net tangible book value, which gives effect to the sale of shares of common stock in this offering at an assumed initial public offering price of $ per share, the midpoint of the range on the cover of this prospectus, and after deducting the underwriting discount and estimated offering expenses payable by us, would have been $ million, or $ per share, at March 31, 2007. This represents an immediate increase in pro forma as adjusted net tangible book value of $ per share to existing stockholders and an immediate dilution of $ per share to investors in this offering. The following table illustrates this per share dilution:

Assumed initial public offering price per share		$
Pro forma net tangible book value per share at March 31, 2007	$	
Increase in pro forma net tangible book value per share attributable to this offering		
Pro forma as adjusted net tangible book value per share after this offering		
Dilution per share to new investors		$

A $1.00 increase (decrease) in the assumed initial public offering price of $ per share would increase (decrease) our pro forma as adjusted net tangible book value by $ million, the pro forma as adjusted net tangible book value per share by $ per share and the dilution in the pro forma net tangible book value to investors in this offering by $ per share, assuming the number of shares offered by us, as set forth on the cover page of this prospectus, remains the same and after deducting the underwriting discount and estimated offering expenses payable by us.

The following table shows, as of March 31, 2007, the number of shares of common stock purchased from us, the total consideration paid to us and the average price paid per share by existing stockholders and by investors purchasing common stock in this offering at an assumed initial public offering price of $ per share, the midpoint of the range on the cover of this prospectus, before deducting the underwriting discount and estimated offering expenses payable by us.

	Shares Purchased		Total Consideration		Average Price Per
	Number	Percent	Amount	Percent	Share
Existing stockholders		%	$	%	$
New investors					
Total		100%	$	100%	

A $1.00 increase (decrease) in the assumed initial public offering price of $ per share would increase (decrease) total consideration paid by new investors in this offering and total consideration paid by all stockholders by $ million, assuming the number of shares offered by us, as set forth on the cover page of this prospectus, remains the same.

Sales of common stock by the selling stockholders in the offering will reduce the number of shares of common stock held by existing stockholders to , or approximately % of the total shares of

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common stock outstanding after the offering, and will increase the number of shares held by new investors to , or approximately % of the total shares of common stock outstanding after the offering.

The above discussion and tables exclude, as of March 31, 2007:

- 2,487,695 shares of our common stock issuable upon exercise of outstanding options, with a weighted average exercise price of $15.14 per share, of which 1,112,443 options were vested and exercisable as of that date;
- 629,994 shares of common stock reserved for awards available for future issuance under our current equity incentive plans;
- 1,500,000 shares of our common stock reserved for future issuance under our 2007 Stock Incentive Plan, which will become effective in connection with this offering; and
- shares of our common stock that may be purchased by the underwriters to cover over-allotments.

Shares available for future issuance under our 2007 Stock Incentive Plan do not include shares that may become available for issuance pursuant to a provision in plan that provides for the automatic annual increase in the number of shares reserved thereunder.

If the underwriters exercise their over-allotment option in full:

- the number of shares of our common stock held by existing stockholders would decrease to approximately % of the total number of shares of our common stock outstanding after this offering;
- the number of shares of our common stock held by new investors would increase to approximately % of the total number of shares of our common stock outstanding after this offering; and
- our pro forma as adjusted net tangible book value at December 31, 2006 would have been $ million, or $ per share of common stock, representing an immediate increase in pro forma net tangible book value of $ per share of common stock to our existing stockholders and an immediate dilution of $ per share to investors purchasing shares in this offering.

To the extent that outstanding options are exercised, you will experience further dilution. If all of our outstanding options were exercised, our pro forma net tangible book value as of March 31, 2007 would have been $ million, or $ per share, and our pro forma as adjusted net tangible book value after this offering would be $ million, or $ per share, causing dilution to investors purchasing shares in this offering of $ per share. In addition, if options outstanding as of March 31, 2007 are exercised, on a pro forma as adjusted basis before deducting underwriting discounts and estimated offering expenses payable by us, existing stockholders will have purchased shares, or % of the shares purchased from us, for approximately $ million, or % of the total consideration paid to us, with an average price per share of $. Shares purchased by new investors will represent % of shares purchased for % of the total consideration.

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SELECTED CONSOLIDATED FINANCIAL DATA

We derived the selected statement of operations data for the years ended December 31, 2004, 2005 and 2006 and the selected balance sheet data as of December 31, 2005 and 2006 from our audited consolidated financial statements and notes thereto included in this prospectus. We derived the selected statement of operations data for the year ended December 31, 2003 and the selected balance sheet data as of December 31, 2003 and 2004 from our audited consolidated financial statements and notes thereto that are not included in this prospectus. We derived the selected statement of operations data for the year ended December 31, 2002 and the selected balance sheet data as of December 31, 2002 from our unaudited consolidated financial statements that are not included in this prospectus. We derived the summary statement of operations data for the three months ended March 31, 2006 and 2007 and the summary balance sheet data as of March 31, 2007 from our unaudited consolidated financial statements and notes thereto included in this prospectus. We have prepared this unaudited information on the same basis as the audited financial statements and have included all adjustments, consisting of normal recurring adjustments, that we consider necessary for a fair statement of our financial position and operating results for such periods. Our historical results are not necessarily indicative of the results that may be expected in the future. The following financial data are only a summary and should be read together with our financial statements and the notes thereto, and the information under Management s Discussion and Analysis of Financial Condition and Results of Operations included in this prospectus.

The pro forma basic and diluted net income per common share data in the statement of operations data for the year ended December 31, 2006 and the three months ended March 31, 2007 reflect the conversion of all of our outstanding shares of convertible preferred stock into an aggregate of 11,537,501 shares of common stock in connection with this offering.

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	Year ended December 31,					Three months ended March 31,	
	2002 (unaudited)	2003	2004	2005	2006	2006 (unaudited)	2007 (unaudited)
	(in thousands, except share data)						
Statement of Operations Data[1]:							
Revenue:							
Product	$ 38,603	$ 46,419	$ 69,069	$ 107,613	$ 155,131	$ 34,679	$ 45,764
Royalty and license fee	229	315	288	277	69,207	14,627	13,190
Total revenue	38,832	46,734	69,357	107,890	224,338	49,306	58,954
Cost of goods sold	18,635	22,448	29,354	42,717	61,640	16,138	16,901
Gross profit	20,197	24,286	40,003	65,173	162,698	33,168	42,053
Operating expenses:							
Research and development	4,369	4,567	6,044	8,548	24,875	11,794	5,454
Selling, general and administrative	14,636	21,947	30,118	43,085	91,493	36,139	21,412
Patent litigation	1,118	4,245	6,204	1,736	60		
Purchased in-process research and development				2,800			
Total operating expenses	20,123	30,759	42,366	56,169	116,428	47,933	26,866
Operating income (loss)	74	(6,473)	(2,363)	9,004	46,270	(14,765)	15,187
Non-operating income (expense):							
Patent lawsuit proceeds, net					262,665	262,665	
Interest income	84	52	107	224	6,741	2,659	355
Interest expense	(331)	(468)	(1,434)	(1,851)	(1,824)	(505)	(427)
Other	(8)	(3)	8	(8)	551	99	41
Total non-operating income (expense)	(255)	(419)	(1,319)	(1,635)	268,133	264,918	(31)
Income (loss) before provision for (benefit from) income taxes	(181)	(6,892)	(3,682)	7,369	314,403	250,153	15,156
Provision for (benefit from) income taxes	1	2	161	(26,012)	132,577	105,456	6,059
Net income (loss)	(182)	(6,894)	(3,843)	33,381	181,826	144,697	9,097
Preferred stock dividend					(77,785)	(58,571)	
Accretion of preferred stock	(8,401)	(8,477)	(8,477)	(8,278)	(7,985)	(2,117)	(1,956)
Undistributed income attributable to preferred stockholders				(19,599)	(34,275)	(34,783)	(4,828)
Net income (loss) attributable to common stockholders	$ (8,583)	$ (15,371)	$ (12,320)	$ 5,504	$ 61,781	$ 49,226	$ 2,313
Net income (loss) per common share[2]:							
Basic	$ (2.78)	$ (4.93)	$ (3.94)	$ 1.70	$ 11.36	$ 9.54	$ 0.42
Diluted	$ (2.78)	$ (4.93)	$ (3.94)	$ 1.26	$ 9.13	$ 7.58	$ 0.34
Weighted-average number of common shares:							
Basic	3,091,455	3,116,780	3,126,247	3,239,294	5,439,966	5,158,407	5,530,721
Diluted	3,091,455	3,116,780	3,126,247	4,367,537	6,767,624	6,490,642	6,887,510
Pro forma net income per common share (unaudited)[2]:							
Basic					$ 10.71		$ 0.53
Diluted					$ 9.93		$ 0.49

Weighted-average number of common shares used in computing pro forma net income per common share (unaudited):		
Basic	16,977,467	17,068,222
Diluted	18,305,125	18,425,011

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(1) Pursuant to Financial Accounting Standards Board Interpretation No. 46(R), *Consolidation of Variable Interest Entities an Interpretation of ARB No. 51,* or FIN 46(R), Masimo Labs is consolidated within our financial statements. Accordingly, all inter-company royalties, option and licensing fees, and other charges between us and Masimo Labs have been eliminated in the consolidation. Also in accordance with FIN 46(R), all direct engineering expenses that have been incurred by us and charged to Masimo Labs have not been eliminated and are included as research and development expense in our consolidated statements of operations. For additional discussion of accounting for Masimo Labs, see Note 4 to the Notes to Consolidated Financial Statements.

(2) See Note 2 to the Notes to Consolidated Financial Statements for a description of the method used to compute basic and diluted net income (loss) per common share and basic and diluted pro forma net income per common share.

	As of December 31,					As of March 31,
	2002 (unaudited)	2003	2004	2005	2006	2007 (unaudited)
	(in thousands)					
Balance Sheet Data:						
Cash and cash equivalents	$ 7,792	$ 11,124	$ 11,794	$ 14,172	$ 55,382	$ 22,907
Working capital	12,343	9,083	6,030	34,213	30,125	44,259
Total assets	32,602	40,397	54,221	100,589	159,073	152,137
Long-term debt, including current portion	4,457	14,393	23,828	29,060	21,042	31,736
Convertible preferred stock(3)	118,727	127,204	135,681	143,959		
Stockholders equity (deficit)(3)	(100,192)	(115,393)	(127,573)	(101,082)	56,961	66,143

(3) Our convertible preferred stock was reclassified to stockholders equity when we eliminated its mandatory redemption provisions in connection with the March 2006 dividend.

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MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

You should read this discussion together with the financial statements, related notes and other financial information included in this prospectus. The following discussion may contain predictions, estimates and other forward-looking statements that involve a number of risks and uncertainties, including those discussed under Risk Factors and elsewhere in this prospectus. These risks could cause our actual results to differ materially from any future performance suggested below.

Overview

We are a global medical technology company that develops, manufactures and markets non-invasive patient monitoring products that improve patient care. We invented Masimo Signal Extraction Technology, or Masimo SET, which provides the capabilities of read-through motion and low perfusion pulse oximetry to address the primary limitations of conventional pulse oximetry. Pulse oximetry is the non-invasive measurement of the oxygen saturation level of arterial blood, or the blood that delivers oxygen to the body s tissues, and pulse rate. Conventional pulse oximetry is subject to technological limitations that reduce its effectiveness and the quality of patient care. In particular, when using conventional pulse oximetry, arterial blood signal recognition can be distorted by motion artifact, or patient movement, and low perfusion, or low arterial blood flow. Low perfusion can also cause the failure of the conventional pulse oximeter to obtain an accurate measurement. Conventional pulse oximetry readings can also be impacted by bright light and electrical interference from the presence of electrical surgical equipment. Published independent research shows that over 70% of the alarms were false outside the operating room using conventional pulse oximetry. Our Masimo SET platform has significantly addressed many of the previous technology limitations of pulse oximetry, and has been recognized as the gold standard in pulse oximetry, the benefits of which have been validated in over 100 independent clinical studies. During 2006, we generated product revenue of $155.1 million, representing a compound annual growth rate, or CAGR, of 41.6% for the four years ended December 31, 2006.

We market a family of patient monitoring solutions which incorporate a monitor or circuit board and consumables, including both proprietary single-patient use and reusable sensors and cables. In addition, we offer a remote-alarm/monitoring solution, software and other accessories. Although our Masimo SET platform is only operable with our proprietary sensors, our sensors have the capability to work with certain competitor pulse oximeters through the use of our adapter cables. In 2005, we launched our Masimo Rainbow SET Pulse CO-Oximetry platform utilizing licensed Rainbow technology from Masimo Labs, which enables the non-invasive measurement of not only arterial blood oxygen saturation level and pulse rate, but also carboxyhemoglobin, or carbon monoxide levels in the blood, and methemoglobin saturation levels in the blood. Along with the release of our Masimo Rainbow SET Pulse CO-Oximetry products, we have developed multi-wavelength sensors that have the ability to monitor multiple parameters with a single sensor.

We have focused on building our U.S. and international sales and marketing infrastructure to market our products to end-users, such as hospitals, and OEM partners for incorporation into their patient-monitoring products. We market our pulse oximetry products to hospitals and the EMS market through our direct sales force, and market our circuit boards to our OEM partners. Today, the primary focus of our hospital sales force is to facilitate the conversion of hospitals to our Masimo SET or Masimo Rainbow SET products. In the United States, we typically enter into long-term sales contracts with hospitals, pursuant to which we ship and install our pulse oximeters at no cost to the hospital in exchange for a commitment to purchase a minimum number of sensors from us over a specified period of time. With the introduction of Masimo Rainbow SET Pulse CO-Oximetry, we have established a small sales force to concentrate on the EMS market. Over the past two years, we have expanded our hospital sales force, including clinical specialists, from 50 employees at December 31, 2004 to 129 employees as of December 31, 2006. We supplement our direct sales with sales through our distributors. During this

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two year period, direct and distributor sales have increased to approximately $104.0 million, or 67.1%, of product revenues for 2006, from $40.6 million, or 58.7%, of product revenues in 2004. We expect the percentage of our revenue from direct sales to continue to increase as we expand our worldwide direct sales force.

The building of our installed base of pulse oximeters, circuit boards and adapter cables generates recurring sales of our consumables, primarily single-patient use sensors. A user of one of our pulse oximeters or our OEMs pulse oximeters can obtain the benefit of the Masimo SET or Masimo Rainbow SET only by using our proprietary sensors that are designed for our system. We estimate that our worldwide installed base was approximately 449,000 units as of December 31, 2006, up from 342,000 units as of December 31, 2005. We estimate our installed base to be the number of pulse oximeters and circuit boards that we have shipped in the past seven years and the number of adapter cables that we have shipped in the past two years.

We currently manufacture bedside and handheld pulse oximeters, a full line of single-patient use and reusable sensors and patient cables. We use third-party contract manufacturers for some of our products and components that can be more efficiently manufactured by these parties, primarily circuit boards, cables and plastics for instrument housings. We perform incoming inspection, final assembly and testing of any products or subassemblies manufactured by third-party contract manufacturers to assure quality control.

Masimo Laboratories, Inc.

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

Under the Cross-Licensing Agreement, we granted Masimo Labs an exclusive, perpetual and worldwide license, with sublicense rights to use all Masimo SET owned by us, including all improvements on this technology, for the measurement of non-vital signs parameters and to develop and sell devices incorporating Masimo SET for monitoring non-vital signs parameters in any product market in which a product is intended to be used by a patient or pharmacist rather than a professional medical caregiver, which we refer to as the Labs Market. We also granted Masimo Labs a non-exclusive, perpetual and worldwide license, with sublicense rights to use all Masimo SET for the measurement of vital signs in the Labs Market.

Vital signs parameters include peripheral venous oxygen saturation, arterial oxygen saturation, or SpO2, mixed venous oxygen saturation, fetal oximetry, sudden infant death syndrome, electrocardiogram, or ECG, blood pressure (non-invasive blood pressure, invasive blood pressure and continuous non-invasive blood pressure), temperature, respiration rate, carbon dioxide, or CO2, pulse rate, cardiac output, electroenchephalogram, or EEG, perfusion index, depth of anesthesia, cerebral oximetry, tissue oximetry and/or electromyography, or EMG, and associated features derived from these parameters, such as 3-D alarms, Pleth Variability Index and other features. Non-vital signs parameters are body fluid constituents other than vital signs parameters, and include, but are not limited to, carbon monoxide, methemoglobin, glucose, total hemoglobin and bilirubin.

We exclusively license from Masimo Labs the right to make and distribute products in the Masimo Market that utilize Rainbow technology for the measurement of carbon monoxide, methemoglobin, fractional arterial oxygen saturation, and total hemoglobin, which includes hematocrit. To date, we have

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developed and commercially released devices that measure carbon monoxide and methemoglobin using licensed Rainbow technology. We also have the option to obtain the exclusive license to make and distribute products that utilize Rainbow technology for the measurement of other non-vital signs parameters, including blood glucose, in product markets where the product is intended to be used by a professional medical caregiver.

From May 1998 through December 2006, Masimo Labs contracted the services of our employees for the development of Rainbow technology. We paid Masimo Labs for the option to market and develop products based on Masimo Labs technology in defined markets. Through December 2005, we had paid Masimo Labs $7.5 million in option fees and nearly all these option fees were used by Masimo Labs to repay us for the services that we had provided to Masimo Labs. In addition, through December 2006, we exercised two licenses, for $2.5 million each, for the right to market products based on the new carbon monoxide and methemoglobin parameter technologies developed by Masimo Labs. As of December 31, 2006, $3.6 million out of the $5.0 million in fees had been used by Masimo Labs to repay us for the shared engineering and other services that we provided to Masimo Labs. We also entered into a Services Agreement with Masimo Labs to govern the services we will provide to Masimo Labs going forward, effective as of January 1, 2007. As part of the Cross-Licensing Agreement, we exercised an additional license for total hemoglobin for a fee of $2.5 million.

The Cross-Licensing Agreement requires us to pay certain royalties on products incorporating the licensed Rainbow technology. The royalty is up to 10% of the Rainbow royalty base, which will include handhelds, tabletop and multi-parameter devices. Handheld products incorporating Rainbow technology will carry a 10% royalty rate. For other products, only the proportional amount attributable for that portion of our products used to measure non-vital sign parameters, sensors and accessories, rather than for measuring vital sign parameters, will be included in the 10% Rainbow royalty base. For multi-parameter devices, the Rainbow royalty base will include the percentage of the revenues based on the number of Rainbow-enabled parameters. Beginning in 2009, for hospital contracts where we place equipment and enter into a sensor contract, we will pay a royalty to Masimo Labs on the total sensor contract revenues based on the ratio of Rainbow enabled devices to total devices.

We are also subject to certain specific annual minimum aggregate royalty payments. These minimum aggregate royalty payments are $3.15 million, $3.5 million, $4.0 million and $5.0 million in the years ended 2007, 2008, 2009 and 2010, respectively, and $5.0 million per year thereafter. In addition, in connection with a change in control, as defined in the Cross-Licensing Agreement, the minimum aggregate annual royalties for all licensed Rainbow parameters payable to Masimo Labs will increase to $5.0 million, $7.0 million, $10.0 million and $15.0 million in the years ending 2007, 2008, 2009 and 2010, respectively, and $15.0 million per year thereafter, and up to $2.0 million per year for each additional Rainbow parameter.

Pursuant to Financial Accounting Standards Board Interpretation No. 46(R), *Consolidation of Variable Interest Entities an Interpretation of ARB No. 51,* or FIN 46(R), Masimo Labs is consolidated within our financial statements for all periods presented. Accordingly, all inter-company royalties, option and license fees and other charges between us and Masimo Labs have been eliminated in the consolidation. Also in accordance with FIN 46(R), all direct engineering expenses that have been incurred by us and charged to Masimo Labs have not been eliminated and are included as research and development expense in our consolidated statements of operations. For additional discussion of Masimo Labs, see Note 4 to the Notes to Consolidated Financial Statements.

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Nellcor Patent Litigation Settlement

In October 1999, we filed a patent infringement lawsuit in the United States District Court for the Central District of California against Mallinckrodt, Inc., now part of Tyco Healthcare, and one of its subsidiaries, Nellcor Puritan Bennett, Inc., collectively referred to as Nellcor. Nellcor is one of the largest manufacturers and distributors of pulse oximetry products in the world. The lawsuit was filed for infringement of our pulse oximetry signal processing patents. Nellcor denied our claims and made counterclaims alleging infringement of its patents by us. This lawsuit resulted in a jury verdict that Nellcor had infringed several of our patents, including one of our read-through motion pulse oximeter patents. In September 2005, the U.S. Federal Court of Appeals ruled that Nellcor infringed several Masimo patents and ordered the lower court to enjoin Nellcor s infringing products. Prior to the issuance of a permanent injunction, Nellcor entered into a settlement agreement with us on January 17, 2006, under which we agreed to settle all pending patent litigation with Nellcor. In return, Nellcor agreed to pay us $263.0 million for damages incurred through January 2006. We granted Nellcor a covenant not to sue on certain new products and Nellcor agreed to pay us royalties on its total U.S. pulse oximetry revenue at least through March 14, 2011. In addition, in January 2006, Nellcor made an advance royalty payment to us of $67.5 million for estimated sales of its products in the United States during the remainder of calendar 2006. In total, we have received $330.5 million in cash from Nellcor pursuant to the settlement agreement.

We recorded the $263.0 million lump sum payment as patent lawsuit proceeds in January 2006 and we recognized approximately $68.8 million of royalty revenue in 2006. We recognize royalty revenue based on the estimated average royalty rate per the settlement agreement multiplied by our estimate of Nellcor s sales for each quarter. This estimate is adjusted when we receive the Nellcor royalty report, 60 days after the end of each quarter. Per our settlement agreement, the 2006 royalty rate will decline significantly and, as a result, we expect our future Nellcor royalties to be significantly below the levels recognized in 2006.

Cash Dividends and Special Bonus Payments

In March 2006, we paid a cash dividend of $10.096 per share, in the aggregate amount of approximately $171.8 million, to holders of our common and preferred stock. Of this amount, $21.7 million relates to dividend payments made to stockholders who exercised stock options by delivering us a promissory note. In accordance with Emerging Issues Task Force, or EITF, 95-16, the $21.7 million in cash dividends have been classified as compensation expense in the accompanying consolidated financial statements, under cost of goods sold, research and development and selling, general and administrative expenses. In February 2007, we paid additional cash dividends of $1.404 per share and $0.77 per share, in the aggregate amount of approximately $37.1 million, to holders of our common and preferred stock. In March 2006 and March 2007, we also made special bonus payments in the aggregate amount of approximately $9.7 million and $2.0 million, respectively, to our employees and directors who held vested stock options as of March 1, 2006. These cash dividends and special bonus payments were made from the after-tax proceeds that we received from our patent infringement lawsuit against Nellcor and interest earned thereon. We do not intend to distribute any future royalties received from Nellcor under the settlement agreement to our stockholders or our option holders.

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The following table identifies the 2006 activity in dividends payable and convertible preferred stock resulting from the accretion, dividends declared and dividends paid during 2006.

	Dividends Payable	Convertible Preferred Stock
	(in thousands)	
Balance as of December 31, 2005	$	$ (143,959)
Accretion of redemption value on convertible preferred stock		(7,985)
Dividends declared:		
Reclassification of cumulative dividends accreted to dividends payable	(63,616)	63,616
Common shares securing the outstanding non recourse notes	(21,673)	
Dividends declared in excess of (i) amounts previously accreted to holders of preferred stock and (ii) amount included in stock compensation expense	(123,620)	
Total dividends declared	(208,909)	63,616
Dividends paid in 2006[1]	171,376	
Balance as of December 31, 2006	$ (37,533)	$ (88,328)

(1) Dividends paid of $149,703 reflected on the Consolidated Statements of Cash Flows for the year ended December 31, 2006 represents the total dividend payment of $171,376 less the amount of $21,673 included in stock compensation expense.

The following is stock-based compensation expense for the year ended December 31, 2006 associated with the dividend and special bonus payment discussed above, as well as related to implementation of FASB 123(R) and other stock related compensation.

	Cost of Goods Sold	Research and Development	Selling, General and Administrative	Total
	(in thousands)			
Dividends declared on common shares securing the outstanding non recourse notes	$ 308	$ 5,101	$ 16,264	$ 21,673
Special bonus payments to holders of vested options to purchase common stock	1,822	3,990	5,900	11,712
Stock option compensation pursuant to adoption of SFAS 123(R)	249	287	794	1,330
Other			355	355
	$ 2,379	$ 9,378	$ 23,313	$ 35,070

Tyco Healthcare Antitrust Litigation

In May 2002, we filed a lawsuit against Tyco Healthcare, parent company of Nellcor, in the United States District Court for the Central District of California, alleging damage to our business as a result of the anti-competitive business practices of Tyco Healthcare in connection with its Nellcor pulse oximetry brand in violation of federal antitrust laws. Specifically, we alleged that we had incurred damages as a result of a series of illegal exclusionary and anti-competitive acts by Tyco Healthcare that were designed to maintain its monopoly in the pulse oximetry market.

In March 2005, a jury found that Tyco Healthcare s use of sole-source contracts, product bundling, market share-based compliance pricing contracts and co-marketing agreements with patient monitoring companies were unlawful restraints of trade and exclusionary dealing arrangements and, as a result, violated federal antitrust laws. The jury awarded us $140.0 million in damages. Under the antitrust laws,

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if the jury verdict is sustained in whole or in part, any damages that are sustained are trebled. Tyco Healthcare filed post-trial motions requesting that the District Court either override the jury decision or grant a new trial. In March 2006, the District Court upheld a portion of the jury verdict and vacated the remaining verdict. In addition, the District Court vacated the jury s damages award and granted Tyco Healthcare a new trial on damages. The District Court held an evidentiary hearing in October 2006 to re-try the damages. On January 25, 2007, the District Court issued a preliminary ruling which did not set damages, but resolved some issues of dispute about damages, and ordered another evidentiary hearing on issues still undecided by the District Court. The District Court held this evidentiary hearing in March 2007. No final ruling from the District Court on the issue of damages has been rendered; however, the effect of the post trial orders from the District Court was to substantially reduce the damages to be awarded, if any damages are ultimately awarded to us by the District Court. Even if we are ultimately awarded damages in this litigation, the amount will be subject to a 50% legal fee contingency agreement, in which case we would receive 50% of the net (of costs) proceeds from the award. Even though most of the legal expenses to date have been on a contingency basis, we expect to incur expenses related to the appellate work, which will be treated as general and administrative expense as incurred.

Revenue and Expense Components

The following is a description of the primary components of our revenue and expenses:

Revenue. Our product revenue consists primarily of sales of consumables, including sensors and cables, circuit boards and pulse oximeters. We sell our consumables and circuit boards to our OEM partners and, pursuant to our OEM agreements, typically recognize revenue upon shipment. We also sell consumables and pulse oximeters directly through our sales force and, based on individual contracts, typically recognize revenue upon shipment. Sales to our distributors are recognized upon the sell-through of our products by our distributors, rather than upon shipment. In the United States, we have long-term contracts with hospitals under which we typically ship and install our pulse oximeters at hospitals at no cost to the hospital in exchange for commitments by the hospital to purchase a minimum number of sensors from us over a specified period of time. In these cases, we do not recognize any revenue at the time the equipment is installed at the hospital. Rather, pursuant to our revenue recognition policy, we recognize revenue as we ship sensors in accordance with the contract.

Our royalty revenue consists of royalties associated with our January 2006 patent infringement settlement with Nellcor. Pursuant to the settlement agreement, we will receive quarterly royalty payments based on the amount of Nellcor s U.S. pulse oximetry revenues. A predetermined royalty rate will be applied against the amount of Nellcor s U.S. oximetry sales and this will determine the amount of royalties we will be paid. Under terms of the agreement, the royalty rates decline from 20% in 2006 to a range of 12% to 15% in 2007 and then to a range of 10% to 12% in each year throughout the remainder of the settlement agreement. As a result of these declining royalty rates, we anticipate that 2006 will represent the highest level of annual royalties that we will earn under this settlement agreement.

Cost of Goods Sold. We manufacture a substantial majority of the products that we sell. Our cost of goods sold includes material and component costs, direct labor and other direct and indirect manufacturing overhead costs. We recognize cost of goods sold when we recognize revenue for the transaction. For equipment placed with a customer pursuant to a long-term sales contract, we capitalize the cost of the equipment shipped as deferred cost of goods sold and amortize the cost to cost of goods sold on a straight-line basis over the term of the contract. In addition, pursuant to our Cross-Licensing Agreement, we are required to pay certain royalties on products incorporating the licensed Rainbow technology.

Research and Development. Our research and development expenses consist primarily of costs associated with the design, development, enhancement and testing of new and existing products. These

expenses include personnel costs, the cost of materials, supplies and services and an allocation of facility and overhead costs. Through December 31, 2006, an aggregate of $10.5 million of our historical research and development expenses were attributable to research and development activities performed by Masimo Labs. However, pursuant to FIN 46(R), Masimo Labs is consolidated within our financial statements and, as a result, these research and development expenses are included in these consolidated financial statements.

Selling, General and Administrative. Selling, general and administrative expenses consist primarily of salaries, promotional, training, trade show, professional fees, facility costs and travel and entertainment expenses. We expect our selling, general and administrative expenses will continue to increase as we continue to build our selling, general and administrative organizations and as we become subject to the additional costs associated with being a public company. Through December 31, 2006, an aggregate of $700,000 of our selling, general and administrative expenses were attributable to Masimo Labs.

Interest Income (Expense) and Other, Net. Interest income (expense) and other, net is comprised of interest income from our cash and cash equivalents and interest expense on our debt and term loans. Other expense typically consists of gains or losses on sales of fixed assets.

Provision for (Benefit from) Income Taxes. Provision for (benefit from) income taxes is comprised of federal, state, local and foreign taxes based on income.

Patent Litigation. Patent litigation expenses, which we report separately from selling, general and administrative expenses, consist of external legal costs exclusively related to our patent infringement lawsuit against Nellcor, which we settled in January 2006. See Business Nellcor Patent Litigation Settlement. We expect future patent litigation expenses that are unrelated to our patent litigation against Nellcor will be classified as selling, general and administrative expenses.

Purchased In-Process Research and Development. Purchased in-process research and development is related to the value assigned to those projects acquired in business combinations or in the acquisition of assets for which the related products have not received regulatory approval or have no alternative future use.

Accretion of Preferred Stock. Accretion of preferred stock represents the increase in carrying value of the convertible preferred stock for accrued dividends and direct offering costs. Accretion is recorded as a reduction to net income (loss) attributable to common stockholders.

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Results of Operations

The following table sets forth, for the periods indicated, our results of operations expressed as dollar amounts and as a percentage of revenues. The patent lawsuit proceeds and the royalty received from Nellcor in the first three months of 2006 have significantly affected our revenues, results of operations and financial position. Accordingly, our results of operations for the year ended December 31, 2006 are difficult to compare to our results of operations for the year ended December 31, 2005 and our results of operations for the three months ended March 31, 2006 are difficult to compare to the three months ended March 31, 2007.

	Year ended December 31,						Three months ended March 31,			
	2004	% of Revenue	2005	% of Revenue	2006	% of Revenue	2006 (unaudited)	% of Revenue	2007 (unaudited)	% of Revenue
	(in thousands, except percentages)									
Revenue:										
Product	$ 69,069	99.6%	$ 107,613	99.7%	$ 155,131	69.2%	$ 34,679	70.3%	$ 45,764	77.6%
Royalty and license fee	288	0.4	277	0.3	69,207	30.8	14,627	29.7	13,190	22.4
Total revenue	69,357	100.0	107,890	100.0	224,338	100.0	49,306	100.0	58,954	100.0
Cost of goods sold	29,354	42.3	42,717	39.6	61,640	27.5	16,138	32.7	16,901	28.7
Gross profit	40,003	57.7	65,173	60.4	162,698	72.5	33,168	67.3	42,053	71.3
Operating expenses:										
Research and development	6,044	8.7	8,548	7.9	24,875	11.1	11,794	23.9	5,454	9.3
Selling, general and administrative	30,118	43.4	43,085	39.9	91,493	40.8	36,139	73.3	21,412	36.3
Patent litigation	6,204	8.9	1,736	1.6	60	0.0		0.0		0.0
Purchased in-process research and development		0.0	2,800	2.6		0.0		0.0		0.0
Total operating expenses	42,366	61.1	56,169	52.1	116,428	51.9	47,933	97.2	26,866	45.6
Operating income (loss)	(2,363)	(3.3)	9,004	8.4	46,270	20.6	(14,765)	(29.9)	15,187	25.8
Non-operating income (expense):										
Patent lawsuit proceeds, net		0.0		0.0	262,665	117.1	262,665	532.7		0.0
Interest income	107	0.2	224	0.2	6,741	3.0	2,659	5.4	355	0.6
Interest expense	(1,434)	(2.1)	(1,851)	(1.7)	(1,824)	(0.8)	(505)	(1.0)	(427)	(0.7)
Other	8	0.0	(8)	0.0	551	0.2	99	0.2	41	0.1
Total non-operating income (expense)	(1,319)	(1.9)	(1,635)	(1.5)	268,133	119.5	264,918	537.3	(31)	(0.1)
Income (loss) before provision for (benefit from) income taxes	(3,682)	(5.2)	7,369	6.9	314,403	140.1	250,153	507.3	15,156	25.7
Provision for (benefit from) income taxes	161	0.2	(26,012)	(24.1)	132,577	59.1	105,456	213.9	6,059	10.3
Net income (loss)	(3,843)	(5.5)	33,381	30.9	181,826	81.0	144,697	293.5	9,097	15.4
Preferred stock dividend		0.0		0.0	(77,785)	(34.7)	(58,571)	(118.8)		0.0
Accretion of preferred stock	(8,477)	(12.2)	(8,278)	(7.7)	(7,985)	(3.6)	(2,117)	(4.3)	(1,956)	(3.3)
Undistributed income attributable to preferred stockholders		0.0	(19,599)	(18.2)	(34,275)	(15.3)	(34,783)	(70.5)	(4,828)	(8.2)
Net income (loss) attributable to common stockholders	$ (12,320)	(17.7)%	$ 5,504	5.0%	$ 61,781	27.4%	$ 49,226	99.8%	$ 2,313	3.9%

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Comparison of the Three Months ended March 31, 2007 to the Three Months ended March 31, 2006

Revenue. Total revenue increased 19.6% to $59.0 million for the three months ended March 31, 2007 from $49.3 million for the three months ended March 31, 2006.

Product revenues increased 32.0% to $45.8 million in the three months ended March 31, 2007 from $34.7 million for the three months ended March 31, 2006. This increase was primarily due to higher consumable sales resulting from an increase in our installed base of circuit boards, pulse oximeters and adapter cables, which together generated additional revenue for cables and sensors, to 478,000 at March 31, 2007 from 368,000 at March 31, 2006. Revenue generated by our direct sales channel and distribution channel increased 41.1% to $33.3 million for the three months ended March 31, 2007, while revenues from our OEM channel increased by 12.4% to $1.4 million. Our Rainbow technology product revenue increased to $1.2 million in the three months ended March 31, 2007 from $344,000 in the three months ended March 31, 2006.

Our royalty and license fee revenue decreased to $13.2 million in the three months ended March 31, 2007 from $14.6 million in the three months ended March 31, 2006, primarily due to a lower royalty rate associated with our 2006 settlement agreement with Nellcor. For the three months ended March 31, 2007, our reported Nellcor royalties are based upon our estimate of Nellcor s U.S. pulse oximeter sales for that period. In the event that our quarterly estimate differs from their actual quarterly sales, there will be a required adjustment which will be in the following fiscal quarter.

Cost of Goods Sold. Cost of goods sold increased 4.7% to $16.9 million in the three months ended March 31, 2007 from $16.1 million in the three months ended March 31, 2006. Our gross margin increased to 71.3% for the three months ended March 31, 2007 from 67.3% for the three months ended March 31, 2006. The improvement in gross margin was due to a special bonus payment of $1.8 million and an increase in our provision for obsolete inventory of $620,000 in the three months ended March 31, 2006. These improvements were offset by lower royalty revenues from Nellcor of $1.4 million in the three months ended March 31, 2007.

Research and Development. Research and development expenses decreased 53.8% to $5.5 million for the three months ended March 31, 2007, from $11.8 million for the three months ended March 31, 2006. The prior year expense included a charge of $8.3 million in stock-based compensation associated with the dividend and special bonus payments. Notwithstanding that charge, research and development expenses increased $1.3 million due to increased payroll and payroll related costs associated with increased research and development staffing levels which rose from 69 at March 31, 2006 to 115 at March 31, 2007. Included in total research and development expenses are $259,000 and $831,000 of engineering expenses incurred by Masimo Labs for the three months ended March 31, 2007 and 2006, respectively.

Selling, General and Administrative. Selling, general and administrative expenses decreased 40.8% to $21.4 million for the three months ended March 31, 2007, from $36.1 million in the three months ended March 31, 2006, which included a $21.0 million charge in stock-based compensation associated with the dividend and special bonus payments. Notwithstanding that charge, selling, general and administrative expenses increased a total of $6.3 million, which was primarily due to a $2.6 million increase in staffing which rose from 219 at March 31, 2006 to 305 at March 31, 2007. Additional increased spending was attributable to $1.2 million in marketing related expenses, including trade show costs and product samples, $1.1 million in travel and entertainment expenses and $1.0 million in professional service fees. Included in these total selling, general and administrative expenses are $99,000 and $47,000 of expenses incurred by Masimo Labs for the three months ended March 31, 2007 and 2006, respectively.

Patent Lawsuit Proceeds, Net. Patent lawsuit proceeds, net were $262.7 million for the three months ended March 31, 2006. This was a result of proceeds from the patent settlement with Nellcor of $263.0 million, less current and related legal fees of $300,000. There were no such proceeds for the three months ended March 31, 2007.

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Interest Income (Expense) and Other, Net. Interest income (expense) and other, net was $31,000 of expense for the three months ended March 31, 2007, compared to $2.3 million of income for the three months ended March 31, 2006. This change was primarily due to the decrease in interest income of $2.3 million, resulting from lower cash balances in 2007.

Provision for (Benefit from) Income Taxes. Our provision for income taxes was $6.1 million for the three months ended March 31, 2007, compared to $105.5 million for the three months ended March 31, 2006. This decrease in the provision was primarily due to a decrease in our taxable income which resulted from the proceeds from the patent settlement during the three months ended March 31, 2006.

Accretion of Preferred Stock. Accretion of preferred stock decreased to $2.0 million for the three months ended March 31, 2007, from $2.1 million for the three months ended March 31, 2006. This decrease was due to the reduction in the accretion of the offering costs. The accretion represents the increase in the carrying value primarily for dividends on our redeemable Series B, Series C, Series D, Series E, Series F and Series G preferred stock in accordance with the purchase agreements for such securities.

Comparison of the Year ended December 31, 2006 to the Year ended December 31, 2005

Revenue. Total revenue increased 107.9% to $224.3 million for the year ended December 31, 2006 from $107.9 million for the year ended December 31, 2005. A significant portion of the increase in revenue was due to fiscal 2006 royalties of $68.8 million related to the Nellcor settlement agreement.

Product revenues increased 44.2% to $155.1 million in the year ended December 31, 2006, from $107.6 million for the year ended December 31, 2005. This increase was primarily due to an increase in our installed base of circuit boards, pulse oximeters and adapter cables, which together generate additional demand for cables and sensors, from 342,000 at December 31, 2005 to 449,000 at December 31, 2006. Revenue generated by our direct sales channel and distribution channel increased 50.5% to $104.0 million for the year ended December 31, 2006, while revenues from our OEM channel increased by 33.8% to $51.5 million. We began selling Rainbow products in 2005 and generated $3.7 million in sales from these products in 2006 compared to $700,000 in 2005.

Our royalty and license fee revenue increased from $277,000 in 2005 to $69.2 million in 2006, primarily due to royalties received from Nellcor under the terms of our settlement agreement.

Cost of Goods Sold. Cost of goods sold increased 44.3% to $61.6 million for the year ended December 31, 2006, from $42.7 million for the year ended December 31, 2005. Our gross margin increased to 72.5% for the year ended December 31, 2006, from 60.4% for the year ended December 31, 2005. This increase in gross margin was due to the Nellcor royalty revenue of $68.8 million, which was partially offset by $2.1 million of special bonus payments and $249,000 of stock-based compensation expense. Notwithstanding the Nellcor royalty and stock-based compensation, our product margins improved due to a high percentage of revenue from our sensor products combined with higher realized circuit board margins and the impact of higher Rainbow product revenues.

Research and Development. Research and development expenses increased 191.0% to $24.9 million for the year ended December 31, 2006, from $8.5 million for the year ended December 31, 2005. The $24.9 million included a charge of $9.4 million in stock-based compensation associated with the dividend and special bonus payments. Notwithstanding that charge, research and development expenses increased $5.3 million due to increased payroll and payroll related costs associated with increased research and development staffing levels. Research and development staffing increased from 65 at December 31, 2005 to 98 at December 31, 2006. Included in these total research and development expenses are $3.4 million and $2.6 million of engineering expenses incurred by Masimo Labs for the years ended December 31, 2006 and 2005, respectively.

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Selling, General and Administrative. Selling, general and administrative expenses increased 112.4% to $91.5 million for the year ended December 31, 2006, from $43.1 million in the year ended December 31, 2005. The $48.4 million increase included a charge of $23.3 million in stock-based compensation associated with the dividend and special bonus payments. Notwithstanding that charge, selling, general and administrative expenses increased $12.3 million due to increased selling, general and administrative staffing. Selling, general and administrative staffing increased from 201 at December 31, 2005 to 292 at December 31, 2006. Additional increased spending was attributable to $3.4 million in travel and entertainment expenses and $1.5 million in employee recruiting and training activities. Included in these total selling, general and administrative expenses are $147,000 and $147,000 of activities performed by Masimo Labs for the years ended December 31, 2006 and 2005, respectively.

Patent Litigation. Litigation expenses for our patent infringement lawsuit against Nellcor decreased 96.5% to $60,000 for the year ended December 31, 2006, from $1.7 million for the year ended December 31, 2005. This decrease was primarily due to the settlement of the patent litigation in January 2006.

Purchased In-Process Research and Development. We did not incur any charges related to purchased in-process research and development in 2006. As a result of our December 2005 acquisition of Andromed, we incurred purchased in-process research and development expenses of $2.8 million in 2005.

Patent Lawsuit Proceeds, Net. Patent lawsuit proceeds, net were $262.7 million for the year ended December 31, 2006. This was a result of proceeds from the patent settlement with Nellcor of $263.0 million, less current and related legal fees of $300,000. There were no proceeds for the year ended December 31, 2005.

Interest Income (Expense) and Other, Net. Interest income (expense) and other, net was $5.5 million of income for the year ended December 31, 2006, compared to $1.6 million of expense for the year ended December 31, 2005. This change was primarily due to the increase in interest income of $6.5 million from the investment of the settlement proceeds during the year ended December 31, 2006.

Provision for (Benefit from) Income Taxes. Our provision for income taxes was $132.6 million for the year ended December 31, 2006, compared to a net benefit from income taxes of $26.0 million for the year ended December 31, 2005. This increase in provision was primarily due to an increase in our taxable income which resulted from both the income from the patent settlement and improved operating results during the year ended December 31, 2006. In addition, the net benefit from income taxes of $26.0 million for the year ended December 31, 2005 was primarily due to the reversal of all federal and state deferred tax valuation allowances.

Accretion of Preferred Stock. Accretion of preferred stock decreased to $8.0 million for the year ended December 31, 2006, from $8.3 million for the year ended December 31, 2005. This was due to the reduction in the accretion of the offering costs. The accretion represents the increase in the carrying value of our redeemable Series B, Series C, Series D, Series E, Series F and Series G preferred stock based on our certificate of incorporation, which requires the accretion of specific dividends and direct costs of issuing such securities. The accretion for each of Series B through G preferred stock began when such series was initially issued. In 2006, as a result of the dividend declarations made to stockholders in February 2006 and December 2006, all previous accretion for all Series B through Series G preferred stock was reclassified to dividends payable.

Comparison of the Year ended December 31, 2005 to the Year ended December 31, 2004

Revenue. Total revenue increased 55.6% to $107.9 million for the year ended December 31, 2005, compared to $69.4 million for the year ended December 31, 2004. During the 2005, we increased our

installed base of circuit boards, pulse oximeters and adapter cables, which together generate the additional demand for cables and sensors, by 44.3% to 342,000 at December 31, 2005, as compared to 237,000 at December 31, 2004. The increase in our installed base resulted in an increase in sales of our product revenues, which rose to $107.6 million in 2005 from $69.1 million in 2004. Revenues generated by our direct and distribution channels increased 69.0% to $69.1 million in 2005, while revenues from our OEM channel increased by 36.6% to $38.5 million. In 2005, we introduced our new Rainbow technology product, the Rad-57, which accounted for $700,000 of 2005 revenue.

Cost of Goods Sold. Cost of goods sold increased 45.5% to $42.7 million for the year ended December 31, 2005, from $29.4 million for the year ended December 31, 2004. Our gross margins increased to 60.4% in 2005 from 57.7% in 2004. This increase was primarily due to increased sales of consumable products and higher margins realized on these products.

Research and Development. Research and development expenses increased 41.4% to $8.5 million for the year ended December 31, 2005, from $6.0 million for the year ended December 31, 2004. This was primarily due to increases in payroll and related expenses of $1.0 million resulting from the addition of research and development personnel, $500,000 of licensing expense and $400,000 of additional equipment and supplies to support product development activities. Included in these total research and development expenses are $2.6 million and $2.0 million of activities performed by Masimo Labs in the years ended December 31, 2005 and 2004, respectively.

Selling, General and Administrative. Selling, general and administrative expenses increased 43.1% to $43.1 million for the year ended December 31, 2005, from $30.1 million for the year ended December 31, 2004. This increase was primarily due to increases in personnel costs of $7.3 million, legal fees of $1.0 million, travel and related expenses of $930,000, group purchasing organization fees of $635,000 and employee recruiting and training of $640,000. Higher personnel costs were due to a 52.3% increase in headcount at December 31, 2005 from December 31, 2004, primarily as a result of our increased focus on direct sales. Included in these selling, general and administrative expenses are $147,000 and $100,000 of activities performed by Masimo Labs for the years ended December 31, 2005 and 2004, respectively.

Patent Litigation. Litigation expenses for our patent infringement lawsuit against Nellcor decreased 72.0% to $1.7 million for the year ended December 31, 2005, from $6.2 million for the year ended December 31, 2004. This decrease was primarily due to legal fees related to the 2004 jury trial for the Nellcor patent infringement lawsuit. In 2005, the costs were primarily related to the appeal of the jury verdict and subsequent settlement discussions.

Purchased In-Process Research and Development. As a result of our December 2005 acquisition of Andromed, we incurred purchased in-process research and development expense of $2.8 million in 2005. We did not incur any charges related to purchased in-process research and development in 2004.

Interest Income (Expense) and Other, Net. Interest income (expense) and other, net increased to $1.6 million of expense for the year ended December 31 2005, from $1.3 million of expense for the year ended December 31, 2004, due to an increase of interest expense of $417,000 caused by a higher principal balance on our long-term debt. This was partially offset by an increase of interest income of $117,000 from higher cash balances.

Provision for (Benefit from) Income Taxes. Our net benefit from income taxes was $26.0 million for the year ended December 31, 2005, compared to a provision for income taxes of $161,000 for the year ended December 31, 2004. As a result of the Nellcor settlement, we determined that a full valuation allowance against our net U.S. deferred tax assets was unnecessary. Therefore, during the fourth quarter of 2005, we recorded a reversal of all federal and state deferred tax valuation allowances.

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Accretion of Preferred Stock. Accretion of preferred stock decreased to $8.3 million for the year December 31, 2005, from $8.5 million for the year December 31, 2004, due to the extension of the redemption date of our convertible preferred stock from December 2005 to June 2006. The accretion represents the increase in the carrying value of our Series B, Series C, Series D, Series E, Series F and Series G convertible preferred stock for accrued dividends and direct offering costs. The accretion for each series of preferred stock began when such series was initially issued.

Quarterly Results of Operations

The following table sets forth unaudited selected quarterly operating results for the two years ended December 31, 2006 and the three months ended March 31, 2007. We believe that the following selected quarterly information includes all adjustments that consist only of normal, recurring adjustments that we consider necessary to present this information fairly. This financial information should be read in conjunction with our financial statements and related notes appearing in this prospectus. Our results of operations have fluctuated in the past and are likely to continue to fluctuate significantly from quarter to quarter in the future. Therefore, results of operations for any previous periods are not necessarily indicative of results of operations to be recorded in the future.

	For the three months ended								
	March 31, 2005	June 30, 2005	September 30, 2005	December 31, 2005	March 31, 2006	June 30, 2006	September 30, 2006	December 31, 2006	March 31, 2007
	(in thousands, except per share data)								
	(unaudited)								
Revenue	$ 24,782	$ 26,290	$ 27,606	$ 29,212	$ 49,306	$ 55,774	$ 57,646	$ 61,612	$ 58,954
Gross profit	15,013	16,038	16,350	17,772	33,168	40,818	42,942	45,770	42,053
Operating income (loss)	3,693	3,775	3,289	(1,753)	(14,765)	22,496	20,301	18,238	15,187
Net income	2,922	3,117	2,555	24,787	144,697	13,923	12,296	10,910	9,097
Net income attributable to common stockholders[2]	$ 176	$ 228	$ 117	$ 5,062	$ 49,226	$ 4,496	$ 3,974	$ 3,497	$ 2,313
Net income per common share[1][3]:									
Basic	$ 0.06	$ 0.07	$ 0.04	$ 1.53	$ 9.54	$ 0.82	$ 0.72	$ 0.63	$ 0.42
Diluted	$ 0.05	$ 0.06	$ 0.03	$ 1.04	$ 7.58	$ 0.66	$ 0.58	$ 0.51	$ 0.34
Pro forma net income per common share[2][4]:									
Basic					$ 8.67	$ 0.82	$ 0.72	$ 0.64	$ 0.53
Diluted					$ 8.03	$ 0.76	$ 0.67	$ 0.59	$ 0.49

(1) See Note 2 to the Notes to Consolidated Financial Statements for a description of the method used to compute basic and diluted net income (loss) per common share and basic and diluted pro forma net income per common share.

(2) The sum of the quarterly net income attributable to common stockholders for the years ended December 31, 2005 and 2006 do not equal the annual amounts due to differences in the weighted average common shares outstanding between the quarterly and annual computations.

(3) The sum of the quarterly basic net income per common share for the year ended December 31, 2006 and the sum of the diluted net income per common share for the years ended December 31, 2005 and 2006, do not equal the annual related per common share amounts due to differences in the weighted average common shares outstanding and the undistributed earnings allocation percentages between the quarterly and annual computations.

(4) The sum of the quarterly basic and diluted pro forma net income per common share for the year ended December 31, 2006 does not equal the annual related per common share amount due to differences in the weighted average common shares outstanding, between the quarterly and annual computations.

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In the fourth quarter of 2005, we incurred the write-off of $2.8 million in purchased in-process research and development expense related to the acquisition of Andromed. In addition, we expensed a previously capitalized license fee and incurred higher commission and tradeshow expenses than in prior fiscal 2005 quarters. The capitalized license fee related to two advance royalty payments totaling $500,000 that we made to a third party in June and November 2005 to assist the third party in developing a product of interest to us. We had the option to convert the advanced royalty payments into equity of the third party and, as a result, we capitalized these payments. Shortly after we made the second advanced royalty payment to the third party, however, we acknowledged that the product would not be developed by the third party and we determined that it would be unfeasible for us to convert our advanced royalty payments into equity of the third party. Accordingly, we concluded that the appropriate accounting treatment would be to write-off the advance royalty payment in the fourth quarter of 2005. The increase in fourth quarter net income was attributable to the reversal of the tax valuation allowance which had previously been established due to the uncertainty of future profitability.

In the first quarter of 2006, we recorded a $21.7 million compensation charge related to employee and non-employee directors exercise of stock options through the issuance of a promissory note, which required the payment of dividends on such shares to be treated as compensation expense. In addition, we recorded a $9.7 million charge related to a special bonus payment made to option holders who held vested shares on March 1, 2006. In total, these first quarter 2006 expenses amounted to $31.4 million and, without these charges, our first quarter 2006 operating income would have been $16.6 million. The significant increase in first quarter 2006 net income was due to the $263.0 million patent settlement with Nellcor. The first quarter 2006 net income attributable to common stockholders was impacted by the first quarter 2006 dividend declaration made to preferred stockholders. For further details on net income attributable to common stockholders, see Note 2 to the Notes to Consolidated Financial Statements.

In the fourth quarter of fiscal 2006, we declared an additional dividend of $37.1 million and incurred a $2.0 million special bonus charge related to a special bonus payment made to option holders who held vested options on March 1, 2006. In addition, we incurred higher tradeshow expenses and wrote off approximately $880,000 of previously capitalized initial public offering cost incurred in 2006 related to our discontinued 2006 registration statement process. The fourth quarter 2006 net income attributable to common stockholders was impacted by the fourth quarter 2006 dividend declaration to preferred stockholders. For further details on net income attributable to common stockholders, see Note 2 to the Notes to Consolidated Financial Statements.

Liquidity and Capital Resources

Since our inception, we have financed our operations primarily through the private sale of equity securities. As of March 31, 2007, we raised $81.7 million through seven preferred stock private equity financings, and $16.3 million through the exercise of stock options for a total of $98.0 million. Our most recent round of financing was completed in September 2001. As of March 31, 2007, we had cash and cash equivalents of $22.9 million.

Under the terms of our patent litigation settlement with Nellcor, Nellcor paid us $263.0 million for damages incurred through January 2006 and made an advance royalty payment to us of $67.5 million related to sales of Nellcor s products for the remainder of 2006. In total, we have received $330.5 million in cash from Nellcor through December 2006. In March 2006 and February 2007, we declared dividends in the aggregate amount of approximately $208.9 million to holders of our common and preferred stock. In addition, in March 2006 and March 2007, we made special bonus payments in the aggregate amount of approximately $11.7 million to our employees and directors who held vested stock options as of March 1, 2006. The majority of these cash dividends and special bonus payments were made from the after-tax proceeds that we received from our settlement with Nellcor and interest earned thereon. In the future, we do not intend to distribute any royalties received from Nellcor under the settlement agreement

to our stockholders or our option holders. For further details on the litigation settlement, see Business Nellcor Patent Litigation Settlement.

In the fourth quarter of 2005, we wrote off $2.8 million in purchased in-process research and development expense related to the acquisition of Andromed. We believe this technology will provide a platform from which new acoustic monitoring products can be developed. In the near term, we are utilizing the technology to develop a new acoustic respiratory monitoring device. The total duration of the development effort as measured since the date of acquisition is expected to take at least 27 months to complete a commercially viable product; the product is expected to be available for sale in 2008. Since January 2006 and through April 2007, we have incurred approximately $2.9 million in development efforts and plan to spend an additional $2.6 million to cover the remaining development costs through March 31, 2008. As a result, we currently project the total development costs to be approximately $5.5 million. Salary and related expenses are projected to account for approximately 69.8% of the total development expense and the remaining expenses include prototype, engineering, and outside services and facilities. If the technology is not successful or timely, the financial effects on us will be very small. To date, and until we receive 510(k) clearance from the FDA, all our development costs are being expensed into the period in which they are incurred. While this product would expand our market opportunity and allow us to accelerate revenue growth, we believe we can support our annual projected product revenue growth without this new product.

Cash Flows from Operating Activities. Cash used by operating activities was $4.4 million in the three months ended March 31, 2007. This consists primarily of an increase in royalties receivable of $11.8 million, related primarily to a royalty receivable from Nellcor. In addition, accounts receivable and deferred costs of goods sold rose by $5.0 million and $3.4 million, respectively, due to a growth in our business. This cash used was offset by our net income of $9.1 million and an increase in accounts payable of $3.8 million and income taxes payable of $3.1 million also resulting from overall growth and profitability of our business.

Cash provided by operating activities was $189.6 million in 2006. This consists primarily of our net income of $181.8 million, an increase in deferred revenue of $6.7 million resulting from growth of the business, an increase in the provision for deferred income taxes of $6.4 million, an increase in accrued compensation of $5.0 million, including a $2.0 million accrual for the special bonus, and depreciation and amortization of $3.7 million. This was offset by an increase in accounts receivable of $8.0 million, an increase in deferred cost of goods sold of $6.1 million and an increase in inventory of $5.0 million, all resulting from growth of the business.

In 2005, net cash provided by operating activities was $4.5 million, mainly due to net income of $33.4 million and an increase in deferred revenue of $3.0 million, offset by a benefit from deferred income taxes of $27.7 million which was a result of the reversal of the valuation allowance provided to reduce deferred tax assets, an increase in inventory of $5.2 million and deferred cost of goods sold of $3.6 million.

In 2004, cash used in operating activities was $5.1 million. In addition to our net loss of $3.8 million, the cash used was primarily due to an increase in deferred cost of goods sold of $5.1 million, an increase in inventory of $3.4 million and an increase in accounts receivable of $2.6 million, all due to growth of the business. This was offset by a $2.1 million increase in accounts payable primarily due to increased inventory and deferred cost of goods.

Cash Flows from Investing Activities. Cash used in investing activities for the three months ended March 31, 2007, was $1.6 million consisting of $1.3 million of property and equipment purchases and $335,000 for the increase in intangible assets, to support the growth of the business.

Cash used in investing activities in 2006 was $8.3 million primarily consisting of $5.9 million of property and equipment purchases and $1.3 million related to the Andromed acquisition. The property and equipment purchases included purchases of manufacturing equipment of $2.1 million, computer hardware and software of $1.2 million and leasehold improvements of $800,000, to support the growth of the business.

Cash used in investing activities in 2005 was $8.3 million consisting primarily of $5.2 million of property and equipment purchases and $2.0 million related to the Andromed acquisition. The property and equipment purchases include $2.3 million of manufacturing equipment, and $1.1 million of demonstration equipment.

Cash used in investing activities in 2004 was $3.8 million primarily due to $2.8 million of property and equipment purchases, to support the growth of the business.

Cash Flows from Financing Activities. Cash used in financing activities for the three months ended March 31, 2007 was $26.4 million. This primarily consists of dividends paid of $37.2 million and repayment of long term debt of $1.9 million, offset by $12.6 million of new borrowings.

Cash used in financing activities in 2006 was $139.9 million. This primarily consists of dividends paid of $149.7 million offset by $14.4 million of proceeds from the issuance of common stock from stock option exercises.

Cash provided by financing activities in 2005 was $6.2 million. This primarily consists of proceeds from equipment financing of $11.2 million, offset by $6.1 million in debt payments.

Cash provided by financing activities in 2004 was $9.5 million, primarily due to equipment financing of $13.4 million, offset by $3.9 million in debt payments.

Future Liquidity Needs. In the future, in addition to funding our working capital requirements, we anticipate our primary use of cash to be the equipment that we provide to hospitals under our long-term sensor purchase agreements. We anticipate additional capital purchases related to expanding our worldwide manufacturing capability as well as additional investments in productivity enhancing tools, including a new customer relationship management system. Our focus on international expansion will also require additional investments in facilities and infrastructure in the Americas, Europe, Japan and Asia. The amount and timing of our actual investing activities will vary significantly depending on numerous factors, such as the progress of our product development efforts, our timetable for international manufacturing and sales and marketing expansion and both domestic and international regulatory requirements. Despite these capital investment requirements, we anticipate that our existing cash and cash equivalents and the proceeds from this offering will be sufficient to meet our working capital requirements, capital expenditures, and operations for at least the next 12 months.

Current Financing Arrangements. As of March 31, 2007, we have various arrangements that allow for the financing of the equipment placed with hospitals in connection with the related long-term sensor purchase agreements. During the years ended December 31, 2004, 2005 and 2006 and the three months ended March 31, 2006 and 2007, we borrowed a total of $13.4 million, $11.2 million, $0, $0 and $12.6 million, respectively, under these facilities. As of December 31, 2005, 2006 and March 31, 2007, respectively, we had outstanding under these financing agreements $27.7 million, $20.5 million and $31.3 million. Principal and interest payments under these financing agreements are $1.0 million per month based on an average interest rate of 7.6%. At March 31, 2007, the carrying value of the equipment collateralizing these borrowings was $7.3 million.

In April 2007, the Company entered into an additional financing agreement for $7.5 million. This borrowing is for a period of four years and carries an interest rate of approximately 8.0%. This financing

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agreement allows the third-party financing company to file Uniform Commercial Code agreements on the related equipment. However, there are no other capital or debt covenant requirements associated with these borrowings. The borrowings can be repaid at any time without any pre-payment penalty. The monthly principal and interest payments on this new borrowing will be approximately $183,000.

In June 2001, we entered into a Master Selective Business Security Agreement, or Master Agreement, with one of our preferred stockholders allowing us to borrow up to a maximum of $5.0 million. The Master Agreement consisted of an equipment line whereby all draws are collateralized by equipment placed at hospitals under long-term sensor purchase agreements. Each draw is converted into a five-year note with interest and principal paid on a monthly basis. The interest rate on each note is based on 475 basis points over the U.S. Treasury Rate on the date of the borrowing. The most recent draw was in December 2002 and there are no additional borrowings available under this Master Agreement. As of December 31, 2005, 2006 and March 31, 2007, we had $1.3 million, $316,000 and $197,000, respectively, outstanding under this borrowing at an average interest rate of 8.3%. At March 31, 2007, the carrying value of the equipment collateralizing these borrowings was $122,000.

Contractual Obligations. The following table summarizes our outstanding contractual obligations as of December 31, 2006, and the effect those obligations are expected to have on our cash liquidity and cash flow in future periods:

	Payments Due By Period				
	Less than 1 year	1-3 years	3-5 years	More than 5 years	Total
			(in thousands)		
Long-Term Debt[1]	$ 7,476	$ 11,050	$ 2,275	$	$ 20,801
Operating Leases[2]	2,182	3,354	418		5,954
Purchase Commitments[3]	15,830				15,830
Employment Agreements[4]	831	695			1,526
Capital Leases (including interest)[5]	65	130	79		274
Total Contractual Obligations	$ 26,384	$ 15,229	$ 2,772	$	$ 44,385

(1) Principal payments owed on our equipment financing arrangements.
(2) Facility, equipment and automobile leases.
(3) Certain inventory items under non cancellable purchase orders to secure better pricing and ensure we will have materials on hand.
(4) Potential commitments made under employment agreements with two of our executive officers and two employees.
(5) Leased office equipment.

As of March 31, 2007, the Company incurred an additional $12.6 million in long term debt, payable ratably over four years. See Liquidity and Capital Resources Current Financing Arrangements, herein.

In addition to these contractual obligations, we have the following annual minimum royalty commitments to Masimo Labs:

	Payments Due By Period			
	Less than 1 Year	1-3 Years	3-5 Years	More than 5 years
		(in thousands)		
Minimum royalty commitment to Masimo Labs	$ 3,150	$ 7,500	$ 10,000	[1]

(1) Subsequent to 2009, the royalty agreement requires a $5.0 million minimum annual royalty payment unless the agreement is amended, restated or terminated.

Pursuant to Financial Accounting Standards Board Interpretation No. 46(R), *Consolidation of Variable Interest Entities an Interpretation of ARB No. 51*, or FIN 46(R), Masimo Labs is consolidated within our financial statements for all periods presented. Accordingly, all inter-company royalties, option and license fees and other charges between us and Masimo Labs have been eliminated in the consolidation.

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Also in accordance with FIN 46(R), all direct engineering expenses that have been incurred by us and charged to Masimo Labs have not been eliminated and are included as research and development expense in our consolidated statements of operations. For additional discussion of Masimo Labs, see Note 4 to the Notes to Consolidated Financial Statements.

For the foreseeable future, we anticipate that we will continue to be required by FIN 46(R) to consolidate Masimo Labs; however, in the event that Masimo Labs secures additional external financing and/or expands its customer base or is no longer financially dependent upon us and we are no longer the primary beneficiary of Masimo Labs activities, we may be able to discontinue consolidating Masimo Labs.

Off-Balance Sheet Arrangements

We do not currently have, nor have we ever had, any relationships with unconsolidated entities or financial partnerships, such as entities referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. In addition, we do not engage in trading activities involving non-exchange traded contracts. As a result, we are not materially exposed to any financing, liquidity, market or credit risk that could arise if we had engaged in these relationships.

Related Party Transactions

For a description of our related party transactions, see Certain Relationships and Related Party Transactions.

Critical Accounting Policies and Estimates

Our financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenue and expenses for each reporting period. Management regularly evaluates its estimates and assumptions. These estimates and assumptions are based on historical experience and on various other factors that are believed to be reasonable under the circumstances, and form the basis for making management s most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effects of matters that are inherently uncertain. Management believes that the following accounting policies involve a higher degree of complexity and warrant specific description.

Revenue Recognition

We recognize revenue pursuant to the requirements of American Institute of Certified Public Accountants, or AICPA, Statement of Position, or SOP 97-2, *Software Revenue Recognition;* as amended by SOP 98-9, *Software Revenue Recognition, With Respect to Certain Transactions;* EITF Issue No. 03-05, Applicability of AICPA Statements of Position 97-2, *Software Revenue Recognition, to Non-Software Deliverables in an Arrangement Containing More-Than-Incidental Software*; and other authoritative accounting guidance.

We enter 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. Additionally, while the majority of our 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: (i) whether an arrangement exists; (ii) how the arrangement consideration should be allocated among the deliverables if there are multiple deliverables; (iii) when to recognize revenue on the deliverables; and (iv) whether undelivered

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elements are essential to the functionality of the delivered elements. In addition, our revenue recognition policy requires an assessment as to whether collectibility is probable, which inherently requires us to evaluate the creditworthiness of customers. Changes in judgments on these assumptions and estimates could materially impact the timing of revenue recognition.

We derive revenue primarily from four sources: (i) direct sales of pulse oximetry and related products to end user hospitals, emergency medical response organizations and other direct customers; (ii) direct sales of pulse oximetry and related products to distributors who then typically resell to end user hospitals, emergency medical response organizations and other direct customers; (iii) direct sales of integrated circuit boards to OEM customers who incorporate our embedded software technology into their multi-parameter monitoring devices; and (iv) long-term sales contracts to end user hospitals in which we typically provide up front monitoring equipment at no charge in exchange for a multi-year consumable product purchase commitment.

For direct sales to end user hospitals, emergency medical response organizations, other direct customers as well as OEMs, we recognize 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) collectibility is reasonably assured. Revenue from sale of our products is generally recognized when title and risk of loss transfers to the customer upon shipment, the terms of which are shipping point or destination. We use contracts and customer purchase orders to determine the existence of an arrangement. We use shipping documents and/or third-party proof of delivery to verify that title has transferred. We assess whether the fee is fixed or determinable based upon the terms of the agreement associated with the transaction. To determine whether collection is probable we assess a number of factors but primarily rely upon past transaction history with the customer, if available.

Our sales under long-term purchase contracts are generally structured such that we agree to provide up-front and at no charge, certain monitoring equipment, installation, training and ongoing warranty support in exchange for the hospital s agreement to purchase sensors over the term of the agreement, typically three to six years. Under SOP 97-2, we have determined that its patented algorithm and software architecture, which resides within the monitors is more than incidental to the product as a whole. In accordance with EITF 03-05, we have also determined that the non-software deliverables (i.e. monitor housing, adapter cables, etc.) are considered essential to the functionality of the delivered elements. Furthermore, no payments are due to us from the hospital customer until sensors are shipped or delivered to the hospital at fixed prices per sensor over the term of the arrangement. Accordingly, we do not recognize any revenue when the monitoring and related equipment is delivered to the hospitals and installation and training is complete. We recognize revenue for all of the delivered elements as the sensors are delivered under the long-term purchase commitment. 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 contract.

Sales to our distributors are recognized on the sell-through method. Our distributors purchase primarily sensor products which they then resell to hospitals that are fulfilling their purchase obligation to us under the hospital s long-term sensor purchase commitments. Because of the underlying contractual relationship between us and the end-user hospital, revenue is deferred until our commitment to our end user consumer is fulfilled. In the distribution channel, we believe this occurs when the sensors are sold through by the distributor to the end-user. As a result, management believes that our distributors function primarily as a fulfillment house and, accordingly, believes the use of the sell-through method is appropriate.

Our distributors purchase product at specified distributor pricing and then may resell the product to end-user hospitals with whom we have separate pricing agreements. Where distributor prices are higher than end-user hospital contracted prices, we provide rebates to these distributors for the difference

between distributor prices and end-user hospital prices. We estimate and provide allowances for these programs at the time of sales as a reduction to revenue and accounts receivable.

We provide 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 levels. We estimate and provide allowances for these programs at the time of sale as a reduction to revenues and an increase to deferred revenues.

In general, customers do not have a right of return for credit or refund. However, we allow returns under certain circumstances. At the end of each period, we estimate and accrue for these returns as a reduction to revenue and accounts receivable. We estimate returns based on several factors, including contractual limitations and past returns history.

Warranty Reserves

We maintain warranty reserves for the estimated future repair or replacement of products sold as required by our product warranties, which generally range from six months to one year, based on the product type. For direct, OEM and distribution sales, we establish, at the time of sale, the warranty reserves based upon historical experiences. In the case of long-term sales agreements, we typically warranty the products for the term of the agreement, which ranges from three to six years. Under these long-term sales agreements, consistent with the deferral of revenue associated with these contracts, we record the related warranty expense as it is incurred over the life of the contract. As necessary, specific reserves may be established and maintained as significant incremental repair issues are identified. As of December 31, 2005, December 31, 2006, and March 31, 2007, the warranty reserve balance was $415,000, $599,000 and $560,000, respectively.

Inventory/Reserves for Excess or Obsolete Inventory

Inventories are stated at the lower of cost or market. Cost is determined using a standard cost method, which approximates FIFO (first-in, first-out). Inventory valuation allowances are recorded for materials that have become obsolete or are no longer used in current production and for inventory that has a market value less than the carrying value in inventory. We generally purchase raw materials in quantities that we anticipate will be fully used within one year. However, changes in operating strategy and customer demand, and frequent unpredictable fluctuations in market values for such materials can limit our ability to effectively utilize all of the raw materials purchased and sold through resulting finished goods to customers for a profit. We regularly monitor potential inventory excess, obsolescence and lower market values compared to standard costs and, when necessary, reduce the carrying amount of our inventory to its market value. Specific reserves are maintained to reduce the carrying value of inventory items on hand that we know may not be used in finished goods. A general inventory reserve is also maintained based on our experience for future limitations on our ability to utilize the inventory on hand. Our inventory reserves were $2.0 million, $2.9 million and $3.1 million at December 31, 2005, December 31, 2006 and March 31, 2007, respectively. If our estimates for potential inventory losses are low, our earnings will be affected.

Allowances for Doubtful Accounts

We maintain allowances for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. This allowance is used to state trade receivables at a net estimated realizable value. We rely on prior experience to estimate the amount that we expect to collect on the gross receivables outstanding, which cannot be known with exact certainty as of the time of issuance of this report. We maintain a specific allowance for customer accounts that we know may not be collectible due to customer liquidity issues. We also maintain a general allowance for future collection losses that arise from customer accounts that do not indicate an inability, but may be unable, to pay. Our accounts

receivable balance, including those from related parties, was $15.5 million, $22.4 million and $27.9 million, net of allowances for doubtful accounts of $444,000, $1.6 million and $1.7 million at December 31, 2005, December 31, 2006 and March 31, 2007, respectively.

Litigation and Other Contingencies

Management regularly evaluates our exposure to threatened or pending litigation and other business contingencies. Because of the uncertainties related to the amount of loss from litigation and other business contingencies, the recording of losses relating to such exposures requires significant judgment about the potential range of outcomes. As additional information about current or future litigation or other contingencies becomes available, our management will assess whether such information warrants the recording of additional expense. Management is in discussion with a former distributor over alleged commissions owed to a former distributor. Management does not believe that any resolution of this dispute will be material to these consolidated financial statements. Other than this item, management is not aware of any potential losses that would require to be accrued at December 31, 2006 and December 31, 2005.

Stock-Based Compensation

We have historically issued stock options to reward our employees and directors. Prior to December 31, 2005, we accounted for these option grants under the recognition and measurement principles of Accounting Principles Board, or APB, Opinion No. 25, *Accounting for Stock Issued to Employees,* and related interpretations, and applied the disclosure provisions of Statement of Financial Accounting Standards, or SFAS, No. 123, *Accounting for Stock-Based Compensation,* as amended by SFAS No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure an amendment of Financial Accounting Standards Board, or FASB, Statement No. 123.* This accounting treatment resulted in a pro forma stock option expense that was reported in the footnotes to our consolidated financial statements for those years.

For option grants made on or prior to December 31, 2005, we recorded stock-based compensation, typically associated with options granted to non-employees or directors based upon the difference, if any, between the estimated fair value of common stock underlying the options on the date of grant and the option exercise price. The fair value of the common stock for options granted prior to December 31, 2004 was originally estimated solely by our board of directors, with input from management. We believe the members of our board of directors have extensive experience in the medical device market and many of our directors are accredited venture capital investors. For grants made prior to December 31, 2004, we did not obtain contemporaneous valuations by an unrelated valuation specialist. Since there was no public market for our shares, our board of directors exercised judgment in determining the estimated fair value of our common stock on the date of grant based on several objective and subjective factors, including our operating and financial performance, corporate milestones, product development and market acceptance, the superior rights and preferences of our convertible preferred stock and the risk and non-liquid nature of our common stock.

Effective January 1, 2006, we adopted the provisions of SFAS No. 123(R), *Share Based Payment,* which requires us to expense the estimated fair value of employee stock options and similar awards based on the fair value of the award on the date of grant. In March 2005, the SEC issued Staff Accounting Bulletin 107, or SAB 107, relating to SFAS No. 123(R). We have applied the provisions of SAB 107 in the adoption of SFAS No. 123(R).

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Effective January 1, 2006, the fair value of each option is estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions used for grants:

	Year ended December 31, 2006	Three months ended March 31, 2007
Risk-free interest rate	4.7%	4.5%
Expected term	6.5 years	6.5 years
Estimated volatility	47.0%	41.6%
Expected dividends	0%	0%

The Black-Scholes option pricing model requires the use of certain assumptions, including fair value, expected term, expected volatility, expected dividends, risk-free interest rate, and expected forfeiture rate to calculate the fair value of stock-based payment awards.

As a non-public company, we estimate the current price of the underlying share based on valuations established by the board of directors. Historically, the board of directors has used various sources to establish the value of our stock. In the future, as a publicly traded entity, we will rely on daily reported prices of our shares.

Since January 2005, the fair value of our common stock has ranged from $8.25 per share to $14.00 per share. In January 2006, as a result of our patent litigation settlement with Nellcor, the Board increased the estimated fair market value of our common stock from $14.00 to $26.53 per share. Since this date, the Board has continued to assess the value of our common stock based on various sources of information. As disclosed more fully in Note 12 to the Notes to Consolidated Financial Statements that are included in this prospectus, during the 21 months ended March 31, 2007, we have granted stock options with exercise prices ranging from $14.00 to $38.60 per share. No options granted during this period were at prices below the fair market value as established by our Board and compensation committee.

We do not have information available which is indicative of future exercise and post-vesting behavior to estimate the expected term. As a result, we adopted the simplified method of estimating the expected term of a stock option, as permitted by SAB 107. Under this method, the expected term is presumed to be the mid-point between the vesting date and the contractual end of the term. The use of the simplified method requires our option plan to be consistent with a plain vanilla plan. The simplified method will not be available for options granted after December 31, 2007.

As a non-public entity as of December 31, 2006, historic volatility is not available for our shares. As a result, we estimated volatility based on a peer group of companies, which collectively provides a reasonable basis for estimating volatility. We intend to continue to consistently use the same group of publicly traded peer companies to determine volatility in the future until sufficient information regarding the volatility of its share price becomes available or the selected companies are no longer suitable for this purpose.

We do not expect to declare dividends in the future. As part of a one-time patent settlement, our board of directors declared a dividend in March 2006 and declared two dividends in December 2006. These dividends were declared only due to the receipt of settlement proceeds in connection with patent infringement litigation with a competitor. Absent such a settlement, we would not have declared and paid any of these dividends.

The risk-free interest rate is based on the implied yield available on U.S. Treasury zero-coupon issues with a remaining term approximately equal to the expected life of our stock options. The estimated pre-vesting forfeiture rate is based on our historical experience and the composition of option plan

participants, among other factors, and reduces the compensation expense recognized. If the actual forfeitures differ from the estimates, adjustments to compensation expense may be required in future periods.

Stock-based compensation expense related to the adoption of SFAS 123(R) amounted to $1.3 million for 2006 and $457,000 for the three months ended March 31, 2007, and the related deferred tax asset established was $513,000. We elected to recognize compensation costs on a straight-line basis over the requisite service period for the entire award.

We also issue stock options to non-employees, generally for services, which we account for under the provisions of SFAS No. 123 and EITF Abstract No. 96-18, *Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling Goods or Services.* Options granted to consultants were valued at the date of grant using the Black-Scholes option pricing model with a dividend yield of 0%, an expected volatility of 0%, an average risk-free rate of 4.13%, and an expected life of ten years. Services provided by consultants include sales and marketing or financing related services. Options vest over the service period ranging from immediately vested to vesting over five years.

Accounting for Income Taxes

As part of the process of preparing our combined consolidated financial statements, we are required to determine our income taxes in each of the jurisdictions in which we operate. This process involves estimating our actual current tax expenses together with assessing temporary differences resulting from recognition of items for income tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within our consolidated balance sheet. We must then assess the likelihood that our deferred tax assets will be recovered from future taxable income and, to the extent we believe that recovery is not likely, establish a valuation allowance. To the extent we establish a valuation allowance or increase this allowance in a period, we must reflect this increase as an expense within the tax provision in the statement of operations.

Management s judgment is required in determining our provision for income taxes, our deferred tax assets and liabilities and any valuation allowance recorded against our net deferred tax assets. We continue to monitor the realizability of our deferred tax assets and adjust the valuation allowance accordingly. During the fourth quarter of 2005, we determined that a full valuation allowance against our net U.S. deferred tax assets was not necessary due to the Nellcor patent litigation settlement. In making this determination, we considered all available positive and negative evidence, including projected future taxable income, tax planning strategies and recent financial performance. In December 2005, we recorded a reversal of certain federal and state deferred tax valuation allowances consisting primarily of net operating losses and deferred revenue. This resulted in a non-recurring tax benefit of $31.2 million.

As of December 31, 2006, we had fully utilized our prior year s federal and California net operating loss carryforwards of approximately $23.4 million and $10.9 million, respectively. However, as of December 31, 2006, we had approximately $14.3 million of net operating loss carryforwards from our foreign jurisdictions which begin to expire in 2007 and approximately $10.7 million of net operating losses generated in 2006 from various states which begin to expire in 2012.

Under FIN 46(R), our consolidated income tax provision or benefit and the net deferred tax assets include Masimo Labs income taxes provision or benefit and deferred tax assets. For income tax purposes, Masimo Labs is not a member of our consolidated group and files its separate federal and California income tax returns.

In July 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement No. 109,* or FIN 48, which became effective for us on

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January 1, 2007. FIN 48 prescribes a recognition threshold and a measurement attribute for the financial statement recognition and measurement of tax positions taken or expected to be taken in a tax return. For those benefits to be recognized, a tax position must be more-likely-than-not to be sustained upon examination by taxing authorities. The adoption of FIN 48 resulted in a reduction of our beginning retained earnings of $618,000. As of the adoption date, the balance of gross unrecognized tax benefits is $3.8 million, of which $599,000 (net of the federal benefit on state taxes), if recognized, would affect the effective tax rate. The remaining balance relates to timing differences, of which the ultimate deductibility is highly certain, but there is uncertainty about the timing of such deductibility. The amount of unrecognized tax benefits did not materially change as of March 31, 2007. It is expected that the amount of unrecognized tax benefits may change in the next 12 months; however, quantification of such change cannot be estimated. We recognize penalties and interest related to unrecognized tax benefits in income tax expense. Interest and penalties are immaterial as of the date of adoption and are included in unrecognized tax benefits. We conduct business in multiple jurisdictions, and as a result, one or more of our subsidiaries file income tax returns in the U.S. federal, various state, local and foreign jurisdictions. Due to the existence of net operating loss carryforwards, all years since inception in 1989 are open for examination by major taxing authorities.

Recent Accounting Pronouncements

In February 2006, the FASB issued SFAS No. 155, *Accounting for Certain Hybrid Financial Instruments an Amendment of FASB Statements No. 133 and 140.* SFAS No. 155 allows financial instruments that have embedded derivatives to be accounted for as a whole (eliminating the need to bifurcate the derivative from its host) if the holder elects to account for the whole instrument on a fair value basis. SFAS No. 155 is effective for financial assets acquired or issued after the beginning of the entity s first fiscal year that begins after September 15, 2006. The adoption of SFAS No. 155 did not have a material impact on our results of operations or financial position.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurement.* SFAS 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. We are currently evaluating the impact of adopting SFAS 157 on our consolidated financial statements.

In September 2006, the FASB issued SFAS No. 158, *Employer s Accounting for Defined Benefit Pension and Other Postretirement Plans an Amendment of FASB Statements No. 87, 88, 106 and 132R.* SFAS 158 requires an employer to recognize in its statement of financial position an asset for a plan s over funded status or a liability for a plan s under funded status, measure a plan s asset and its obligations that determine its funded status as of the end of the employer s fiscal year and recognize changes in the funded status of a defined benefit postretirement plan in the year in which the changes occur. Those changes will be reported in comprehensive income and as a separate component of stockholders equity. SFAS 158 is effective for fiscal years ending after December 15, 2008. We do not expect the adoption of this statement to have a material impact on our consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment to FASB Statement No. 115.* SFAS 159 permits entities to choose to measure financial instruments and certain other items at fair value at specified election dates. An entity shall report unrealized gains and losses on items, for which the fair value option has been elected, in earnings. Most of the provisions of SFAS 159 apply only to entities that elect the fair value option. SFAS 159 is effective for fiscal years ending after November 15, 2007. We do not expect the adoption of this statement to have a material impact on our consolidated financial statements.

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Quantitative and Qualitative Disclosures About Market Risk

We are exposed to various market risks that may arise from adverse changes in market rates and prices, such as interest rates, foreign exchange fluctuations and inflation. We do not enter into derivatives or other financial instruments for trading or speculative purposes.

Interest Rate Risk

Our exposure to market risk for changes in interest rates relates to the increase or decrease in the amount of interest income we can earn on our investment portfolio and on the increase or decrease in the amount of interest expense we must pay with respect to our various outstanding debt instruments. Our risk associated with fluctuation to interest expense is limited to our outstanding term loans and financing arrangements, which have fixed interest rates. Under our current policies, we do not use interest rate derivative instruments to manage exposure to interest rate changes. We ensure the safety and preservation of our invested principal funds by limiting default risk, market risk and reinvestment risk. We reduce default risk by investing in investment grade securities. A hypothetical 100 basis point drop in interest rates along the entire interest rate yield curve would not significantly affect the fair value of our interest-sensitive financial instruments at December 31, 2006. Declines in interest rates over time will, however, reduce our interest income and expense while increases in interest rates will increase our interest income and expense.

Foreign Currency Exchange Rate Risk

A majority of our assets and liabilities are maintained in the United States in U.S. dollars and our sales and expenditures are transacted in U.S. dollars. The expenses and capital spending of our foreign entities are transacted in the respective country s local currency and are subject to foreign exchange rate risk. Our foreign currency transactions are translated into U.S. dollars at prevailing rates and gains or losses resulting from foreign currency transactions are included in current period income or loss as incurred. Our foreign entities balance sheets are translated in U.S. dollars at the month end spot rates and the statement of operations and cash flows using the average exchange rate for the periods and any foreign exchange gain or loss is included in equity as a component of accumulated other comprehensive income (loss).

Inflation Risk

We do not believe that inflation has had a material effect on our business, financial condition or results of operations during the periods presented, and we do not anticipate that it will have a material adverse effect in the future.

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BUSINESS

Overview

We are a global medical technology company that develops, manufactures and markets non-invasive patient monitoring products that improve patient care. We were incorporated in California in May 1989 and reincorporated in Delaware in May 1996. We invented Masimo Signal Extraction Technology, or Masimo SET, which provides the capabilities of read-through motion and low perfusion pulse oximetry to address the primary limitations of conventional pulse oximetry. Pulse oximetry is the non-invasive measurement of the oxygen saturation level of arterial blood, or the blood that delivers oxygen to the body s tissues, and pulse rate. Our Masimo SET platform has significantly addressed many of the previous technology limitations, and has been recognized as the gold standard in pulse oximetry, the benefits of which have been validated in over 100 independent clinical studies. During fiscal 2006, we generated product revenue of $155.1 million and we increased our revenue at a compound annual growth rate, or CAGR, of approximately 41.6% for the four years ended December 31, 2006.

We market a family of patient monitoring solutions which incorporate a monitor or circuit board and consumables, including both proprietary single-patient use and reusable sensors and cables. In addition, we offer a remote alarm/monitoring solution, software and other accessories. Our solutions and related products are based upon our proprietary Masimo SET algorithms and related software architecture. This software-based technology is incorporated into a variety of product platforms depending on our customers specifications. We sell our products to end-users through our direct sales force and certain distributors, and certain of our products to our original equipment manufacturer, or OEM, partners, for incorporation into their products. We estimate that our worldwide installed base of our pulse oximeters, OEM monitors that incorporate Masimo SET and adapter cables was approximately 449,000 units as of December 31, 2006. Our installed based is the primary driver for the recurring sales of our consumables, primarily single-patient sensors. Based on industry reports, we estimate that the worldwide pulse oximetry market is over $900 million, the largest component of which is the sale of consumables.

We believe that the reliability and accuracy of our Masimo SET platform, along with our remote-alarm and monitoring solutions, will facilitate the expansion of our pulse oximetry products into areas beyond critical care settings, including the general care areas of the hospital. Additionally, we have developed products that non-invasively monitor parameters beyond arterial blood oxygen saturation level and pulse rate. In 2005, we launched our Masimo Rainbow SET platform utilizing licensed Rainbow technology, which we believe includes the first FDA-cleared devices to non-invasively measure carboxyhemoglobin, or carbon monoxide levels in the blood, and methemoglobin saturation levels in the blood. We believe that the use of products incorporating Rainbow technology will become widely adopted for the non-invasive monitoring of these parameters. In addition, we believe that we will develop and introduce additional parameters in the future based on our proprietary technology platforms.

Our technology is supported by a substantial intellectual property portfolio that we have built through internal development, acquisitions and license agreements. As of December 31, 2006, we had over 440 issued and pending patents worldwide. We have exclusively licensed from our development partner, Masimo Laboratories, Inc., or Masimo Labs, the right to incorporate Rainbow technology into our products intended to be used by professional caregivers, including but not limited to hospital caregivers and EMS facility caregivers. On January 17, 2006, we settled all existing patent litigation with Nellcor, a division of Tyco Healthcare. Under the terms of the settlement, Nellcor has agreed to discontinue the sale of its products found to infringe our patents and will pay us royalties at least through March 14, 2011 on the U.S. sales of its pulse oximetry products.

Industry Background

Pulse oximetry has gained widespread clinical acceptance as a standard patient vital sign measurement because it can give clinicians an early warning of low arterial blood oxygen saturation levels, known as

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hypoxemia. Early detection is critical because hypoxemia can lead to a lack of oxygen in the body s tissues, which can result in brain damage or death in a matter of minutes. Pulse oximeters are currently used in critical care settings, including emergency rooms, operating rooms, recovery rooms, intensive care units, or ICUs, and the EMS market.

In addition, clinicians use pulse oximeters to estimate whether there is too much oxygen in the blood, a condition called hyperoxemia. In premature babies, hyperoxemia can lead to permanent eye damage or blindness. By ensuring that oxygen saturation levels in babies remains under 96%, clinicians believe they can lower the incidence of hyperoxemia. Hyperoxemia can also cause problems for adults, such as increased risk of postoperative infection and tissue damage. In adults, to prevent hyperoxemia, clinicians use pulse oximeters to administer the minimum level of oxygen necessary to maintain normal saturation levels.

Pulse oximeters use sensors attached to an extremity, typically the fingertip. These sensors contain light emitting diodes, or LEDs, that transmit red and infrared light from one side of the extremity through the tissue to a photodetector on the other side of the extremity. The photodetector in the sensor measures the amount of red and infrared light absorbed by the tissue. A microprocessor then analyzes the changes in light-absorption to provide a continuous, real-time measurement of the amount of oxygen in the patient s arterial blood. Pulse oximeters typically give audio and visual alerts, or alarms, when the patient s arterial blood oxygen saturation level or pulse rate falls outside of a designated range. As a result, clinicians are able to immediately initiate treatment to prevent the serious clinical consequences of hypoxemia and hyperoxemia.

Limitations of Conventional Pulse Oximetry

Conventional pulse oximetry is subject to technological limitations that reduce its effectiveness and the quality of patient care. In particular, when using conventional pulse oximetry, arterial blood signal recognition can be distorted by motion artifact, or patient movement, and low perfusion, or low arterial blood flow. Motion artifact can cause conventional pulse oximeters to inaccurately measure the arterial blood oxygen saturation level due mainly to the movement and recognition of venous blood. Venous blood, which is partially depleted of oxygen, may cause falsely low oxygen saturation readings. Low perfusion can also cause the failure of the conventional pulse oximeter to obtain an accurate measurement. Conventional pulse oximetry readings can also be impacted by bright light and electrical interference from the presence of electrical surgical equipment. Independent, published research shows that conventional pulse oximeters are subject to operating limitations, including:

- inaccurate measurements, which can lead to the non-detection of a hypoxemic event or improper and unnecessary treatment;
- false alarms, which occur when the pulse oximeter falsely indicates a drop in the arterial blood oxygen saturation level which can lead to improper therapy, the inefficient use of clinical resources as clinicians respond to false alarms, or the non-detection of a true alarm if clinicians become desensitized to frequently occurring false alarms; and
- signal drop-outs, which is the loss of a real-time signal as the monitor attempts to find or distinguish the pulse, which can lead to the non-detection of hypoxemic events.

Published independent research shows that over 70% of the alarms were false outside the operating room using conventional pulse oximetry. In addition, in the operating room, conventional pulse oximeters routinely failed to give measurements at all due to weak physiological signals, or low perfusion. Manufacturers of conventional pulse oximeters have attempted to address some of these limitations, with varying degrees of success. Some devices have attempted to minimize the effects of motion artifact by repeating the last measurement before motion artifact is detected, until a new, clean signal is detected and a new measurement can be displayed, known as freezing values. Other devices have

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averaged the signal over a longer period of time, known as long-averaging, in an attempt to reduce the effect of brief periods of motion. These solutions, commonly referred to as alarm management techniques, mask the limitations of conventional pulse oximetry. Several published studies have demonstrated that some of these alarm management techniques have actually contributed to increased occurrences of undetected true alarms, or events where hypoxemia occurs, but is not detected by the pulse oximeter.

Conventional pulse oximetry technology also has several practical limitations. Because the technology cannot consistently measure oxygen saturation levels of arterial blood in the presence of motion artifact or low perfusion, the technology is not robust enough to allow for its use in non-critical care settings of the hospital, such as general care areas, where the hospital staff-to-patient ratio is significantly lower. In order for pulse oximetry to become a standard patient monitor in these settings, these limitations must be overcome.

In addition, conventional pulse oximeters cannot distinguish oxygenated hemoglobin, or the component of red blood cells that carries oxygen, from dyshemoglobin, which is hemoglobin that is incapable of carrying oxygen. As a result, pulse oximeters will report falsely high oxygen levels when dyshemoglobins are present in the blood. Although currently there are lab-based tests that detect dyshemoglobins, they are invasive and do not provide immediate or continuous results.

Pulse Oximetry Market Opportunity

The pulse oximetry market consists of pulse oximeters and consumables, including single-patient use and reusable sensors, cables and other pulse oximetry accessories that are primarily sold to the hospital and EMS markets. According to a Frost & Sullivan report dated May 2003, U.S. pulse oximetry equipment market revenue, which includes stand-alone devices and multi-parameter patient monitoring modules, was estimated to be $201 million in 2006 and was expected to increase to $249 million by 2009, representing a CAGR of 7.3%. Additionally, a Frost & Sullivan report dated March 2004 estimated that U.S. pulse oximetry sensor market revenue would be $461 million in 2006 and would increase to $622 million by 2010, representing a CAGR of 7.8%. Based on these estimates, Frost & Sullivan estimated that the total U.S. pulse oximetry market would be $662 million in 2006. Frost & Sullivan expects the growth in the U.S. pulse oximetry sensor market to be driven by:

- ongoing adoption of low perfusion, motion-tolerant technology;
- aggressive awareness campaigns;
- rising patient acuity, or severity of illnesses, which increases the need for monitoring in the intermediate and sub-acute settings;
- expansion of the market for pulse oximetry monitoring to the general surgical floor;
- greater efficiencies for the health care worker through increased reliability, improved detection algorithms and the ability to reject false alarms; and
- adoption of pulse oximetry outside the hospital and in the faster growing alternate care market.

Based on this estimate for the U.S. market, we estimate that the worldwide pulse oximetry market was over $900 million in 2006.

Additional Market Opportunities

Expansion to Non-Critical Care Settings

We believe there are opportunities to expand the market for pulse oximetry by applying Masimo SET s proven benefits from critical care settings to non-critical care settings, as well as settings outside of the

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hospital. It is currently estimated that over 86% of all U.S. hospital beds are located in non-critical care areas, where continuous monitoring is not widely used. A published study showed that approximately 264,000 hospital deaths over a three-year period were attributable to patient safety incidents, or generally preventable patient events in non-critical care areas. The study concluded that the failure to timely diagnose and treat patients accounted for over 70% of those deaths, suggesting that improved patient monitoring in non-critical care settings can alert clinicians of patient distress and help to improve patient care.

Carboxyhemoglobin Detection

We believe there are opportunities to expand the market for patient monitoring by enabling the measurement of additional blood constituents beyond arterial blood oxygen saturation level and pulse rate. For example, carbon monoxide is the leading cause of accidental poisoning death in the United States, responsible for an estimated 3,800 fatalities and 40,000 emergency room visits annually. Carbon monoxide poisoning, which involves carbon monoxide binding with hemoglobin cells, thereby preventing them from carrying oxygen, can cause severe neurological damage, permanent heart damage or death in a matter of minutes. Quick diagnosis and treatment of carbon monoxide poisoning is critical in saving lives and preventing long-term damage. The National Academy of Clinical Biochemistry, or NACB, recommends that clinicians routinely utilize point-of-care tests for the presence of carboxyhemoglobin, or carbon monoxide bound to hemoglobin, to screen patients with flu-like symptoms or headaches in the emergency room for carbon monoxide poisoning. CO-Oximetry, an invasive lab-based test that involves passing a blood sample through a CO-Oximeter, is currently used to measure carboxyhemoglobin saturation levels. We believe that the primary opportunity for non-invasive blood carbon monoxide monitoring is in the EMS and emergency department settings, but may extend into other critical care settings as well, such as the operating room, or OR. Carbon monoxide can in some cases be produced by the anesthesia machine, which can, in some circumstances, create dangerous levels of carbon monoxide. This occurrence is known as Monday Morning Phenomenon, which may be diagnosed with non-invasive monitoring of carbon monoxide in the OR. In addition, patients who have moderate levels of carbon monoxide in their blood upon hospital admission, either from smoking or exposure to carbon monoxide, often have complications during anesthesia administration. If carbon monoxide is detected in their blood, surgeries can be postponed until the patient s carbon monoxide level has returned to a safe level for surgery.

Methemoglobin Detection

Another opportunity to expand the market for patient monitoring is to enable the non-invasive measurement of methemoglobin, another form of hemoglobin that is unable to carry oxygen to tissues throughout the body. Since hemoglobin is the key carrier of oxygen in the blood, its replacement by methemoglobin can cause cyanosis, or bluish discoloration of the skin caused by lack of oxygen in the blood. According to a research report published by Johns Hopkins University in September 2004, approximately 30 different drugs routinely administered in hospitals can cause methemoglobinemia, or the presence of an abnormal amount of methemoglobin in the blood. This study found 414 cases, or 19% of all patients reviewed, of acquired methemoglobinemia, which were detected in many areas of the hospital and various patient populations over a 28-month period. The methemoglobinemia resulted in one fatality and three near-fatalities. In addition, pesticides, herbicides and other industrial chemicals can cause methemoglobinemia. Some of the 30 drugs that the Johns Hopkins University report found to cause methemoglobinemia are benzocaine, a local anesthetic, which is routinely used in procedures, ranging from endoscopy to surgery, inhaled nitric oxide, routinely used in the Neonatal Intensive Care Unit, nitroglycerin used to treat cardiac patients and dapsone used to treat infections. The NACB recommends that clinicians routinely utilize point of care tests to measure the level of methemoglobin in patients receiving benzocaine, a local anesthetic. In addition, two clinical studies indicated that patients with sepsis showed increased blood methemoglobin levels. As a result, we intend to investigate whether monitoring this blood constituent may help with the diagnosis and early treatment of sepsis.

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Future Applications

We believe that our core signal processing and sensor technologies are widely applicable and expect to develop and launch future applications utilizing our proprietary technology platforms.

The Masimo Solution

Our innovative and proprietary technologies and products are designed to overcome the primary limitations of pulse oximetry, which involve maintaining accuracy in the presence of motion artifact and weak signal to noise situations. Our Masimo SET platform, which became available to hospitals in the United States in 1998, is the basis of our pulse oximetry products and we believe represented the first significant technological advancement in pulse oximetry since its introduction in the early 1980s. Our products have been recognized as the gold standard in pulse oximetry due to their ability to provide clinicians with reliable, continuous, real-time information even in the presence of both motion artifact and low perfusion. In addition, our products benefits have been validated through over 100 independent clinical studies.

Masimo SET utilizes five signal processing algorithms, four of which are proprietary, in parallel, to deliver high precision, sensitivity and specificity in the measurement of arterial blood oxygen saturation levels and pulse rate. Sensitivity is the ability to detect true events and specificity is the ability to reject false alarms. One of our proprietary processing algorithms, Discrete Saturation Transform, separates signal from noise in real-time through the use of adaptive filtering, and an iterative sampling technique that tests each possible saturation value for validity. Masimo SET signal processing can therefore identify the venous blood and other noise, isolate them, and extract the arterial signal.

The following table summarizes the results of a recent independent study, which details the clinical advantages of Masimo SET versus currently available competitive platforms that claim accuracy during patient motion. This study analyzes the results of 160 motion tests on ten subjects, including machine generated motion and motion generated by the volunteers.

Adult Study:	Missed True Events	False Alarms
Masimo SET	3%	5%
Nellcor N600	43%	28%
GE TruSat	83%	18%

Source: Shah N, Estanol L. Anesthesiology 2006; 105:A929

To complement our Masimo SET platform, we have developed a wide range of proprietary single-patient use and reusable sensors, cables and other accessories designed specifically to work with Masimo SET software and hardware. Although our technology platforms operate solely with our proprietary sensor lines, our sensors have the capability to work with certain competitive pulse oximetry monitors through the use of adapter cables. Our LNOP neonatal adhesive sensors have been clinically proven to exhibit greater durability compared to competitive sensors.

In 2005, we introduced our Masimo Rainbow SET platform, leveraging our Masimo SET and incorporating licensed Rainbow technology to enable reliable, real-time monitoring of additional parameters beyond arterial blood oxygen saturation and pulse rate. The Masimo Rainbow SET platform has the unique ability to distinguish oxygenated hemoglobins from certain dyshemoglobins, hemoglobin incapable of transporting oxygen, and allows for the rapid, non-invasive monitoring of carboxyhemoglobin and methemoglobin, which we refer to as Pulse CO-Oximetry. Along with the release of our Rainbow SET Pulse CO-Oximetry products, we have developed multi-wavelength sensors that have the ability to monitor multiple parameters with a single sensor. We believe that the use of Masimo Rainbow SET Pulse CO-Oximetry products will become widely adopted for the non-invasive monitoring of these parameters.

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Additionally, we market our RadNet and RadLink remote-alarm and monitoring systems for use with our Masimo SET pulse oximeters and Rainbow SET Pulse CO-Oximeters. These systems currently allow wireless and remote monitoring of the oxygen saturation and pulse rate of up to 28 patients simultaneously, and may facilitate the expansion of our products into areas beyond the critical care settings, such as the general care areas.

Benefits of Our Products and Technology

We believe that our technology and products offer several key benefits, including:

Accurate, Real-Time Measurement. The Masimo SET platform has the ability to provide more accurate measurements with fewer missed events and false alarms than any other pulse oximeter in the market place. As a result, our pulse oximeters have been recognized as the gold standard for pulse oximetry, with 50% of the top hospitals in the United States, including four of the top five, according to U.S. News and World Reports Honor Roll for 2006, making Masimo SET their primary pulse oximetry platform.

Increased Quality of Patient Care. The proven accuracy and reliability of Masimo SET pulse oximetry allows for better clinical decisions, leading to fewer medical errors and better patient care. In one independent study conducted at the University of Virginia, Masimo SET pulse oximetry was credited with a 92.3% success rate on critical, unstable patients on whom conventional pulse oximetry failed, resulting in a significant increase in patient safety and caregiver efficiency. We believe that the non-invasive monitoring of carboxyhemoglobin will improve the quality of care based on the number of emergency room visits reported for carbon monoxide poisoning. We believe the non-invasive monitoring of methemoglobin will also improve patient care based on reported drug interactions that increase methemoglobin levels in the blood.

Reduced Cost of Care. Several independent studies have shown that hospitals can reduce their costs as a result of using Masimo SET products. Factors contributing to lower costs include a reduction in sensor usage as a result of more durable sensors, fewer invasive arterial blood gas procedures needed, less oxygen administration and a reduction in length of stay as the result of weaning patients off of ventilators more quickly. In addition, we expect that the non-invasive monitoring of carboxyhemoglobin and methemoglobin will help reduce the cost of care by reducing the need for invasive blood tests and limiting the costs from complications caused by incorrect diagnoses.

Masimo SET Platform Allows for Expansion into Non-Critical Care Settings. We believe the ability of Masimo SET products to provide reliable monitoring with fewer false alarms has expanded and will continue to expand the use of pulse oximetry into other settings where patient motion and false alarms, have historically prevented its use. Since the introduction of Masimo SET, we believe that pulse oximetry has become a standard of care in the EMS market. In addition, hospitals and other care centers can reduce their costs by moving less critically ill patients from the ICU to the general care areas where these patients can be continuously and accurately monitored in a more cost-effective manner. Many patients in the general care areas are at risk of dying due to inadequate oxygenation. To mitigate this risk, patients in the general care areas need to be continuously monitored. Our RadNet and RadLink systems enable the Masimo SET and Rainbow SET platforms to wirelessly and remotely monitor patients in the general care areas of the hospital that are not under the constant supervision of clinicians.

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Upgradeable Platform for the Monitoring of Additional Parameters. Products with our new MX circuit board contain our Masimo SET pulse oximetry technology as well as circuitry to support Rainbow parameters. At the time of purchase, or at any time in the future, our customers and our OEMs customers will have the option of purchasing a software parameter, which will allow the customer to expand their patient monitoring systems to monitor additional parameters with a cost-effective solution.

Our Strategy

Since inception, our mission has been to develop non-invasive patient monitoring solutions that improve patient outcomes and reduce the cost of patient care. We intend to continue to grow our business and to improve our market position by pursuing the following strategies:

Continue to Expand Our Market Share In Pulse Oximetry. We grew our product revenue from $38.6 million in 2002 to $155.1 million in 2006, representing a four year CAGR of approximately 41.6%. In the last two years alone, we estimate that we have doubled our market share from approximately 8.0% to 16.5% of the estimated $900 million worldwide pulse oximetry market. This growth can be attributed to the increased access to pulse oximetry customers through our agreements with group purchasing organizations, or GPOs, and our increased relationships with OEM partners, the expansion of our direct sales force, and strong, independent clinical evidence that demonstrates the benefits of our technology. We supplement our direct sales with sales through our distributors. Direct and distributor sales increased to approximately $104.0 million, or 67.0%, of product revenues for 2006, from $13.9 million, or 35.9%, of product revenues in 2002. We expect the percentage of our revenue from direct sales to continue to increase as we expand our worldwide sales force.

Expand the Pulse Oximetry Market to Other Patient Care Settings. We believe the ability to continuously and accurately monitor patients outside of critical care settings, including the general care areas of the hospital, are currently unmet medical needs and have the potential to significantly improve patient care and increase the size of the pulse oximetry market. We believe the ability of Masimo SET and Masimo Rainbow SET to accurately monitor and address the limitations of conventional pulse oximetry has enabled, and will continue to enable, us to expand into non-critical care settings and thus significantly expand the market for our products. To further support our expansion into the general care areas, we market a wireless floor monitoring solution, RadNet, that currently enables continuous monitoring of up to 28 patients oxygen saturation and pulse rate with one system, utilizing our Masimo SET or Masimo Rainbow SET platform. In addition to RadNet, we offer RadLink, a standalone system that wirelessly sends alarm information from a specific monitor to one or more clinician-worn pagers. The American Hospital Association estimated that there were approximately 947,000 staffed beds in all U.S.-registered hospitals in 2004. In 2000, approximately 86.6% of all hospital beds in the United States were located in non-critical care settings according to a study published in the Journal of Critical Care Medicine, which suggests a potential to monitor an additional approximately 820,000 beds in the United States alone.

Utilize Our Customer Base and OEM Relationships to Market Our Masimo Rainbow SET Pulse CO-Oximetry Products Incorporating Licensed Rainbow Technology. We sold our first Masimo Rainbow SET Pulse CO-Oximetry products in September 2005. We are currently selling our Rainbow SET products through our direct sales force. In addition, we plan to sell our MX circuit boards in our own pulse oximeters and to our OEM partners, equipped with circuitry to support Rainbow SET Pulse CO-Oximetry parameters which can be activated at time of sale or through a subsequent software upgrade. We believe that the clinical need of these measurements along with our installed customer base will help drive the adoption of our Rainbow SET Pulse CO-Oximetry products.

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Continue to Innovate and Maintain Our Technology Leadership Position. We invented and pioneered what we believe is the first pulse oximeter to accurately measure arterial blood oxygen saturation level and pulse rate in the presence of motion artifact and low perfusion. In addition, through our license of Rainbow technology from Masimo Labs, we launched our Rainbow SET Pulse CO-Oximetry platform that enabled what we believe are the first FDA-cleared non-invasive monitoring of carboxyhemoglobin and methemoglobin. We plan to continue to innovate and develop new technologies and products internally and through our collaboration with Masimo Labs, for the non-invasive monitoring of other parameters. In February 2007, The Wall Street Journal reported that our patent portfolio was ranked as fifth strongest in the medical device industry by The Patent Board, an independent research institution.

Our Products

We develop, manufacture and market a patient monitoring solution which incorporates a monitor or circuit board and consumables including both proprietary single-patient use and reusable sensors and cables. In addition, we offer a remote-alarm/monitoring solution and software.

The following chart summarizes our principal product components and sales channels:

Product Components	Description	Sales Channel
Patient Monitoring Solution:		
Circuit Boards	Signal processing apparatus for all Masimo SET and licensed Rainbow technology platforms	Incorporated into our proprietary pulse oximeters and sold to OEM partners who incorporate our circuit boards into their patient monitoring systems
Pulse Oximeters/Monitors	Bedside and handheld monitoring devices that incorporate Masimo SET with and without licensed Rainbow technology	Sold directly and through distributors and in some cases to our OEM partners to end-users
Consumables	Extensive line of both single-patient use and reusable sensors	Sold directly and through distributors and to OEM partners who sell to end-users
	Patient cables, as well as adapter cables that enable the use of our sensors on certain competitive monitors	
Remote-Alarm and Monitoring Solutions	Network-linked wired or wireless, multiple patient floor monitoring solutions	Sold directly to end-users
	Standalone wireless alarm notification solutions	
Software	Rainbow parameters and other proprietary features sold to installed monitors	Sold directly and through OEM partners who sell to end-users

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Circuit Boards

Masimo SET MS Circuit Boards. Our Masimo SET MS circuit boards perform all signal processing and other pulse oximetry functions incorporating the Masimo SET platform. Our MS circuit boards are included in our proprietary monitors for direct sale or sold to our OEM partners for incorporation into their monitors. Once incorporated into a pulse oximeter, the MS circuit boards perform all data acquisition processing and report the pulse oximetry levels to the host monitor. The circuit boards and related software interface directly with our proprietary sensors to calculate arterial blood oxygen saturation level and pulse rate. We released the MS-1 circuit board in 1996 and currently sell MS-3, MS-5, MS-7, MS-11 and MS-13 circuit boards, which vary in size and power consumption.

Masimo Rainbow SET MX Circuit Boards. Our next-generation circuit board is the foundation for our Masimo Rainbow SET Pulse CO-Oximetry platform, utilizing technology licensed from Masimo Labs. The MX circuit boards measure arterial blood oxygen saturation levels and pulse rate, and have the circuitry to enable the measurement of carboxyhemoglobin, methemoglobin and potentially other parameters. Customers can choose to buy additional parameters beyond arterial blood oxygen saturation levels and pulse rate at the time of sale or at any time in the future through software upgrade. As additional parameters are developed, each new parameter may be available as a software upgrade to the existing system.

Pulse Oximeters

Radical. We believe that the Radical pulse oximeter is the most advanced and versatile pulse oximetry monitor available. The Radical, using Masimo SET, offers three-in-one capability to be used as:

- a standalone device for bedside monitoring;
- a detachable, battery-operated handheld unit for easy portable monitoring; and
- a monitor interface via SatShare, proprietary technology allowing our products to work with certain competitor products, to upgrade existing conventional multi-parameter patient monitors to Masimo SET.

Radical is a fully-equipped standalone pulse oximeter with a detachable module, which functions as a battery-operated, handheld pulse oximeter. The handheld module can be connected with any other Radical base station, which allows Radical to stay with the patient, enabling continuous and reliable arterial blood oxygen saturation monitoring as patients are transported within the hospital. For example, Radical can continuously monitor a patient from the ambulatory environment, to the emergency room, to the operating room, to the general floor, and on until the patient is discharged. Radical delivers the accuracy and reliability of Masimo SET with multi-functionality, ease of use and a convenient upgrade path for existing monitors.

Our SatShare technology enables a conventional monitor to upgrade to Masimo SET through a simple cable connection from the back of Radical to the sensor input port of the conventional monitor. No software upgrades or new modules are necessary for the upgrade, which can be completed in minutes. SatShare allows hospitals to standardize the technology and sensors used throughout the hospital while allowing them to gain more accurate monitoring capabilities and additional multi-functionality in a cost-effective manner. This has facilitated many hospital-wide conversions of previously installed competitor monitors to Masimo SET. We received FDA clearance for Radical in October 1999 and began commercially shipping Radical in 2000.

Radical-7. The Radical-7 incorporates the MX circuit board which enables Rainbow SET parameters. We received FDA clearance in October 2006 and began shipping Radical-7 in 2007, which permits the non-invasive monitoring of arterial blood oxygen saturation levels, pulse rate, perfusion index and carboxyhemoglobin and methemoglobin saturation levels, Pleth Variability Index and 3D alarms through

a software purchase. Over time, we expect the Radical-7 to replace the Radical as our primary bedside Masimo SET pulse oximeter.

Rad-8. The Rad-8 is a bedside pulse oximeter with a lower cost design and fewer features as compared to Radical, allowing for the Rad-8 to be offered at a lower price point.

Rad-5. In addition to Radical, we have developed handheld pulse oximeters using Masimo SET. Our Rad-5 and Rad-5v handheld oximeters were the first dedicated handhelds with Masimo SET.

Rad-57. In March 2005, we introduced Rad-57, and in September 2005, we launched commercial sales of the first handheld Pulse CO-Oximeter that employs licensed Rainbow technology. We believe Rad-57 is the first FDA-cleared device to non-invasively measure carboxyhemoglobin saturation levels in the blood. Rad-57 also measures arterial blood oxygen saturation levels and pulse rate.

Rad-57 CM. In December 2005, we sold Rad-57 CM in Europe and we received FDA-clearance to market the product in the United States in March 2006. We believe Rad-57 CM to be the first FDA-cleared device to non-invasively measure both carboxyhemoglobin and methemoglobin saturation levels in the blood. Rad-57 CM also measures arterial blood oxygen saturation levels and pulse rate.

Consumable Products

Sensors and Cables. We have developed one of the broadest lines of single-patient use and reusable sensors and cables. Masimo SET sensors are uniquely designed to reduce interference from physiological and non-physiological noise. Our proprietary technology platforms operate only with our proprietary sensor lines. However, through the use of adapter cables, we can connect our sensors to certain competitive pulse oximetry monitors. We sell our sensors and cables to end-users through our direct sales force and our distributors and OEM partners.

Our single-patient use sensors offer several advantages over reusable sensors, including improved performance, cleanliness, increased comfort and greater reliability. In addition, our LNOP single-patient use sensors offer several advantages over competitive disposable sensors, including a more durable tape material that is less likely to tear and an adhesive that can be easily rejuvenated with an alcohol swab. As a result, the sensor can be moved and reapplied multiple times during a patient s stay. Our LNOP single-patient neonatal adhesive sensors have been shown in independent, published studies to last approximately twice as long as the market-leading disposable sensor. Our reusable sensors, which include ear and forehead sensors, are primarily used for short-term hospital stays and spot checks. We currently sell over 40 different sensors for adults, children, infants and pre-term infants.

SofTouch Sensors. We have developed SofTouch sensors, designed with less adhesive or no adhesive at all for compromised skin conditions. These include single-patient sensors for babies and multi-site reusable sensors for pediatrics and adults.

Trauma and Newborn Sensors. We believe we were the first to develop two specialty sensor lines, specifically designed for trauma and resuscitation situations, as well as for newborns. These sensors contain an identifier which automatically sets the oximeter to monitor with maximum sensitivity and the shortest-averaging mode and allows for quick application, even in wet and slippery environments.

Blue Sensors. In 2005, we introduced what we believe to be the first FDA-cleared sensor to accurately monitor arterial blood oxygen saturation levels in cyanotic infants and children with abnormally low oxygen saturation levels.

Masimo Rainbow SET Sensors. We believe we were the first to develop proprietary, multi-wavelength sensors for use with our Rainbow SET Pulse CO-Oximetry products. As opposed to traditional sensors

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that only have the capability to monitor arterial blood oxygen saturation levels and pulse rate, our Rainbow sensors can also monitor carboxyhemoglobin and methemoglobin. Our licensed Rainbow SET sensors are the only sensors that are compatible with our licensed Rainbow SET products.

Remote-Alarm and Monitoring Solutions

RadNet. RadNet enables Masimo SET and Rainbow SET monitors with a wired or wireless monitoring system to provide continuous, centralized monitoring of remotely located patients, with the ability to monitor up to 28 patients per system.

RadLink. RadLink is a standalone wireless alarm notification system that sends alarm information to one or more clinician-worn pagers.

PPO+. PPO+, or Personal Pulse Oximeter, is a patient-wearable pulse oximeter and electrocardiogram, or ECG, monitor that can wirelessly transmit patients arterial blood oxygen saturation level, pulse rate and ECG to the RadNet. PPO+ is ideally suited for monitoring ambulatory patients in the general care areas, emergency department, emergency department waiting room and any other area where the patient is ambulatory.

Both RadNet and PPO+ are OEM products from Welch Allyn.

Software All of our monitors, including Radical-7 and certain future OEM products, which incorporate the MX board will allow purchases of software for Rainbow parameters as well as other future parameters or features that can be field installed.

Sales and Marketing

As of April 30, 2007, we had 250 employees in sales and marketing in the United States and abroad, including 91 sales representatives and 40 clinical specialists. We currently sell all of our products both directly to hospitals and the EMS market via our sales force, and certain distributors, and sell certain of our products to our OEM partners for incorporation into their products.

Our direct and distributor revenues accounted for approximately 67.0% of our total product revenue in 2006. The primary focus of our sales representatives is to facilitate the conversion of competitor accounts to our Masimo SET pulse oximetry products. In addition to sales representatives, we employ clinical specialists to work with our sales representatives to educate end-users on the benefits of Masimo SET and assist with the introduction and implementation of our technology and products to their sites. Our sales and marketing strategy for pulse oximetry has been and will continue to be focused on building end-user awareness of the clinical and cost-saving benefits of our Masimo SET platform. More recently, we have expanded this communication and educational role to include our Masimo Rainbow SET Pulse CO-Oximetry products, with specifically carboxyhemoglobin and methemoglobin.

Additionally, we sell certain of our products through our OEM partners who both incorporate our boards into their monitors and resell our consumables to their customers installed base of Masimo SET products. Our OEM agreements allow us to expand the availability of Masimo SET through the sales and distribution channels of each OEM partner. To facilitate clinician awareness of Masimo SET installations, all of our OEM partners have agreed to place the Masimo SET logo prominently on their instruments. As of December 31, 2006, we had agreements with 44 OEM partners whom we believe account for over 90% of worldwide shipments of pulse oximeters incorporated into multi-parameter monitors. As of December 31, 2006, our OEM partners had collectively launched a total of 96 patient monitoring products worldwide incorporating Masimo SET.

In order to facilitate our direct sales to hospitals, we have signed contracts with five of the six largest GPOs, based on their total volume of negotiated purchases, and are in negotiations with several others.

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In return for the GPOs to put our products on contract, we have agreed to pay the GPOs a percentage of our revenues from their member hospitals.

Our marketing efforts are designed to build end-user awareness through advertising, direct mail and trade shows. In addition, we distribute published clinical studies, sponsor accredited educational seminars for doctors, nurses, biomedical engineers, and respiratory therapists and conduct clinical evaluations. We expect to increase the size of our sales and marketing force worldwide during 2007, as we continue to establish additional sales channels on a global basis.

Competition

The medical device industry is highly competitive and many of our competitors have substantially greater financial, technical, marketing and other resources than we do. While we regard any company that sells pulse oximeters as a potential customer, we also recognize that the companies selling pulse oximeters on an OEM basis and/or pulse oximetry sensors are also potential competitors. Our primary competitor, Nellcor, currently holds a substantial share of the pulse oximetry market. Nellcor sells its own pulse oximeters to end-users, sells pulse oximetry modules to other monitoring companies on an OEM basis and licenses, to certain OEMs, the right to make their pulse oximetry platforms compatible with Nellcor sensors. Although Nellcor is still a competitor of ours, we recently settled a patent infringement case against them following an appellate ruling which found that Nellcor had infringed three of our patents. See Nellcor Patent Litigation Settlement. We face substantial competition from larger medical device companies, including companies that develop products that compete with our proprietary Masimo SET. We believe there are seven companies that have announced products which claim to offer read-through motion accuracy. Based on those announcements and our investigations, we believe that many of these products include technology that infringes our intellectual property rights. We have settled claims against four of the eight identified companies and intend to vigorously enforce and protect our proprietary rights with respect to the other companies whom we believe are infringing our technology. Three of the four remaining companies, GE Medical Systems, Philips Medical Systems and Mindray Medical International Ltd., are OEM licensees of ours.

We believe that the principal competitive factors in the market for pulse oximetry products include:

- accurate monitoring during both patient motion and low perfusion;
- ability to increase other clinically beneficial parameters related to oxygenation and respiration, such as carboxyhemoglobin and methemoglobin;
- competitive pricing;
- sales and marketing capability;
- access to hospitals which are members of GPOs;
- access to OEM partners; and
- patent protection.

Masimo Laboratories, Inc.

Masimo Laboratories, Inc., or Masimo Labs, is an independent entity spun off from us to our stockholders in 1998. Joe E. Kiani and Jack Lasersohn, members of our board of directors, are also members of the board of directors of Masimo Labs. Joe E. Kiani, our Chairman and Chief Executive Officer, is also the Chairman and Chief Executive Officer of Masimo Labs.

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We have a cross-licensing agreement with Masimo Labs for certain technologies. The following table outlines our rights under the Cross-Licensing Agreement relating to specific end user markets and the related technology applications of specific parameters.

	End User Markets	
Parameters	**Professional Caregiver and EMS**	**Patient and Pharmacist**
Vital Signs[1]	Masimo (owns)	Masimo Labs (non-exclusive license)
Non-Vital Signs[2]	Masimo (exclusive license)	Masimo Labs (owns)

(1) Vital signs parameters includes SpO2, peripheral venous oxygen saturation, mixed venous oxygen saturation, fetal oximetry, sudden infant death syndrome, ECG, blood pressure (non-invasive blood pressure, invasive blood pressure and continuous non- invasive blood pressure), temperature, respiration rate, CO2, pulse rate, cardiac output, EEG, perfusion index, depth of anesthesia, cerebral oximetry, tissue oximetry and/or EMG, and associated features derived from these parameters, such as 3-D alarms, Pleth Variability Index and other features.

(2) Non-vital signs parameters includes the body fluid constituents other than vital signs parameters and include, but are not limited to, carbon monoxide, methemoglobin, blood glucose, total hemoglobin and bilirubin.

Our License to Masimo Labs. We granted Masimo Labs an exclusive, perpetual and worldwide license, with sublicense rights, to use all Masimo SET owned by us for the measurement of non-vital signs parameters and to develop and sell devices incorporating Masimo SET for monitoring non-vital signs parameters in the Labs Market. We also granted Masimo Labs a non-exclusive, perpetual and worldwide license, with sublicense rights, to use Masimo SET for the measurement of vital signs in the Labs Market. In exchange, Masimo Labs pays us a 10% royalty on the amount of vital signs sensors and accessories sold by Masimo Labs.

The Labs Market is defined as any product market in which a product is intended to be used by a patient or pharmacist rather than a professional medical caregiver regardless of the particular location of the sale, including sales to doctors, hospitals, EMS professionals or otherwise, provided the product is intended to be recommended, or resold, for use by the patient or pharmacist.

Masimo Labs License to Us. We exclusively licensed from Masimo Labs the right to make and distribute products in the Masimo Market that utilize Rainbow technology for the measurement of carbon monoxide, methemoglobin, fractional arterial oxygen saturation, and total hemoglobin, which includes hematocrit. To date, we have developed and commercially released devices that measure carbon monoxide and methemoglobin using licensed Rainbow technology. We also have the option to obtain the exclusive license to make and distribute products in the Masimo Market that utilize Rainbow technology for the measurement of other non-vital signs parameters, including blood glucose. These licenses are exclusive until the later of 20 years from the grant of the applicable license or the expiration of the last patent included in the Rainbow technology related to the applicable parameter.

The Masimo Market is defined as those product markets where the product is intended to be used by a professional medical caregiver, including hospital caregivers, surgicenter caregivers, paramedic vehicle caregivers, doctor s offices caregivers, EMS facility caregivers and vehicles where emergency medical services are provided.

Our license to Rainbow technology for these parameters in these markets is exclusive on the condition that we continue to pay Masimo Labs royalties on our products incorporating Rainbow technology, subject to certain minimum unit and aggregate royalty thresholds, and that we use commercially reasonable efforts to develop or market products incorporating the licensed Rainbow technology. The royalty is up to 10% of the Rainbow royalty base, which includes handhelds, tabletop and multi-parameter devices. Handheld products incorporating Rainbow technology will carry a 10% royalty rate.

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For other products, only the proportional amount attributable for that portion of our products used to measure non-vital signs parameters, sensors and accessories, rather than for measuring vital signs parameters, will be included in the 10% Rainbow royalty base. For multi-parameter devices, the Rainbow royalty base will include the percentage of the revenues based on the number of Rainbow-enabled parameters. Beginning in 2009, for hospital contracts where we place equipment and enter into a sensor contract, we will pay a royalty to Masimo Labs on the total sensor contract revenues based on the ratio of Rainbow enabled devices to total devices.

We are also subject to certain specific annual minimum aggregate royalty payments. These minimum aggregate royalty payments are $3.15 million, $3.5 million, $4.0 million and $5.0 million in the years ended 2007, 2008, 2009 and 2010, respectively, and $5.0 million per year thereafter.

To date, we have paid Masimo Labs a fee of $7.5 million for an exclusive option to measure non-vital signs parameters and we have exercised the option for licenses to measure carbon monoxide, methemoglobin, fractional arterial oxygen saturation, and total hemoglobin, for an additional aggregate amount of $7.5 million. We have 180 days after proof of feasibility to exercise the above-referenced option to obtain a license to the remaining non-vital signs parameters, including carbon monoxide, methemoglobin, total hemoglobin and bilirubin, for an additional $500,000 each, and blood glucose, which is $2.5 million.

Change in Control. The Cross-Licensing Agreement provides that, upon a change in control:

- if the surviving or acquiring entity ceases to use Masimo as a company name and trademark, all rights to the Masimo trademark will be assigned to Masimo Labs;
- the option to license technology developed by Masimo Labs for use in blood glucose monitoring will be deemed automatically exercised and a $2.5 million license fee for this technology will become immediately payable to Masimo Labs;
- per product minimum royalties, to the extent less than the annual minimums, will be payable to Masimo Labs; and
- the minimum aggregate annual royalties for all licensed Rainbow parameters payable to Masimo Labs will increase to $5.0 million, $7.0 million, $10.0 million and $15.0 million in the years ended 2007, 2008, 2009 and 2010 and after until the exclusive period of the agreement ends, respectively, plus up to $2.0 million per other Rainbow parameters.

A change in control includes any of the following with respect to us or Masimo Labs:

- the sale of all or substantially all of either party s assets to a non-affiliated third party;
- the acquisition by a non-affiliated third party of 50% or more of the voting power of either party;
- Joe E. Kiani, our Chief Executive Officer and the Chief Executive Officer of Masimo Labs, resigns or is terminated from his position with either party; and
- the merger or consolidation of either party with a non-affiliated third party.

Ownership of Improvements. Any improvements to Masimo SET or Rainbow technology made by Masimo Labs, by us, or jointly by Masimo Labs with us or with any third party that relates to non-vital signs monitoring, and any new technology acquired by Labs, is and will be owned by Masimo Labs. Any improvements to the Masimo SET platform or Rainbow technology made by Masimo Labs, by us, or jointly by Masimo Labs with us or with any third party that relates to vital signs monitoring, and any new technology acquired by us, is and will be owned by us. However, in either case, any improvements to the technology, excluding acquired technology, will be assigned to the other party and be subject

to the terms of the licenses granted under the Cross-Licensing Agreement. Any new non-vital signs

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monitoring technology utilizing Masimo SET that we develop will be owned by Masimo Labs and will be subject to the same license and option fees as if it had been developed by Masimo Labs. Also, we will not be reimbursed by Masimo Labs for our expenses relating to the development of any such technology.

Masimo Labs Services Agreement. We have also entered into a services agreement, or the Services Agreement, with Masimo Labs. Under this Services Agreement, we provide Masimo Labs with engineering services and accordingly, charge Masimo Labs for these direct salary and payroll related expenses. In addition, at the end of each quarter, we charge Masimo Labs for its share of accounting, human resources, legal, facility and equipment costs, which we collectively refer to as indirect expenses. From its inception in 1998 through December 31, 2006, Masimo Labs has incurred approximately $11.2 million in both direct and indirect expenses. We expect Masimo Labs to continue to engage us for these services. However, pursuant to the Services Agreement, Masimo Labs may terminate the agreement by providing 30 days notice, while we may terminate with 180 days notice.

Research and Product Development

We believe that ongoing research and development efforts are essential to our success. As of April 30, 2007, we employed 119 engineers and engineering support staff. We expect to significantly increase the size of our research and development staff during 2006. Our research and development efforts focus primarily on continuing to enhance our technical expertise in pulse oximetry, enabling the non-invasive monitoring of other parameters and developing remote-alarm and monitoring solutions.

Although we and Masimo Labs each have separate research and development projects, we collaborate with Masimo Labs on multiple research and development activities related to Rainbow technology and other technologies. Under the Cross-Licensing Agreement, the parties have agreed to allocate proprietary ownership of technology developed by either party based on the functionality of the technology. We will have proprietary rights to all technology related to the non-invasive measurement of vital signs parameters, and Masimo Labs will have proprietary ownership of all technology related to the non-invasive measurement of non-vital signs parameters. In addition, under our Services Agreement with Masimo Labs, we provide Masimo Labs with professional and management support services, including accounting, human resources, legal and accounting services. Through December 2006, Masimo Labs had approximately 13 full-time equivalent engineers supporting its development efforts. In January 2007, Masimo Labs realigned its development efforts and, as of April 30, 2007, it had five full-time engineers supporting its development efforts.

Our total research and development expenditures for 2006 were $24.9 million, which included $9.4 million of stock-based compensation, and $3.4 million related to expenses incurred by Masimo Labs pursuant to the Cross-Licensing Agreement.

In the three months ended March 31, 2007, research and development expense was $5.5 million, which included $259,000 of expense related to Masimo Labs. In 2005, total research and development expenditures were $11.3 million, which included $2.8 million of in-process research and development and $2.6 million related to expenses incurred by Masimo Labs pursuant to the Cross-Licensing Agreement. In 2004, we incurred $6.0 million in research and development expenditures, of which $2.0 million was related to expenses incurred by Masimo Labs pursuant to the Cross-Licensing Agreement. We expect our research and development expenses to increase in 2007 and beyond as we expand our research and development force, enhance our existing products and technologies and develop new ones.

Intellectual Property

We believe that in order to maintain a competitive advantage in the marketplace, we must develop and maintain protection of the proprietary aspects of our technology. We rely on a combination of patent, trademark, trade secret, copyright and other intellectual property rights and measures to protect our intellectual property.

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We have developed a patent portfolio internally, as well as through acquisitions and licensing, that covers many aspects of our product offerings. As of April 30, 2007, we had 241 issued patents and over 188 pending applications in the United States, Europe, Japan, Australia, Canada and other countries throughout the world. In addition, as of April 30, 2007, technology we licensed from our development partner, Masimo Labs, was supported by 33 issued patents and over 50 pending applications in the United States and internationally. Some of our earliest patents begin to expire in 2011. Some of Masimo Labs earliest patents begin to expire in 2015. Additionally, as of April 30, 2007, we owned 35 U.S. registered trademarks and 102 foreign registered trademarks, as well as trade names that we use in conjunction with the sale of our products.

Under the Cross-Licensing Agreement, we and Masimo Labs have agreed to allocate proprietary ownership of technology developed based on the functionality of the technology. We will have proprietary ownership, including ownership of all patents, copyrights and trade secrets, of all technology related to the non-invasive measurement of vital signs parameters, and Masimo Labs will have proprietary ownership of all technology related to the non-invasive measurement of non-vital signs parameters. We also rely upon trade secrets, continuing technological innovations and licensing opportunities to develop and maintain our competitive position. We seek to protect our trade secrets and proprietary know-how, in part, with confidentiality agreements with consultants, vendors and employees, although we cannot be certain that the agreements will not be breached, or that we will have adequate remedies for any breach.

There are risks related to our intellectual property rights. For further detail on these risks, see Risk Factors.

Nellcor Patent Litigation Settlement

In October 1999, we filed a patent infringement lawsuit in the United States District Court for the Central District of California against Mallinckrodt, Inc., now part of Tyco Healthcare, and Nellcor, a subsidiary of Mallinckrodt, Inc., one of the largest manufacturers and distributors of pulse oximetry products in the world, for infringement of our pulse oximetry signal processing patents. Nellcor denied our claims and made counterclaims alleging infringement of their patents by us. This lawsuit resulted in a jury verdict that Nellcor had infringed several of our patents, including one of our read-through motion pulse oximeter patents, and Masimo had not infringed the remaining Nellcor patent in the lawsuit. After the jury verdict, the District Court upheld the jury verdict on two of our patents, found one of our patents not infringed and another unenforceable. The Federal Court of Appeals, reinstated the jury verdict of infringement for the patent that the District Court had found not infringed and in total affirmed that three of our patents were infringed by Nellcor and ordered the District Court to enjoin the sale of Nellcor s infringing products. The patents under which we ultimately prevailed generally relate to calculating oxygen saturation in the presence of motion induced noise, calculating oxygen saturation with adaptive Kalman filters, using alternative calculations for the same physiological parameter, and a particular method for reducing noise in the signal.

Prior to the court issuing a permanent injunction, Nellcor entered into a settlement agreement with us on January 17, 2006, under which we agreed to settle all pending patent litigation with Nellcor and granted Nellcor a covenant not to sue on certain new products. In return, Nellcor agreed to stop selling the products that were found to infringe and paid us $263.0 million for damages incurred through January 2006. In addition, under the settlement agreement, Nellcor agreed to pay us:

- a royalty of 7% of its pulse oximetry revenue for products shipped, serviced and licensed to its partners in the U.S. during 2006;

- an additional ongoing royalty of 13% of its pulse oximetry revenue for products shipped, serviced and licensed to its partners in the U.S. at any time on or after February 1, 2006,

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which may be reduced to 10% in the event Nellcor implements specific changes to its products for devices that were found to infringe; and

an additional ongoing royalty of 2% of its pulse oximetry revenue for products shipped, serviced and licensed to its partners in the U.S. in 2007.

In January 2006, Nellcor made an advance royalty payment to us of $67.5 million related to sales of Nellcor s products during the remainder of 2006. Through December 31, 2006, we received $330.5 million in cash from Nellcor. All royalties accruing under the settlement agreement on or after January 1, 2007 must be paid to us within 60 days of the end of each calendar quarter.

The term of the settlement agreement will continue until the later of March 14, 2011, the latest expiration date of our patents covered by the settlement agreement or the last availability of Nellcor s products covered by our covenant not to sue Nellcor. Nellcor s obligation to pay us royalties on its total U.S. pulse oximetry revenue will continue at least until March 14, 2011.

We believe the result of this judgment was to strengthen the patents on which we prevailed, which included some patents supporting our Masimo SET platform. We intend to continue to protect our rights and pursue additional infringement claims against other companies whose products we believe infringe our patents.

We recorded the $263.0 million lump sum payment as patent lawsuit proceeds in January 2006. We recognize royalty revenue based on the estimated average royalty rate per the settlement agreement multiplied by our estimate of Nellcor s sales for each quarter. This estimate is adjusted when we receive the Nellcor royalty report, 60 days after the end of each quarter. We recognized approximately $68.8 million of royalty revenue in 2006. Per our settlement agreement, the 2006 royalty rate will decline significantly and, as a result, we expect our future Nellcor royalties to be significantly below the levels recognized in 2006.

Dividends and Special Bonus Payments

In March 2006, we paid a cash dividend of $10.096 per share, in the aggregate amount of approximately $171.8 million, to holders of our common and preferred stock, and in February 2007, we paid additional cash dividends of $1.404 per share and $0.77 per share, in the aggregate amount of approximately $37.1 million, to holders of our common and preferred stock. In addition, in March 2006 and March 2007, we made special bonus payments in the aggregate amount of approximately $11.7 million to our employees and directors who held vested stock options as of March 1, 2006. The majority of the funds used to pay these cash dividends and special bonus payments were made from the after-tax proceeds that we received from our patent infringement lawsuit against Nellcor. We do not intend to distribute any future royalties received from Nellcor under the settlement agreement to our stockholders or our option holders. For further details on the litigation settlement, see Business Nellcor Patent Litigation Settlement.

Government Regulation

FDA s Premarket Clearance and Approval Requirements

Unless an exemption applies, each medical device that we wish to market in the United States must first receive either 510(k) clearance, by filing a 510(k) pre-market notification, or PMA approval, by filing a PMA application, from the FDA pursuant to the Federal Food, Drug, and Cosmetic Act. The FDA s 510(k) clearance process usually takes from four to twelve months, but it can last longer. The process of obtaining PMA approval is much more costly, lengthy and uncertain. It generally takes from one to three years or even longer. We cannot be sure that 510(k) clearance or PMA approval will ever be obtained for any product we propose to market.

The FDA decides whether a device must undergo either the 510(k) clearance or PMA approval process based upon statutory criteria. These criteria include the level of risk that the agency perceives is

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associated with the device and a determination whether the product is a type of device that is similar to devices that are already legally marketed. Devices deemed to pose relatively less risk are placed in either class I or II, which requires the manufacturer to submit a pre-market notification requesting 510(k) clearance, unless an exemption applies. The premarket notification must demonstrate that the proposed device is substantially equivalent in intended use and in safety and effectiveness to a legally marketed predicate device that is either in class I, class II, or is a class III device that was in commercial distribution before May 28, 1976, for which the FDA has not yet called for submission of a PMA application. All of our current devices are Class II devices.

Class I devices are those for which safety and effectiveness can be assured by adherence to the FDA s general regulatory controls for medical devices, which include compliance with the applicable portions of the FDA s Quality System Regulation, facility registration and product listing, reporting of adverse medical events, and appropriate, truthful and non-misleading labeling, advertising, and promotional materials (General Controls). Some Class I devices also require premarket clearance by the FDA through the 510(k) premarket notification process described below.

Class II devices are subject to the FDA s General Controls, and any other special controls as deemed necessary by the FDA to ensure the safety and effectiveness of the device. Premarket review and clearance by the FDA for Class II devices is accomplished through the 510(k) premarket notification procedure. Pursuant to the Medical Device User Fee and Modernization Act of 2002 (MDUFMA), as of October 2002 unless a specific exemption applies, 510(k) premarket notification submissions are subject to user fees. Certain Class II devices are exempt from this premarket review process.

Class III devices are those devices which have a new intended use, or use advanced technology that is not substantially equivalent to that of a legally marketed device. The safety and effectiveness of Class III devices cannot be assured solely by the General Controls and the other requirements described above. These devices almost always require formal clinical studies to demonstrate safety and effectiveness and must be approved through the premarket approval process described below. Premarket approval applications (and supplemental premarket approval applications) are subject to significantly higher user fees under MDUFMA than are 510(k) premarket notifications.

After a device receives 510(k) clearance, any modification that could significantly affect its safety or effectiveness, or that would constitute a major change in its intended use, requires a new 510(k) clearance or could require a PMA approval. The FDA requires each manufacturer to make this determination in the first instance, but the FDA can review any decision. If the FDA disagrees with a manufacturer s decision not to seek a new 510(k) clearance, the agency may retroactively require the manufacturer to seek 510(k) clearance or PMA approval. The FDA also can require the manufacturer to cease marketing and/or recall the modified device until 510(k) clearance or PMA approval is obtained. We have modified some of our 510(k) cleared devices, including our Masimo SET Software and Radical, but have determined that, in our view, based on FDA guidance as to when to submit a 510(k) notification for changes to a cleared device, new 510(k) clearances or PMA approvals are not required. We cannot assure you that the FDA would agree with any of our decisions not to seek 510(k) clearance or PMA approval. If the FDA requires us to seek 510(k) clearance or PMA approval for any modification, we also may be required to cease marketing and/or recall the modified device until we obtain a new 510(k) clearance or PMA approval.

Devices deemed by the FDA to pose the greatest risk, such as life-sustaining, life-supporting or implantable devices, or deemed not substantially equivalent to a legally marketed predicate device, are placed in class III. These devices are required to undergo the PMA approval process in which the manufacturer must prove the safety and effectiveness of the device to the FDA s satisfaction. A PMA application must provide extensive preclinical and clinical trial data and also information about the device and its components regarding, among other things, device design, manufacturing and labeling.

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After approval of a PMA, a new PMA or PMA supplement is required in the event of a modification to the device, its labeling or its manufacturing process.

A clinical trial may be required in support of a 510(k) submission and generally is required for a PMA application. These trials generally require an Investigational Device Exemption, or IDE, application approved in advance by the FDA for a specified number of patients, unless the product is deemed a nonsignificant risk device eligible for more abbreviated IDE requirements. The IDE application must be supported by appropriate data, such as animal and laboratory testing results. Clinical trials may begin if the IDE application is approved by the FDA and the appropriate institutional review boards at the clinical trial sites.

We believe that our OEM partners may be required to obtain 510(k) premarket clearance from the FDA for products that incorporate Masimo SET circuit boards and sensors. In order to facilitate our OEM partners in obtaining 510(k) clearance for their products that incorporate Masimo SET boards and sensors, we have submitted 37 510(k) notices covering our Masimo SET circuit boards and sensors.

In the future, we may be required to submit additional 510(k) clearance to address new claims, uses or products. We cannot assure you that FDA will not deem one or more of our future products (or those of our OEM partners) to be a class III device subject to the more burdensome PMA approval process.

Pervasive and Continuing FDA Regulation

A host of regulatory requirements apply to our marketed devices, including the Quality System Regulation (which requires manufacturers to follow elaborate design, testing, control, documentation and other quality assurance procedures), the Medical Device Reporting regulation (which requires that manufacturers report to the FDA specified types of adverse events involving their products), labeling regulations, and the FDA s general prohibition against promoting products for unapproved or off-label uses. Since our inception, we have had three voluntary recalls of our products, none of which were material. Class II devices also can have special controls such as performance standards, postmarket surveillance, patient registries and FDA guidelines that do not apply to class I devices. Unanticipated changes in existing regulatory requirements or adoption of new requirements could hurt our business, financial condition and results of operations.

Our OEM partners and we are subject to inspection and market surveillance by the FDA to determine compliance with regulatory requirements. If the FDA finds that our OEM partners or we have failed to comply, the agency can institute a wide variety of enforcement actions, ranging from a public warning letter to more severe sanctions such as:

- fines, injunctions and civil penalties;
- recall, detention or seizure of our products;
- the issuance of public notices or warnings;
- operating restrictions, partial suspension or total shutdown of production;
- refusing our requests for 510(k) clearance or PMA approval of new products;
- withdrawing 510(k) clearance or PMA approvals already granted; and
- criminal prosecution.

The FDA also has the authority to request repair, replacement or refund of the cost of any medical device manufactured or distributed by us. Our failure (or the failure of our OEM partners) to comply with applicable requirements could lead to an enforcement action that may have an

adverse effect on our financial condition and results of operations.

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Other U.S. Regulation

We and our OEM partners also must comply with numerous federal, state and local laws relating to matters such as safe working conditions, manufacturing practices, environmental protection, fire hazard control and hazardous substance disposal. We cannot be sure that we will not be required to incur significant costs to comply with these laws and regulations in the future or that these laws or regulations will not hurt our business, financial condition and results of operations. Unanticipated changes in existing regulatory requirements or adoption of new requirements could hurt our business, results of operations and financial condition.

Environmental

Our manufacturing processes involve the use, generation and disposal of hazardous materials and wastes, including silicone adhesives, solder and solder paste, sealants, epoxies and various solvents such as methyl ethyl ketone, acetone and isopropyl alcohol. As such, we are subject to stringent federal, state and local laws relating to the protection of the environment, including those governing the use, handling and disposal of hazardous materials and wastes. Future environmental laws may require us to alter our manufacturing processes, thereby increasing our manufacturing costs. We believe that our products and manufacturing processes at our facilities comply in all material respects with applicable environmental laws and worker health and safety laws; however, the risk of environmental liabilities cannot be completely eliminated.

Health Care Fraud and Abuse

In the United States, there are federal and state anti-kickback laws that generally prohibit the payment or receipt of kickbacks, bribes or other remuneration in exchange for the referral of patients or other health-related business. For example, the Federal Health Care Programs Anti-Kickback Law (42 U.S.C. § 1320a-7b(b)) prohibits anyone from, among other things, knowingly and willfully offering, paying, soliciting or receiving any bribe, kickback or other remuneration intended to induce the referral of patients for, or the purchase, order or recommendation of, health care products and services reimbursed by a federal health care program (including Medicare and Medicaid). Recognizing that the federal anti-kickback law is broad and potentially applicable to many commonplace arrangements, the Office of Inspector General within the Department of Health and Human Services, or OIG, has issued regulations, known as the safe harbors, which identify permissible practices. If all of the requirements of an applicable safe harbor are met, an arrangement will not be prosecuted under this law. Safe harbors exist for a number of arrangements relevant to our business, including, among other things, payments to bona fide employees, certain discount arrangements, and certain payment arrangements involving GPOs. The failure of an arrangement to fit precisely within one or more safe harbors does not necessarily mean that it is illegal. However, conduct that does not fully satisfy each requirement of an applicable safe harbor may result in increased scrutiny by government enforcement authorities, such as the OIG or the Department of Justice. Violations of this federal law can result in significant penalties, including imprisonment, monetary fines and assessments, and exclusion from Medicare, Medicaid and other federal health care programs. Exclusion of a manufacturer would preclude any federal health care program from paying for its products. In addition to the federal anti-kickback law, many states have their own kickback laws. Often, these state laws closely follow the language of the federal law. Some state anti-kickback laws apply regardless of whether federal health care program payment is involved. Federal and state anti-kickback laws may affect our sales, marketing and promotional activities, educational programs, pricing and discount practices and policies, and relationship with health care providers by limiting the kinds of arrangements we may have with hospitals, EMS providers, GPOs and others in a position to purchase or recommend our products.

Federal and state false claims laws prohibit anyone from presenting, or causing to be presented, claims for payment to third-party payers that are false or fraudulent. For example, the federal Civil False Claims

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Act (31 U.S.C. § 3729 et seq.) imposes liability on any person or entity who, among other things, knowingly presents, or causes to be presented, a false or fraudulent claim for payment by a federal health care program (including Medicaid and Medicare). Manufacturers, like us, can be held liable under false claims laws, even if they do not submit claims to the government, where they are found to have caused submission of false claims by, among other things, providing incorrect coding or billing advice about their products to customers that file claims, or by engaging in kickback arrangements with customers that file claims. A number of states also have false claims laws, and some of these laws may apply to claims for items or services reimbursed under Medicaid and/or commercial insurance. Sanctions under these federal and state laws may include civil monetary penalties, exclusion of a manufacturer s products from reimbursement under government programs, and imprisonment.

The Health Insurance Portability and Accountability Act of 1996, or HIPAA, created two new federal crimes: health care fraud and false statements related to healthcare matters. The health care fraud statute prohibits knowingly and willingly executing a scheme to defraud any health care benefit program, including private payers. A violation of this statute is a felony and may result in fines, imprisonment or exclusion from government sponsored programs. The false statements statute prohibits knowingly and willfully falsifying, concealing or covering up a material fact or making any materially false, fictitious or fraudulent statement in connection with the delivery of or payment for health care benefits, items or services. A violation of this statute is a felony and may result in fines or imprisonment.

Due to the breadth of some of these laws, it is possible that some of our current or future practices might be challenged under one or more of these laws. In addition, there can be no assurance that we would not be required to alter one or more of our practices to be in compliance with these laws. Evolving interpretations of current laws or the adoption of new federal or state laws or regulations could adversely affect many of the arrangements we have with customers and physicians. Our risk of being found in violation of these laws is increased by the fact that some of these laws are open to a variety of interpretations. If our past or present operations are found to be in violation of any of these laws, we could be subject to civil and criminal penalties, which could hurt our business, results of operations and financial condition.

Privacy and Security of Health Information

Numerous federal, state and international laws and regulations govern the collection, use, and disclosure of patient-identifiable health information, including HIPAA. HIPAA applies to covered entities, which include most healthcare facilities that purchase and use our products. The HIPAA Privacy Rule restricts the use and disclosure of patient information, and requires covered entities to safeguard that information and to provide certain rights to individuals with respect to that information. The HIPAA Security Rule establishes elaborate requirements for safeguarding patient information transmitted or stored electronically. We are not a covered entity and our business is not directly subject to HIPAA. In certain circumstances the HIPAA rules require covered entities to contractually bind us, as a business associate, to protect the privacy and security of health information we may encounter during activities like training customers on the use of our products or investigating product performance. The HIPAA standards also apply to the use and disclosure of health information for research, and require the covered entity performing the research to obtain the written authorization of the research subject (or an appropriate waiver) before providing that subject s health information to sponsors like us for purposes related to the research. These covered entities also typically impose contractual limitations on our use and disclosure of the health information they disclose to us. We may be required to make costly system modifications to comply with the privacy and security requirements that will be imposed on us contractually by covered entities, and our failure to comply may result in liability and adversely affect our business.

Numerous other federal and state laws protect the confidentiality of patient information, including state medical privacy laws and federal and state consumer protection laws. These various laws in many cases are not preempted by the HIPAA rules and may be subject to varying interpretations by the courts and

government agencies, creating complex compliance issues for us and our customers and potentially exposing us to additional expense, adverse publicity and liability. Other countries also have, or are developing, laws governing the collection, use and transmission of personal or patient information and these laws could create liability for us or increase our cost of doing business.

New health information standards, whether implemented pursuant to HIPAA, congressional action or otherwise, could have a significant effect on the manner in which we must handle health care related data, and the cost of complying with these standards could be significant. If we do not properly comply with existing or new laws and regulations related to patient health information we could be subject to criminal or civil sanctions.

Foreign Regulation

Many foreign countries in which we market or may market our products have regulatory bodies and restrictions similar to those of the FDA. International sales are subject to foreign government regulation, the requirements of which vary substantially from country to country. The time required to obtain approval by a foreign country may be longer or shorter than that required for FDA approval and the requirements may differ. Companies are now required to obtain the CE Mark prior to sale of some medical devices within the European Union. During this process, the sponsor must demonstrate compliance with the International Organization for Standardization s manufacturing and quality requirements. We do have CE Marking on all our products that require such markings. We cannot assure you that we or our OEM partners will be able to obtain necessary foreign government approvals or successfully comply with foreign regulations. Our failure to do so could hurt our business, results of operations and financial condition.

Third-Party Reimbursement

Health care providers, including hospitals, that purchase our products generally rely on third-party payers, including the Medicare and Medicaid programs and private payers, such as indemnity insurers and managed care plans, to cover and reimburse all or part of the cost of the products and the procedures in which they are used. As a result, demand for our products is dependent in part on the coverage and reimbursement policies of these payers. No uniform coverage or reimbursement policy for medical technology exists among all third-party payers, as coverage and reimbursement can differ significantly from payer to payer.

CMS, the federal agency responsible for administering the Medicare program, along with its contractors, establishes coverage and reimbursement policies for the Medicare program. Because a large percentage of the hospitals using our products treat elderly or disabled individuals who are Medicare beneficiaries, Medicare s coverage and reimbursement policies are particularly significant to our business. In addition, private payers often follow the coverage and reimbursement policies of Medicare. We cannot assure you that government or private third-party payers will cover and reimburse the procedures using our products in whole or in part in the future or that payment rates will be adequate.

In general, Medicare will cover a medical product or procedure when the product or procedure is reasonable and necessary for the diagnosis or treatment of an illness or injury, or to improve the functioning of a malformed body part. Even if the medical product or procedure is considered medically necessary and coverage is available, Medicare may place restrictions on the circumstances where it provides coverage. For example, several Medicare local contractors have issued policies that restrict coverage for pulse oximetry in the hospital inpatient and outpatient settings to a limited number of conditions including limiting coverage to patients who (i) exhibit signs of acute respiratory dysfunction, (ii) have chronic lung disease, severe cardiopulmonary disease or neuromuscular disease involving the muscles of respiration, (iii) are under treatment with a medication with known pulmonary toxicity, or (iv) have sustained multiple trauma or complaints of acute chest pain.

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Reimbursement for our products may vary not only by the type of payer involved but also based upon the setting in which the product is furnished and utilized. For example, Medicare payment may be made, in appropriate cases, for patient stays in the hospital inpatient and outpatient settings involving the use of our products. Medicare generally reimburses hospitals based upon prospectively determined amounts. For hospital inpatient stays, the prospective payment generally is determined by the patient s condition and other patient data and procedures performed during the inpatient stay, using a classification system known as diagnosis-related groups, or DRGs. Prospective rates are adjusted for, among other things, regional differences, co-morbidity, and complications. Hospitals generally do not receive separate Medicare reimbursement for the specific costs of purchasing our products for use in the inpatient setting. Rather, Medicare reimbursement for these costs is deemed to be included within the prospective payments made to hospitals for the inpatient services in which the products are utilized.

In contrast, some differences may be seen in the reimbursement for use of our products in hospital outpatient departments. In this setting, Medicare payments also are generally made under a prospective payment system based on the ambulatory payment classifications, or APCs, under which individual items and procedures are categorized. Procedures that are comparable, both clinically and in terms of the resources required, to the same clinical APCs. Hospitals receive the applicable APC payment rate for the procedure regardless of the actual cost for such treatment. Some outpatient services such as oximetry services, though assigned a separate APC, do not receive separate reimbursement. Rather, their reimbursement is deemed packaged into the APC for an associated procedure. Effective January 1, 2007, however, reimbursement for certain pulse oximetry monitoring services, including those using our products, will no longer be packaged, but rather may receive a separate payment under APC 0443 (Overnight Pulse Oximetry) when no other separately payable services are provided. This could result in an increase in Medicare payments to our customers for the use of our products in the hospital outpatient setting.

Because PPS payments in both the hospital inpatient and outpatient settings are based on predetermined rates and may be less than a hospital s actual costs in furnishing care, hospitals have incentives to lower their operating costs by utilizing products that will reduce the length of inpatient stays, decrease labor or otherwise lower their costs. We cannot be certain that a hospital will purchase our products, despite the clinical benefits and opportunity for cost savings that we believe can be derived from their use. If hospitals cannot obtain adequate coverage and reimbursement for our products, or the procedures in which they are used, our business, financial condition and results of operations could suffer.

Our success in non-U.S. markets depends largely upon the availability of coverage and reimbursement from the third-party payers through which health care providers are paid in those markets. Health care payment systems in non-U.S. markets vary significantly by country, and include single-payer, government managed systems as well as systems in which private payers and government-managed systems exist side-by-side. Our ability to achieve market acceptance or significant sales volume in international markets we enter will be dependent in large part on the availability of reimbursement for procedures performed using our products under health care payment systems in such markets. There can be no assurance that reimbursement for our products, or the procedures in which our products are used, will be obtained or that such reimbursement will be adequate.

Manufacturing

Our strategy is to manufacture products in-house when it is efficient and cost-effective for us to do so. We currently manufacture internally our bedside and handheld pulse oximeters, our full line of disposable and reusable sensors and most of our patient cables. As of April 30, 2007, we had 888 employees and contract employees in manufacturing worldwide. We maintain a 25,000 square foot International Organization for Standardization 13485:2003 certified manufacturing area in our facility in Irvine, California, and a 53,200 square foot facility in Mexicali, Mexico.

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We will continue to utilize third-party contract manufacturers for products and subassemblies that can be more efficiently manufactured by these parties, such as our circuit boards. We monitor our third-party manufacturers and perform inspections and product tests at various steps in the manufacturing cycle to ensure compliance with our specifications. We also do full functional testing of our circuit boards.

We and our contract manufacturers rely on sole source suppliers for some components, including digital signal processor chips and analog to digital converter chips. We and our contract manufacturers have taken steps to minimize the impact of a shortage or stoppage of shipments of digital signal processor chips or analog to digital converter chips, including maintaining excess inventory and designing software that may be easily ported to another digital signal processor chip. In the event of a delay or disruption in the supply of sole source components, we believe that we and our contract manufacturers will be able to locate additional sources of these sole source components on commercially reasonable terms and without experiencing material disruption in our business or operations.

We have four major suppliers, and our agreements with each provide for varying terms with respect to term, termination and pricing. The initial terms of each of these agreements have expired, however, in each case the parties have either continued to perform under the agreement or the agreement provides for automatic renewal. While one such agreement does not provide for express termination rights, the remaining three agreements allow for termination upon specified notice, ranging from 120 days to six months, to the non-terminating party. Each of these agreements allow for pricing adjustments: all four involve annual pricing negotiation, and one also one assures us of the most favorable pricing offered to any other customer.

Employees

As of April 30, 2007, we had approximately 1,313 full-time employees and contract employees worldwide, 119 of which were engaged in research and development, 888 of which were engaged in manufacturing and quality assurance, 250 of which were engaged in sales and marketing and 56 of which were engaged in general and administrative functions. We believe that our relations with our employees are good.

Segment Information and Enterprise Reporting

Our chief decision maker, the Chief Executive Officer, reviews financial information presented on a consolidated basis, accompanied by disaggregated information about revenues by geographic region for purposes of making operating decisions and assessing financial performance. Accordingly, we consider Masimo to be in a single reporting segment, specifically non-invasive patient monitoring and related products. We do not assess the performance of its geographic regions on other measures of income or expense, such as depreciation and amortization, operating income or net income. In addition, our assets are primarily located in the United States and are not allocated to any specific region. The Company does not produce reports for, or measure the performance of, its geographic regions on any asset-based metrics. Therefore, geographic information is presented only for revenues.

The following schedule presents an analysis of our product sales based upon the geographic area to which the product was shipped (in thousands):

	Year Ended December 31,			Three Months Ended March 31,	
	2004	2005	2006	2006	2007
Geographic Area by Destination					
United States	$ 53,354	$ 86,948	$ 120,047	$ 27,300	$ 34,584
All foreign countries	15,715	20,665	35,084	7,379	11,180
Total product sales	$ 69,069	$ 107,613	$ 155,131	$ 34,679	$ 45,764

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Facilities

We lease approximately 122,000 square feet of space in Irvine, California, for our corporate headquarters and product manufacturing, research and development, warehousing and distribution operations. The lease covering 72,000 square feet of this space expires in October 2009. We have the right to renew this lease for an additional five-year period at the end of the lease term. In February 2006, we entered into a lease for an additional 50,200 square feet of space adjacent to our current facility for office space and research and development. This lease expires in March 2010. We have an option to renew this lease for an additional five-year period at the end of the lease term. We also lease approximately 53,200 square feet of space in Mexicali, Mexico, for the manufacture of our sensors and accessories under a shelter labor agreement with Industrial Vallera de Mexicali, S.A. de C.V., or IVEMSA. IVEMSA is a Mexican maquiladora, which is a shelter services provider incorporated in Mexico that is licensed to operate factories and plants in Mexico. The shelter program allows foreign companies to manufacture in Mexico without being required to organize and operate their own subsidiary, for example, as a Mexican corporation. As a result, the risks of labor liability, ownership of facilities and legal presence of foreign corporations in Mexico are avoided. We entered into the agreement with IVEMSA to establish and run a facility to manufacture our sensors and accessory products. IVEMSA leases the space directly from the owner of the property under three lease agreements covering three adjoining modules. The first lease agreement, which covers approximately 17,000 square feet of space, expires in June 2008. The second lease of approximately 15,500 square feet of space expires in June 2008. The third lease of approximately 20,700 square feet of space expires in December 2011.

In addition, Masimo Europe, Ltd. leases approximately 3,400 square feet as its headquarters in Limonest, France to support its sales, marketing, customer service and administrative functions. Masimo Japan, K.K. leases approximately 2,000 square feet of space as its headquarters in Tokyo, Japan, which it uses for sales, marketing, customer service and administrative functions, as well as maintaining product inventory. In addition, Masimo Canada ULC leases approximately 23,700 square feet of space as its headquarters in Montreal, Canada, which it uses primarily for research and development activities. We also maintain small sales offices in Germany, the United Kingdom, Italy, Spain and Osaka and Fukuoka, Japan.

We anticipate that we will need additional space in the foreseeable future. In addition, we are negotiating to move our Mexicali manufacturing operations into a 80,000-100,000 square foot facility to be built in the same industrial park as our current Mexicali, Mexico facility.

Legal Proceedings

In May 2002, we filed a lawsuit against Tyco Healthcare, parent company of Nellcor, in the United States District Court for the Central District of California, alleging damage to our business as a result of the anti-competitive business practices of Tyco Healthcare. Specifically, we alleged that we had incurred damages as a result of a series of illegal exclusionary and anti-competitive acts by Tyco Healthcare that were designed to maintain its monopoly in the pulse oximetry market in violation of federal antitrust laws.

In March 2005, a jury found that Tyco Healthcare s use of sole-source contracts, product bundling, market share-based compliance pricing contracts and co-marketing agreements with patient monitoring companies were unlawful restraints of trade and exclusionary dealing arrangements and, as a result, violated federal antitrust laws. The jury awarded us $140 million in damages. Under the antitrust laws, if the jury verdict is sustained in whole or in part, all damages are trebled. Tyco Healthcare filed post-trial motions requesting that the District Court either override the jury decision or grant a new trial. In March 2006, the District Court upheld a portion of the jury verdict and vacated the remaining verdict. In addition, the District Court vacated the jury s damages award and granted Tyco Healthcare a new trial on damages. As a result, we may not receive any damages in this lawsuit. The District Court held an

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evidentiary hearing in October 2006 to re-try the damages. On January 25, 2007, the District Court issued a preliminary ruling which did not set damages, but resolved some issues of dispute about damages, and ordered another evidentiary hearing on issues still undecided by the District Court. The District Court held this evidentiary hearing in March 2007. No final ruling from the District Court on the issue of damages has been rendered; however, the effect of the post trial orders from the District Court was to substantially reduce the damages to be awarded, if any damages are ultimately awarded to us by the District Court. Even if we are ultimately awarded damages in this litigation, the amount will be subject to a 50% legal fee contingency agreement, in which case we would receive 50% of the net (of costs) proceeds from the award. Even though most of the legal expenses to date have been on a contingency basis, we expect to incur expenses related to the appellate work, which will be treated as general and administrative expenses, as incurred.

We believe the jury verdict we received in the Tyco Healthcare antitrust litigation has been important in our efforts to increase our market share among certain large hospital systems and GPOs that were formerly closed as a result of Tyco Healthcare s anti-competitive conduct. The lawsuit has been and will continue to be a diversion of management s attention from the implementation of our business strategy. See Risk Factors for a description of the risks related to our litigation against Tyco Healthcare.

Other than the proceedings described above, we are not currently involved in any material legal proceedings.

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MANAGEMENT

Executive Officers and Directors

The following table sets forth information about our executive officers and directors as of April 30, 2007:

Name	Age	Position(s)
Joe E. Kiani	42	Chief Executive Officer & Chairman of the Board of Directors
Ammar Al-Ali	43	Chief Technical Officer
Olivier Berthon	40	President, Masimo Europe
Mark P. de Raad	48	Executive Vice President & Chief Financial Officer
Mohamed Elmandjra	43	President, Worldwide OEM Business
Rick Fishel	49	President of Masimo Americas
Christopher Kilpatrick	50	Executive Vice President, Business Development, General Counsel & Secretary
Bradley Langdale	43	Executive Vice President, Chief Marketing Officer
Yongsam Lee	42	Executive Vice President, Operations & Chief Information Officer
Anand Sampath	40	Executive Vice President, Engineering
Steven Barker, M.D., Ph.D.[2][3][4]	62	Director
Edward L. Cahill[1][3]	54	Director
Robert Coleman, Ph.D.[1][2]	61	Director
Sanford Fitch[1]	66	Director
Jack Lasersohn[2][3]	54	Director

(1) Member of the Audit Committee.
(2) Member of the Compensation Committee.
(3) Member of the Nominating and Corporate Governance Committee.
(4) Chairman of the Scientific Advisory Board.

Joe E. Kiani is the founder of Masimo and has served as Chief Executive Officer and Chairman of the Board of Directors since our inception in 1989. He is an inventor on more than 50 patents related to signal processing, sensors, and patient monitoring, including patents for the invention of read-through motion and low-perfusion pulse oximetry. Prior to founding Masimo, Mr. Kiani served as Regional Technical Manager for Anthem Electronics, Inc., a distributor of semiconductor and subsystem products, and as Field Applications Engineer for Bell Industries, Inc., which distributes advanced semiconductor components. He also previously served as Product Engineer at Unisys Corporation, a computer manufacturer. Mr. Kiani is currently on the Board of Directors of Saba Software, Inc., a publicly-traded software company focused on human capital development and management solutions and the Medical Device Manufacturers Association (MDMA). Mr. Kiani holds a B.S.E.E. and an M.S.E.E. from San Diego State University.

Ammar Al-Ali has served as our Chief Technical Officer since December 1996. He is an inventor on more than 48 patents related to signal processing, sensors and patient monitoring. From April 1995 to December 1996, Mr. Al-Ali held various positions with us, including Director of Software Development. From January 1992 to November 1994, he served as the Director of Research and Development, Electronics for Ami-Med Corporation, a medical device company that provides instruments for continuous cardiac output. Mr. Al-Ali holds a B.S.E.E. degree from the University of Arizona.

Olivier Berthon has served as president of our European operations since 2003. From April 1999 to June 2003, Mr. Berthon served as Business Development Manager for our European division. From June 1996 to March 1999, Mr. Berthon served as Product Manager at Kontron Instruments, a medical device

company and one of our first OEM partners in Europe. From October 1991 to May 1996, he served as Area Sales Manager at Kontron Instruments. Mr. Berthon holds a Biomedical Engineering Degree from Aix-Marseille III State University, France, and a postgraduate degree in Business Administration from Nice State University, France.

Mark P. de Raad has served as our Executive Vice President and Chief Financial Officer since June 2006. From November 2002 through May 2006, Mr. de Raad served as Vice President, Chief Financial Officer and Secretary for Avamar Technologies, Inc., a start-up enterprise software development company. From September 1997 through November 2002, he served as Vice President, Finance and Chief Financial Officer for ATL Products, Inc., a manufacturer of automated tape libraries. From May 1987 to May 1997, Mr. de Raad was employed by AST Research, Inc., a personal computer manufacturer, where he held various financial management positions the last of which was Vice President Finance and Treasurer and Chief Accounting Officer. Mr. de Raad is a Certified Public Accountant and holds a B.S. in Accounting from the University of Santa Clara.

Mohamed Elmandjra has served as our President, Worldwide OEM Business since August 2006. From December 2001 to July 2006, he served as Chief Executive Officer of ViOptix, Inc., a medical device company specializing in tissue oximetry. From January 1998 to July 1999, Mr. Elmandjra served as Vice President of Marketing of ADAC Laboratories, a nuclear medicine imaging equipment and radiation therapy planning systems company. In July 1999, he was promoted to General Manager of ADAC-UGM and then Senior Vice President of International Operations; he served in this position until December 2000 when ADAC was acquired by Philips Medical Systems, a diagnostic imaging company. Mr. Elmandjra continued his employment with Philips Medical Systems as Senior Vice-President of its International Operations until he joined ViOptix. Mr. Elmandjra holds a Ph.D. in Bioengineering from the University of Pennsylvania and an M.B.A. from the University of Chicago.

Rick Fishel has served as President of Masimo Americas since June 2004. From January 2003 to June 2004, Mr. Fishel was Regional Vice President of Sales for the Information Solutions segment of the McKesson Corporation, a provider of supply, information and care management products and services. From January 2001 to January 2003, he served as National Vice President of Sales for the Consulting Services division of GE Medical Systems, Inc., a provider of medical technology and productivity solutions. Mr. Fishel holds a B.S. in Marketing from Arizona State University.

Christopher Kilpatrick has served as our Executive Vice President, Business Development, General Counsel since May 2002 and also became our corporate Secretary in January 2007. From November 2000 to May 2002, Mr. Kilpatrick served as Head of the Corporate Law Department of the Orange County, California law office of Arter and Hadden LLP. From May 1994 to November 2000, he served as Vice President, General Counsel and a director for Interplay Entertainment Corporation, a developer, distributor and publisher of interactive computer and video games. In April 1995, Mr. Kilpatrick was promoted to President of Interplay, a position he held until November 2000. From June 1982 to April 1994, Mr. Kilpatrick worked at the law firm of Stradling, Yocca, Carlson & Rauth, and as a partner from 1989 to 1994. Mr. Kilpatrick holds a B.A. in Economics from the University of California, Irvine and a J.D. from the University of California, Los Angeles.

Bradley Langdale has served as our Executive Vice President, Chief Marketing Officer since July 2006. From July 1998 to June 2006, Mr. Langdale served as our Executive Vice President, Chief Financial Officer and Secretary and from February 1996 to June 1998, he served as our Vice President, Finance and Chief Financial Officer. From July 1993 to November 1995, Mr. Langdale served as Director of Finance for CareLine, Inc., a publicly-held provider of emergency medical services that was acquired by Laidlaw Inc. in November 1995. From March 1990 to June 1993, Mr. Langdale served as Manager of Financial Forecasting for Sunrise Company, a Real Estate Development company. Prior to March 1990, he was employed by the public accounting firm Price Waterhouse & Company LLP. Mr. Langdale is a

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Certified Public Accountant and holds a B.S. in Economics/Business from the University of California, Los Angeles.

Yongsam Lee has served as our Executive Vice President, Operations and Chief Information Officer since January 2003. From March 1996 to December 2002, Mr. Lee held various positions with us, including Vice President, IT and Vice President, Operations. From October 2001 to April 2002, he served as Director of IT at SMC Networks, Inc., a provider of networking solutions. Mr. Lee holds a B.S. in Applied Physics from the University of California, Irvine.

Anand Sampath has served as our Executive Vice President, Engineering since March 2007. He is an inventor on more than four patents relating to patient monitoring, wireless networks and communications. From April 2006 to March 2007, Mr. Sampath was our Director of Systems Engineering. From October 1995 to March 2006, he held various positions, including Program Manager, Engineering Manager and Distinguished Member of Technical Staff, at Motorola, Inc. Mr. Sampath holds a B.S. in Engineering from Bangalore University.

Steven Barker, M.D., Ph.D. has served as a member of our board of directors since October 2005. Dr. Barker has served as the Professor and Head of Anesthesiology, University of Arizona College of Medicine since October 1995. From August 1990 to October 1995, Dr. Barker served as Chairman of Anesthesiology at the University of California, Irvine. He also holds a joint appointment as Professor of Mechanical and Aerospace Engineering. Dr. Barker is an oral examiner for the American Board of Anesthesiology, and is the Section Editor for Technology, Computing, and Simulation in the journal of Anesthesia and Analgesia. He also holds a B.S. in Physics and an M.S. and a Ph.D. in Mechanical Engineering from the California Institute of Technology and an M.D. from the University of Miami.

Edward L. Cahill has served as a member of our board of directors since January 1999. Mr. Cahill has served as Managing Partner of HLM Venture Partners, a venture capital firm that invests primarily in emerging companies focused on health care information technology, health care services and medical technology since May 2000. From June 1995 to May 2000, Mr. Cahill served as a founding partner of Cahill, Warnock & Company (now Camden Partners), a Baltimore venture capital firm. Previously, Mr. Cahill was a Managing Director of Alex, Brown & Sons, an investment services brokerage, where he headed the firm s health care group from January 1986 through March 1995. Mr. Cahill is also a director of several private health care companies and serves as a trustee of Johns Hopkins Medicine, Johns Hopkins Health System and Mercy Health Services. Mr. Cahill holds an A.B. in American Civilization from Williams College and a Master of Public and Private Management degree from Yale University.

Robert Coleman, Ph.D. has served as a member of our board of directors since February 1997. From September 2002 to September 2003, Dr. Coleman served as Chairman, President and CEO of Argose, Inc., a developer of non-invasive blood glucose monitors. Dr. Coleman was President and CEO of MediSense, Inc., a manufacturer of blood glucose self-testing devices, from 1991 to May 1996, and President of MediSense, Inc., an Abbott Laboratories Company, from June 1996 to December 1996. He co-founded Nova Biomedical Corporation, a manufacturer of clinical laboratory equipment, and served as its President and CEO from April 1976 to August 1991. Dr. Coleman holds a B.S. in Chemistry from Morehead State University and a Ph.D. in Analytical Chemistry from the University of Tennessee.

Sanford Fitch has served as a member of our board of directors since November 2006. From March 2001 to December 2002, Mr. Fitch served as Vice President of Finance and Chief Financial Officer of Alvesta, a fiber optic component manufacturing company. From March 2000 to December 2000, Mr. Fitch served as Senior Vice President of Finance and Chief Financial Officer of Cruel World, an internet-based recruiting company. From December 1994 to November 1998, Mr. Fitch served as Senior Vice President of Finance and Operations and Chief Financial Officer of Conceptus, a manufacturer of

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contraceptive medical devices. From January 1991 to February 1994, he served as Vice President of Finance and Administration and Chief Financial Officer at SanDisk, a manufacturer of flash memory products. Mr. Fitch currently serves on the boards of IRIDEX, a publicly-traded manufacturer of medical laser systems, and FoxHollow Technologies, Inc., a publicly-traded manufacturer of medical devices for the treatment of peripheral artery disease. Mr. Fitch holds a B.S. in Chemistry and an M.B.A. from Stanford University.

Jack Lasersohn has served as a member of our board of directors since January 1995. Mr. Lasersohn is a General Partner of The Vertical Group, a private venture capital firm that is focused on the fields of medical technology and biotechnology. He has over 25 years of experience in health care venture capital investments. Prior to joining The Vertical Group s predecessor, F. Eberstadt, in 1981, Mr. Lasersohn was a corporate attorney with Cravath, Swaine & Moore LLP. He is also a director of Kyphon Inc., a publicly-traded medical device company, and Metabolix Inc., a publicly-traded biotechnology company. He also serves on the boards of a number of private medical device and biotechnology companies. Mr. Lasersohn holds a B.S. in Physics from Tufts University, an M.A. from The Fletcher School of Law and Diplomacy, and a J.D. from Yale Law School.

Board Composition

Our business and affairs are organized under the direction of our board of directors, which currently consists of six members. The primary responsibilities of our board of directors are to provide oversight, strategic guidance, counseling and direction to our management. Our board of directors meets on a regular basis and additionally as required. Our board of directors has determined that five of six directors, Dr. Barker, Mr. Cahill, Dr. Coleman, Mr. Fitch and Mr. Lasersohn are independent directors, as defined by Rule 4200(a)(15) of the National Association of Securities Dealers.

Upon the closing of this offering the terms of office of the board of directors will be divided into three classes. As a result, a portion of our board of directors will be elected each year.

Our class I directors will be Dr. Barker and Mr. Fitch and their term will expire at the annual meeting of stockholders to be held in 2008.

Our class II directors will be Dr. Coleman and Mr. Cahill and their term will expire at the annual meeting of stockholders to be held in 2009.

Our class III directors will be Messrs. Kiani and Lasersohn and their term will expire at the annual meeting of stockholders to be held in 2010.

At each annual meeting of stockholders after the initial classification, the successors to directors whose term will then expire will be elected to serve from the time of election and qualification until the third annual meeting following election. In addition, the authorized number of directors may be changed only by resolution of the board of directors. Any additional directorships resulting from an increase in the number of directors will be distributed among the three classes so that, as nearly as possible, each class will consist of one-third of the directors. This classification of the board of directors may have the effect of delaying or preventing a change in control or management.

Board Committees

Our board of directors has an audit committee, a compensation committee and a nominating and corporate governance committee. Our board of directors is responsible for appointing directors to these committees.

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Audit Committee

Our audit committee is comprised of Mr. Cahill, Dr. Coleman and Mr. Fitch. The functions of this committee include, among others:

- evaluating our independent registered public accountant s qualifications, independence and performance;
- determining the engagement of our independent auditors;
- approving the retention of our independent auditors to perform any proposed audit and permissible non-audit services;
- monitoring the rotation of partners of our independent auditors on our engagement team as required by law;
- reviewing our financial statements;
- reviewing our critical accounting policies and estimates;
- discussing with our management and our independent auditors the results of the annual audit and the review of our quarterly financial statements; and
- reviewing and evaluating, at least annually, the performance of the audit committee and its members, including compliance of the audit committee with its charter.

Under the applicable rules and regulations of NASDAQ, each member of a company s audit committee must be considered independent in accordance with the rules of the NASDAQ Stock Market and Rule 10A-3(b)(1) under the Exchange Act. Our board of directors has determined that all members of our audit committee meet the applicable tests for independence and the requirements for financial literacy under NASDAQ Stock Market rules.

Our board of directors has determined that Mr. Fitch, the chairman of our audit committee, is an audit committee financial expert. Both our independent auditors and management periodically meet with our audit committee.

Compensation Committee

Our compensation committee is comprised of Drs. Barker and Coleman and Mr. Lasersohn. Dr. Coleman chairs our compensation committee. The functions of this committee include, among others:

- determining the compensation and other terms of employment of our executive officers and reviewing and approving corporate performance goals and objectives relevant to such compensation;
- evaluating and recommending the type and amount of compensation to be paid or awarded to our board members;

evaluating and recommending to our board of directors the equity incentive plans, compensation plans and similar programs advisable for us, as well as modification or termination of existing plans and programs;

administering our equity incentive plans;

establishing policies with respect to equity compensation arrangements;

reviewing and approving the terms of any employment agreements, severance arrangements, change in control protections and any other compensatory arrangements for our executive officers; and

reviewing and evaluating, at least annually, the performance of the compensation committee.

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Nominating and Corporate Governance Committee

Our nominating and corporate governance committee is comprised of Dr. Barker and Messrs. Cahill and Lasersohn. Mr. Lasersohn chairs our nominating and corporate governance committee. The functions of this committee include, among others:

- interviewing, evaluating and recommending individuals for membership on our board of directors;
- evaluating nominations by stockholders of candidates for election to our board;
- evaluating director performance on the board and applicable committees of the board and determining whether continued service on our board is appropriate;
- considering and assessing the independence of members of our board of directors;
- developing and reviewing a set of corporate governance policies and principles, including a code of ethics, and recommending changes to such policies and principles;
- considering questions of possible conflicts of interest of directors as such questions arise; and
- evaluating, at least annually, the performance of the nominating and corporate governance committee.

Executive Officers

Our executive officers are elected by, and serve at the discretion of, our board of directors. There are no family relationships between our directors and executive officers.

Compensation Committee Interlocks and Insider Participation

In 2006, our compensation committee consisted of Drs. Barker and Coleman and Mr. Lasersohn. No member of our compensation committee is currently or has been at any time one of our officers or employees, is or was a participant in a related party transaction in 2006, or has served as a member of the board of directors or compensation committee of any entity that has one or more officers serving as a member of our board of directors or compensation committee.

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COMPENSATION

Compensation Discussion and Analysis for Named Executive Officers

Overview Compensation Objectives

The primary objectives of the compensation committee of our board of directors with respect to executive compensation are to attract, retain and motivate the best possible executive talent. The focus is to tie short and long-term cash and equity incentives to the achievement of measurable corporate and individual performance objectives and to align executives incentives with stockholder value creation. To achieve these objectives, the compensation committee has adopted a compensation approach that ties a substantial portion of executives overall compensation to our operational performance. In addition, we evaluate and reward our executive officers based on their willingness to take a leadership position in improving our internal structures and processes and their ability to identify and exploit opportunities to grow our business.

We must match market cash compensation levels and satisfy the day-to-day financial requirements of our candidates through competitive base salaries and cash bonuses. We also compete for key personnel on (i) the basis of our vision of future success, (ii) our culture and company values, (iii) the cohesiveness and productivity of our teams, and (iv) the excellence of our technical and management personnel. In all of these areas, we compete with other medical device and biotechnology companies, where there is significant competition for talented employees. We believe that we must provide competitive compensation packages to attract and retain executive officers and to help our executive management function as a stable team over the longer term. We have adopted an approach to compensation comprised of a mix of short- and long-term components, cash and equity elements in the proportions we believe will provide the proper incentives, reward our senior management team and help us achieve the following goals:

- align our executive officers compensation with our business objectives and the interests of our stockholders;
- foster a goal-oriented, highly-motivated management team whose participants have a clear understanding of business objectives and shared corporate values;
- allocate company resources most effectively in the development of market-leading technology and products;
- control costs in each facet of our business to maximize our efficiency;
- enable us to attract, retain and motivate a world class leadership team; and
- achieve internal equity across our organization.

Our compensation committee does not have any formal policies for allocating compensation among salary, bonus, long-term incentives and other benefits. However, the compensation of our executive officers is based in part on the terms of employment agreements and offer letters we entered into with each of our executive officers, which set forth the initial base salaries and initial option grants for our executive officers, as well as the initial target bonuses for our executives. See Employment Contracts below.

Role of Our Compensation Committee

Our compensation committee approves, administers and interprets our executive compensation and benefit policies. Our compensation committee was appointed by our board of directors, and consists entirely of directors who are outside directors for purposes of Section 162(m) of the Internal Revenue Code, as amended, or the Code, and non-employee directors for purposes of Rule 16b-3 under the Exchange Act. Our compensation committee is comprised of Drs. Barker and Coleman and Mr. Lasersohn. Dr. Coleman is our compensation committee chairperson.

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The compensation committee considers recommendations from Joe E. Kiani, our Chief Executive Officer, in determining executive compensation. While Mr. Kiani discusses his recommendations with the compensation committee, he does not participate in determining his own compensation. In making his recommendations, Mr. Kiani receives input from our Human Resources department and has access to various third-party compensation surveys and compensation data of publicly-traded companies we obtained from SEC filings. This information is also available to our compensation committee. However, because certain aspects of our business and management team are unique, the compensation committee used the peer company data as one resource in determining executive compensation for 2006 and 2007 and not as a stand-alone tool. None of our other executive officers participate in the compensation committee s discussions regarding executive compensation. The compensation committee does not delegate any of its functions to others in determining executive compensation and has not previously engaged consultants with respect to executive compensation matters.

Our compensation committee has taken the following steps to ensure that our approach to executive compensation and benefits is consistent with both our compensation philosophy and our corporate governance guidelines:

- evaluated our compensation practices and assisted in developing and implementing the executive compensation philosophy;
- developed recommendations with regard to executive compensation structures that were reviewed and approved by our compensation committee and board of directors;
- established a practice of prospectively reviewing the performance and determining the compensation earned, paid or awarded to our chief executive officer independent of input from him; and
- established a policy to review on an annual basis the performance of our other executive officers with assistance from our chief executive officer and determining what we believe to be appropriate total compensation.

Components of our Compensation Approach

Our compensation approach consists of five components:

- base salary;
- annual cash bonuses;
- equity-based incentives;
- other benefits; and
- severance and termination protection.

We chose to build our executive compensation approach around these elements because we believe that together they have been and will continue to be effective in achieving our overall objectives. We utilize short-term compensation, including base salary and annual cash bonuses, to motivate and reward our key executives. The use and weight of each compensation element is based on a subjective determination by the compensation committee of the importance of each element in meeting our overall objectives. We believe that, in addition to base salaries and bonuses, stock option and other equity-based awards are the primary compensation-related motivator in attracting and retaining qualified employees.

Base Salary. Base salary will typically be used to recognize the experience, skills, knowledge and responsibilities required of each executive officer, as well as competitive market conditions. In establishing the 2006 and 2007 base salaries of our named executive officers, our compensation committee took into account a number of factors, including the executive s seniority, position and

functional role and level of responsibility. For executives hired in 2006, we also considered the base salary of the individual at his or her prior employment. In addition, in both cases we considered the competitive market for corresponding positions within comparable geographic areas and industries.

The base salary of our named executive group will be reviewed on an annual basis and adjustments will be made to reflect performance-based factors, as well as competitive conditions. We will not apply specific formulas to determine increases. Generally, executive salaries will be adjusted effective June 1 of each year.

Annual Cash Bonuses. For 2006, we had a bonus award plan for our executive officers and certain other exempt employees. Under the bonus award plan, our executives were eligible to receive a cash bonus for 2006 based on our achievement of certain financial targets established by the compensation committee, as well as other quantitative and qualitative factors established by the Chief Executive Officer for the other Named Executive Officers. The criteria for eligibility in our cash bonus plan may change from year-to-year as we continue to evolve and different priorities are established, but are subject to the review and approval of the compensation committee. The compensation committee approves the annual cash bonuses for all executive officers. These bonuses, if earned, are paid after the end of the calendar year.

For 2006, our corporate objectives were grouped into the following categories: achieving certain sales targets, reaching certain development milestones, achieving certain financial targets, completing important milestones in employee training and development and achieving and sustaining company-wide ethical and compliant behavior. Each employee, including each executive officer, has individual objectives for the year which are designed to contribute to the achievement of our corporate objectives.

We have not paid any significant signing or promotion bonuses to our executive officers, nor have we guaranteed any future bonuses to our executive officers.

Equity-Based Incentives. Salaries and bonuses are intended to compensate our executive officers for short-term performance. We also have adopted an equity incentive approach intended to reward longer-term performance and to help align the interests of our executive officers with those of our stockholders. We believe that long-term performance is achieved through an ownership culture that rewards performance by our executive officers through the use of equity incentives. Our equity incentive plans have been established to provide our employees, including our executive officers, with incentives to help align those employees interests with the interests of our stockholders. Our equity incentive plans have provided the principal method for our executive officers to acquire equity interests in our company.

In 2006, some of our executive officers were granted stock options under our 2004 Plan. All new hire option grants and annual option grants vest over a five-year period with 20% vesting on each anniversary of the grant date. All options are granted at the fair market value on the date of grant, as determined by our compensation committee. In the absence of a public trading market for our common stock, the compensation committee determined the fair market value of our common stock in good faith based upon consideration of a number of relevant factors, including the status of our development and commercialization efforts, our results of operations, general market conditions and independent valuations. All equity awards to our employees, including executive officers, and to our directors have been granted and reflected in our consolidated financial statements, based upon the applicable accounting guidance, with the exercise price equal to the fair market value on the grant date based on the valuation determined by the compensation committee of our board of directors with the assistance of independent valuation firms from time to time.

The size and terms of the initial option grant made to each executive officer upon joining us are primarily based on competitive conditions applicable to the executive officer s specific position and are set forth in the executive officer s offer letter from us. In addition, the compensation committee considers the

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number of options owned by other executives in comparable positions within our company using a blended model that considers options awarded as a percentage of shares outstanding and the aggregate value for each option grant.

The annual equity awards we make to our executive officers will be driven by our sustained performance over time, our executive officers ability to impact our results that drive stockholder value, their organization level, their potential to fill roles of increasing responsibility, and competitive equity award levels for similar positions and organization levels in comparable companies. Equity forms a key part of the overall compensation for each executive officer and will be considered each year as part of the annual performance review process and incentive payout calculation. In determining the number of stock options granted to our executive officers in 2006, the compensation committee took into account each executive officer s position, scope of responsibility, ability to affect stockholder value, the individual s historic and recent performance, and our policy of providing compensation equity among our executive officers.

Our board of directors adopted our 2007 Stock Incentive Plan, or 2007 Plan, in November 2006, which permits the grant of stock options, stock appreciation rights, restricted stock, restricted stock units, performance units, performance shares and other stock-based awards. Subject to stockholder approval, the 2007 Plan will become effective in connection with this offering. Upon the effectiveness of our 2007 Plan, no further equity awards will be made under our 2004 Plan. However, any options outstanding under our 2004 Plan will continue to be governed by their existing terms. In connection with our transition to a publicly-traded company, the compensation committee intends to evaluate an annual stock option grant program for executive officers to continue aligning the interests of our executive officers with those of our stockholders.

Other Benefits. We have a 401(k) plan in which substantially all of our employees are entitled to participate. Employees contribute their own funds, as salary deductions, on a pre-tax basis. Contributions may be made up to plan limits, subject to government limitations. The plan permits us to make matching contributions if we choose and we have historically provided matching contributions of up to three percent. We provide health care, dental, vision and life insurance, employee assistance plans and both short- and long-term disability, accidental death and dismemberment benefits to all full-time employees, including our executive officers. These benefits are available to all employees, subject to applicable laws. We believe these benefits are consistent with companies with which we compete for employees.

Severance and Termination Protection

Employment Agreements. Under their employment agreements, Messrs. Kiani and Berthon are entitled to certain severance and change of control benefits, the terms of which are described in detail below under Employment Contracts.

Acceleration of Vesting of Equity-Based Awards. In the event of a change in control of us, certain provisions of our 1996 Plan and our 2004 Plan allow for 50% acceleration of unvested equity awards in the event an acquiror neither assumes awards outstanding under these plans nor issues our award holders substitute equity awards. In addition, our 2007 Plan, under which we will grant future equity awards after the completion of this offering, will permit acceleration of outstanding awards upon a change in control under certain circumstances. See Employee Benefit Plans.

Accounting and Tax Considerations

Effective January 1, 2006, we adopted the fair value provisions of Financial Accounting Standards Board Statement No. 123(R) (revised 2004), Share-Based Payment, or SFAS 123(R). Under SFAS 123(R), we

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are required to estimate and record an expense for each award of equity compensation (including stock options) over the vesting period of the award.

Internal Revenue Code Section 162(m) limits the amount that we may deduct for compensation paid to our chief executive officer and to each of our four most highly compensated officers to $1,000,000 per person, unless certain exemption requirements are met. Exemptions to this deductibility limit may be made for various forms of performance-based compensation. In the past, annual cash compensation to our executive officers has not exceeded $1,000,000 per person, so the compensation has been deductible. In addition to salary and bonus compensation, upon the exercise of stock options that are not treated as incentive stock options, the excess of the current market price over the option price, or option spread, is treated as compensation and accordingly, in any year, such exercise may cause an officer s total compensation to exceed $1,000,000. Under certain regulations, option spread compensation from options that meet certain requirements will not be subject to the $1,000,000 cap on deductibility, and in the past we have granted options that met those requirements. The compensation committee has not yet established a policy for determining which forms of incentive compensation awarded to our executive officers shall be designed to qualify as performance-based compensation. To maintain flexibility in compensating our executive officers in a manner designed to promote our objectives, the compensation committee has not adopted a policy that requires all compensation to be deductible. However, the compensation committee intends to evaluate the effects of the compensation limits of Section 162(m) on any compensation it proposes to grant, and the compensation committee intends to provide future compensation in a manner consistent with our best interests and those of our stockholders.

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Summary Compensation Table

The following table provides information regarding the compensation earned during the fiscal year ended December 31, 2006 by our chief executive officer, our chief financial officer, our former principal financial officer and our three other most highly compensated executive officers who were employed by us as of December 31, 2006. We refer to these executive officers as our named executive officers.

Name and Principal Position(s)	Year	Salary	Bonus	Option Awards[1]	All Other Compensation[2]	Total
Joe E. Kiani *Chief Executive Officer and Chairman*	2006	$ 396,050	$ 205,706	$	$ 72,150[3]	$ 673,906
Mark P. de Raad *Executive Vice President & Chief Financial Officer[4]*	2006	136,746	54,597	109,556	15,667[5]	316,566
Bradley Langdale *Executive Vice President, Chief Marketing Officer[6]*	2006	280,408	113,614	30,711	33,551[7]	458,284
Ammar Al-Ali *Chief Technical Officer*	2006	273,413	113,614	63,752	36,952[8]	487,731
Yongsam Lee *Executive Vice President, Operations & Chief Information Officer*	2006	283,277	113,614		161,367[9]	558,258
Christopher Kilpatrick *Executive Vice President, Business Development, General Counsel & Secretary*	2006	273,277	113,614		220,462[10]	607,353

(1) Amounts reflect the expense to us of stock options granted in 2006, calculated in accordance with SFAS No. 123(R). See Note 12 to the Notes to Consolidated Financial Statements for a discussion of assumptions made in determining the grant date fair value and compensation expense of our stock options.

(2) In March 2006, we made special bonus payments to our employees and directors who held vested stock options as of March 1, 2006. See Management s Discussion and Analysis of Financial Condition and Results of Operations Cash Dividends and Special Bonus Payments.

(3) Consists of $51,098 for incentive trips, $6,600 in 401(k) matching contributions, $3,055 in expenses, and $11,397 in medical insurance premiums.

(4) Mr. de Raad became our Executive Vice President & Chief Financial Officer in June 2006.

(5) Consists of $5,600 for an incentive trip, $4,102 in 401(k) matching contributions, and $5,965 in medical insurance premiums.

(6) Mr. Langdale served as our Chief Financial Officer, Executive Vice President, Marketing, and Secretary until June 2006. Beginning in June 2006, Mr. Langdale became our Executive Vice President, Chief Marketing Officer.

(7) Consists of $12,204 for an incentive trip, $6,570 in 401(k) matching contributions, $4,527 in special bonus payments authorized in 2006, and $10,250 in medical insurance premiums.

(8) Consists of $12,215 for incentive trips, $6,100 in 401(k) matching contributions, $7,439 in special bonus payments authorized in 2006, and $11,198 in medical insurance premiums.

(9) Consists of $16,404 for incentive trips, $133,789 in special bonus payments authorized in 2006, and $11,174 in medical insurance premiums.

(10) Consists of $13,233 for incentive trips, $6,100 in 401(k) matching contributions, $189,952 in special bonus payments authorized in 2006, and $11,177 in medical insurance premiums.

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Grants of Plan-Based Awards in 2006

The following table presents information concerning grants of plan-based awards to each of the named executive officers during the year ended December 31, 2006. For the fiscal year ended December 31, 2006, we granted options to purchase a total of 736,540 shares of our common stock, with a weighted average exercise price of $32.14 per share, to our employees, including grants to our named executive officers. The options included in the table below were issued under our 2004 Plan. Options granted under our 2004 Plan expire ten years from the date of grant. See Employee Benefit Plans 2004 Incentive Stock Option, Nonqualified Stock Option and Restricted Stock Purchase Plan.

The exercise price per share of each option granted to our named executive officers was equal to the fair market value of our common stock, as determined by our compensation committee on the date of the grant. The exercise price is payable in cash, by promissory note, in shares of our common stock previously owned by the optionee, pursuant to the net exercise of the option or in such other consideration approved by our board of directors.

Name	Grant Date	All Other Option Awards: Number of Securities Underlying Options	Exercise Price Per Share[1]	Grant Date Fair Value of Option Awards[2]
Joe E. Kiani				
Mark P. de Raad	7/17/2006	90,000	$ 32.00	$ 1,552,221
Bradley Langdale	7/17/2006	25,610	32.00	441,693
Ammar Al-Ali	7/17/2006	25,980	32.00	448,074
Yongsam Lee				
Christopher Kilpatrick				

(1) See Note 12 to the Notes to Consolidated Financial Statements for a discussion of methodology for determining the exercise price.
(2) Amounts reflect the total fair value of stock options granted in 2006, calculated in accordance with SFAS No. 123(R).

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Outstanding Equity Awards at December 31, 2006

The following table presents the outstanding equity awards held by each of the named executive officers as of the fiscal year ended December 31, 2006, including the value of the stock awards.

	Option Awards[1]			
	Number of Securities Underlying Unexercised Options at December 31, 2006		Option	Option Expiration
Name	Exercisable	Unexercisable	Exercise Price	Date
Joe E. Kiani			$	
Mark P. de Raad		90,000	32.00	7/14/2016
Bradley Langdale		7,280	8.25	1/20/2013
		25,610	32.00	7/14/2016
Ammar Al-Ali		25,980[2]	32.00	7/14/2016
		8,000	8.25	1/01/2015
		5,800	8.25	1/20/2013
Yongsam Lee	2,180	4,360	8.25	1/20/2013
	2,000	2,000	8.25	8/04/2012
	4,000		8.25	1/23/2011
		32,000	8.25	1/01/2015
	2,820	5,640	8.25	7/11/2013
	3,000		8.25	7/17/2011
Christopher Kilpatrick	6,000		5.00	10/17/2009
		2,000	8.25	1/20/2013
	15,000	15,000	8.25	8/04/2012

(1) For each named executive officer, the shares listed in the table above under Option Awards are subject to a single stock option award carrying the varying exercise prices as set forth in the table above. Unless otherwise noted, the shares subject to each stock option vest over a five-year period, with 20% of the shares subject to the option vesting on each anniversary of the grant date.

(2) 100% of the shares subject to the option vest 30 months following the grant date.

Option Exercises in 2006

The following table presents certain information concerning the exercise of options by each of the named executive officers during the fiscal year ended December 31, 2006. As of December 31, 2006, we had not issued any stock awards to our named executive officers or other employees.

	Option Awards	
Name	Number of Shares Acquired on Exercise	Value Realized on Exercise
Joe E. Kiani	1,060,180	$ 14,609,280
Mark P. de Raad		
Bradley Langdale	177,110	2,576,235
Ammar Al-Ali	162,720	2,366,806
Yongsam Lee	82,000	1,129,960
Christopher Kilpatrick	53,300	1,414,049

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Pension Benefits

None of our named executive officers participates in or has account balances in qualified or non-qualified defined benefit plans sponsored by us.

Nonqualified Deferred Compensation

None of our named executive officers participate in or have account balances in non-qualified defined contribution plans or other deferred compensation plans maintained by us. The compensation committee, which is comprised solely of outside directors as defined for purposes of Section 162(m) of the Internal Revenue Code of 1986, as amended, or the Code, may elect to provide our officers and other employees with non-qualified defined contribution or deferred compensation benefits if the compensation committee determines that doing so is in our best interests.

Employment Contracts

Employment Agreement with Joe E. Kiani

In May 1996, we entered into an employment agreement with Mr. Kiani, our Chief Executive Officer, which was most recently amended and restated in April 2007. The agreement automatically renews on a daily basis and terminates three years from the date either party gives notice of termination to the other party.

The current employment agreement sets forth Mr. Kiani s base salary of $411,412 per year, which is subject to adjustment by our board of directors or our compensation committee. Mr. Kiani is entitled to receive an annual bonus equal to 50% of his base salary in the event we attain certain financial goals set by our board of directors or our compensation committee. The employment agreement also entitles Mr. Kiani to participate in or receive benefits under all of our employee benefits plans and to be eligible to participate in any bonus plan created for the payment of bonuses to members of our management. In addition, the agreement provides that we will reimburse Mr. Kiani for all reasonable expenses incurred and paid by him in the course of the performance of his duties under the agreement and that we will further reimburse him for all reasonable travel and lodging expenses for his immediate family in the event his immediate family accompanies him during business travel. Under the employment agreement, reasonable expenses include travel and hospitality expenses for first class airplane travel and accommodations and expenses for travel using private or chartered aircraft. Mr. Kiani is exempt from our travel and expense policy and our expense reimbursement policy.

Under the employment agreement, we may terminate Mr. Kiani s employment for cause, as a result of his disability under certain circumstances or for any other reason. Similarly, Mr. Kiani may terminate his employment for good reason, for health reasons or for any other reason upon six months written notice to us. If Mr. Kiani is terminated for cause, he is entitled to receive his full base salary through the date of termination. If Mr. Kiani s employment is terminated as a result of his death or disability, he or his estate is entitled to receive his full base salary through the date of termination and an additional amount equal to 150% of his base salary then in effect, which shall be paid in equal installments over three consecutive years. If we terminate Mr. Kiani s employment other than for cause, death or disability, or if Mr. Kiani terminates his employment with us for good reason, (i) he is entitled to receive his full base salary through the date of termination and an additional amount equal to 200% of his base salary then in effect, which shall be paid in equal installments over two consecutive years, (ii) all of Mr. Kiani s outstanding options will immediately vest and (iii) we will be required to pay the full exercise price of all vested options held by Mr. Kiani, as well as all withholding taxes on the issuance of the shares underlying the vested options. In addition, if Mr. Kiani s employment is terminated for any reason other than cause or as a result of his death, he will also be entitled to participate in all of our employee benefit plans and programs that he participated in as of the date of his termination for the full term of his employment agreement. If for any reason Mr. Kiani is not permitted to participate in any of our

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employee benefit plans or programs after the date of his termination, he will be entitled to receive an amount in cash equal to the amount of benefits, contributions, payments and credits that he otherwise would have received under these programs or plans during the term of his employment agreement. The foregoing benefits and payments may be subject to a delay of up to six months as necessary to avoid the imposition of additional tax under Section 409A of the Code.

For purposes of Mr. Kiani s employment agreement, termination for cause generally means his termination as a result of his willful and continued failure to substantially perform his duties under his employment agreement, his willful engaging in gross misconduct materially injurious to us or his willful violation of the provisions of his confidentiality agreement with us if the violation results in demonstrably material injury to us. Any termination for cause must be approved by at least 75% of the members of our board of directors. Termination for good reason under the employment agreement generally means as a result of our assignment to Mr. Kiani of any duties other than those contemplated by his employment agreement, a reduction in Mr. Kiani s rate of compensation or fringe benefits, certain failures by us to comply with the compensation terms of the employment agreement, or a change in control of us or our board of directors. A change in control under the employment agreement generally means (i) the acquisition by any person or group of more than 35% of our outstanding voting stock, (ii) a merger or consolidation of us or a sale of all or substantially all our assets (other than a merger to change our jurisdiction of incorporation or with one of our wholly-owned subsidiaries, or a sale of assets to one of our wholly-owned subsidiaries, or (iii) a change in a majority of the members of our board of directors in a rolling two-year period, subject to certain limitations.

Under the employment agreement, if any payments or benefits payable to Mr. Kiani would be subject to the excise tax under Section 4999 of the Code, Mr. Kiani will be entitled to receive an additional gross-up payment to cover the amount of the excise taxes. An independent registered public accounting firm will make the initial determination as to whether a gross-up payment is required under the employment agreement.

See Potential Payments upon Termination or Change in Control below.

Employment Agreement with Olivier Berthon

In December 2005, we entered into an employment agreement with Mr. Berthon, President of Masimo Europe. The agreement continues indefinitely and can be terminated by either party at any time.

The current employment agreement sets forth Mr. Berthon s initial base salary of 140,000 or approximately $185,000 per year, which is subject to adjustment. The agreement entitles Mr. Berthon to receive bonuses upon the achievement of certain milestones based on our revenue, gross margins and profits in Europe. In addition, Mr. Berthon is entitled to a company car for professional use only.

Pursuant to the agreement, in the event Mr. Berthon s employment is terminated, he may not become an employee or representative of any organization that directly or indirectly competes with us in the United States, France or any other country in the European Union in which we conduct operations as of the date of his termination. His agreement not to compete may continue for a period of up to three years following his date of termination, subject to our sole discretion. If and to the extent we enforce the non-competition provision against Mr. Berthon following his termination, Mr. Berthon would be entitled to receive a lump sum payment equal to 50% of his annual base salary as of the date of his termination, which shall be paid in equal installments over the term of the non-competition period.

Offer Letters with Other Executives

Ammar Al-Ali, Mark P. de Raad, Mohamed Elmandjra, Rick Fishel, Christopher Kilpatrick, Bradley Langdale, Yongsam Lee and Anand Sampath each signed an offer letter before commencing their

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employment with us. The offer letters set forth each officer s position and title, starting salary, health benefits, number of options received and the vesting schedule of such options.

Additionally, each offer letter states that employment is at-will, and may be terminated at any time by either the officer or us for any reason. See Potential Payments upon Termination or Change in Control below.

Employee Proprietary Agreements

Each of our named executive officers has also entered into a standard form agreement with respect to proprietary information and inventions. Among other things, this agreement obligates each named executive officer to refrain from disclosing any of our proprietary information received during the course of employment and, with some exceptions, to assign to us any inventions conceived or developed during the course of employment.

Employee Benefit Plans

Third Amended and Restated 1996 Incentive Stock Option, Nonqualified Stock Option and Restricted Stock Purchase Plan

Our Third Amended and Restated 1996 Incentive Stock Option, Nonqualified Stock Option and Restricted Stock Purchase Plan, or 1996 Plan, was initially adopted by our board of directors and approved by our stockholders in May 1996, and was amended and restated by our board of directors and approved by our stockholders in August 1999. The 1996 Plan terminated automatically on May 4, 2006 and we cannot grant any additional awards thereunder. However, options outstanding under the 1996 Plan as of the completion of this offering will continue to be governed by their existing terms under the 1996 Plan.

Awards. The 1996 Plan provides for the grant of the following:

- incentive stock options, or ISOs, as defined under the Code, which may be granted solely to our employees, including officers and employee directors;
- nonstatutory stock options, or NSOs, which may be granted to our directors, consultants or employees, including officers; and
- stock purchase rights, which may be granted to our directors, consultants or employees, including officers.

Share Reserve. As of April 30, 2007, options to purchase an aggregate of 981,015 shares of our common stock were outstanding and no options were available for future grant under the 1996 Plan. Shares issued under the 1996 Plan may be previously unissued shares or reacquired shares bought on the market or otherwise.

Administration. Authority to control and manage the operation and administration of the 1996 Plan is vested with the board of directors, which may delegate some or all of such responsibilities to a committee. The board of directors shall be referred to as, or with respect to any matter as to which responsibility has been delegated to a committee, the committee shall be referred to as, the Administrator. Subject to the terms of the 1996 Plan, the Administrator has the power to determine, among other things, the terms of the options or stock purchase rights granted, including the exercise price of the option or stock purchase right, the designation of stock options as ISOs or NSOs, the number of shares issuable under each option or stock purchase right, the exercisability of each option or stock purchase right, and the form of consideration payable upon the exercise of each option or stock purchase right. The Administrator has the authority to amend, suspend or terminate the 1996 Plan, so long as no such action affects any shares of common stock previously issued and sold or any option

previously granted under the 1996 Plan. During any calendar year, each optionee may be granted options to purchase a maximum of 500,000 shares.

Stock Options. Stock options are granted under the 1996 Plan pursuant to a stock option agreement. The exercise price of all ISOs granted under the 1996 Plan must be at least equal to the fair market value of our common stock on the date of grant. The exercise price of NSOs granted under the 1996 Plan is determined by the Administrator, but in no event may be less than 85% of fair market value. For NSOs intended to qualify as performance-based compensation under Section 162(m) of the Code, the exercise price must be at least equal to the fair market value of our common stock on the date of grant. For any participant who owns stock possessing more than 10% of the voting power of all classes of our outstanding capital stock, the exercise price of any incentive stock option granted must be at least equal to 110% of the fair market value on the grant date and the term of such incentive stock option must not exceed five years. The aggregate fair market value, determined at the time of grant, of shares of our common stock subject to ISOs that are exercisable for the first time by an optionee during any calendar year under all of our stock plans may not exceed $100,000. The options or portions of options that exceed this limit are treated as NSOs. Stock options vest at the rate specified in the stock option agreement, as determined by the Administrator.

In general, the term of all other options granted under the 1996 Plan may not exceed ten years. If a participant s service relationship with us, or any affiliate of ours, terminates due to disability or death, the participant, or his or her beneficiary, may exercise any vested options during the one-year period immediately following termination of service, unless such options expire prior to such time. If an optionee s relationship with us, or any affiliate of ours, ceases for any reason other than disability or death, the optionee may exercise any vested options during the three-month period immediately following the termination of service, unless such options expire prior to such time.

Applicable forms of consideration for the exercise of options granted under the 1996 Plan will be determined by the Administrator and may include cash or common stock previously owned by the optionee that have been held by the participant for at least six months, or payment through delivery of a promissory note, cancellation of indebtedness, a deferred payment arrangement, a broker-assisted exercise or other legal consideration or arrangements approved by the Administrator.

Options granted under our 1996 Plan are generally not transferable by the optionee, other than by will or the laws of descent and distribution, and each option is exercisable during the lifetime of the optionee only by such optionee.

Stock Purchase Rights. The purchase price of stock purchase rights granted under the 1996 Plan is determined by the Administrator, but in no event may be less than 85% of fair market value unless the person to whom the stock purchase right is granted is a 10% stockholder on the date of grant, in which case the purchase price shall be not less than 100% of the fair market value. Stock shall vest at the rate specified in the stock purchase agreement, as determined by the Administrator. The stock purchase agreement may provide, at the discretion of the Administrator, that following termination of a participant s employment with us for any reason, including death or disability, we shall have the right to repurchase any shares of restricted stock issued to a participant pursuant to a stock purchase right. The purchase price for shares repurchased under the restricted stock purchase agreement must be the original price paid by the participant for shares which have not vested and at fair market value for shares which have vested.

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Change in Control. Under the 1996 Plan, in the event of a change in control of us, the unvested shares subject to outstanding options or repurchase rights will become fully vested and the Administrator may further:

- provide for the purchase of each outstanding option or stock purchase right for an amount of cash or other property that could have been received upon the exercise of the option or stock purchase right as if they had been exercisable;
- adjust the terms of the options and stock purchase rights in a manner determined by the Administrator to reflect the merger or sale of assets causing the change in control;
- cause the options and stock purchase rights to be assumed by, or substituted with comparable rights by the successor corporation; or
- make such other provisions as the Administrator may consider equitable.

If the Administrator does not take any of the foregoing actions, all options and stock purchase rights shall terminate upon the change in control, and the Administrator must provide written notice of the proposed transaction to be given to all participants not less than 15 days prior to the effective date of the transaction.

Registration Statements on Form S-8. We intend to file one or more registration statements on Form S-8 under the Securities Act promptly following the completion of this offering to register the shares of our common stock subject to outstanding stock options and reserved for issuance under our 1996 Plan. These registration statements are expected to become effective upon filing. Shares covered by these registration statements will then be eligible for sale in the public markets, subject to any applicable lock-up agreements and to Rule 144 limitations applicable to affiliates.

2004 Incentive Stock Option, Nonqualified Stock Option and Restricted Stock Purchase Plan

Our 2004 Incentive Stock Option, Nonqualified Stock Option and Restricted Stock Purchase Plan, or 2004 Plan, was initially adopted by our board of directors and approved by our stockholders in April 2004. The 2004 Plan was most recently amended by our board of directors in November 2006 and we expect this amendment to be approved by our stockholders prior to the completion of this offering. Unless terminated sooner, the 2004 Plan will terminate automatically in April 2014.

Upon the effectiveness of our 2007 Stock Incentive Plan, or 2007 Plan, in connection with this offering, no further option grants will be made under our 2004 Plan and all of the options available for future grant under our 2004 Plan will automatically become reserved for awards issuable under our 2007 Plan. However, options outstanding under the 2004 Plan as of the completion of this offering will continue to be governed by their existing terms.

Awards. The 2004 Plan provides for the grant of the following:

- ISOs, which may be granted solely to our employees, including officers and employee directors;
- NSOs, which may be granted to our directors, consultants or employees, including officers; and
- stock purchase rights, which may be granted to our directors, consultants or employees, including officers.

Share Reserve. As of April 30, 2007, an aggregate of 3,099,989 shares of our common stock were reserved for issuance under the 2004 Plan, comprised of options to purchase an aggregate of 2,539,525

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shares of common stock outstanding and options to purchase an aggregate of 560,464 shares of common stock available for future grant. Shares issued under the 2004 Plan may be previously unissued shares or reacquired shares bought on the market or otherwise. Any options that are available for future grant under our 2004 Plan as of the effectiveness of our 2007 Plan will automatically be added to the share reserve of the 2007 Plan and will no longer be available for grant under the 2004 Plan. See 2007 Stock Incentive Plan below.

Administration. Authority to control and manage the operation and administration of the 2004 Plan is vested with the board of directors which may delegate some or all of such responsibilities to a committee. The board of directors shall be referred to as, or with respect to any matter as to which responsibility has been delegated to a committee, the committee shall be referred to as the Administrator. Subject to the terms of the 2004 Plan, the Administrator has the power to determine, among other things, the terms of the options or stock purchase rights granted, including the exercise price of the option or stock purchase right, the designation of stock options as ISOs or NSOs, the number of shares issuable under each option or stock purchase right, the exercisability of each option or stock purchase right, and the form of consideration payable upon the exercise of each option or stock purchase right. The Administrator has the authority to amend, suspend or terminate the 2004 Plan, so long as no such action affects any shares of common stock previously issued and sold or any option previously granted under the 2004 Plan. During any calendar year, each optionee may be granted options to purchase a maximum of 500,000 shares under the 2004 Plan.

Stock Options. Stock options are granted under the 2004 Plan pursuant to a stock option agreement. The exercise price of all ISOs granted under the 2004 Plan must be at least equal to the fair market value of our common stock on the date of grant. The exercise price of NSOs granted under the 2004 Plan is determined by the Administrator, but in no event may be less than 85% of fair market value. For NSOs intended to qualify as performance-based compensation under Section 162(m) of the Code, the exercise price must be at least equal to the fair market value of our common stock on the date of grant. For any participant who owns stock possessing more than 10% of the voting power of all classes of our outstanding capital stock, the exercise price of any incentive stock option granted must be at least equal to 110% of the fair market value on the grant date and the term of such incentive stock option must not exceed five years. The aggregate fair market value, determined at the time of grant, of shares of our common stock subject to ISOs that are exercisable for the first time by an optionee during any calendar year under all of our stock plans may not exceed $100,000. The options or portions of options that exceed this limit are treated as NSOs. Stock options vest at the rate determined by the Administrator, provided that at least 20% of the shares subject to any option shall become exercisable each year over a five-year period. At the discretion of the Administrator, the stock option agreement may provide that for 90 days following termination of a participant s employment with us or one of our subsidiaries, we will have the right to repurchase, at the fair market value of our common stock, any shares issued to a participant pursuant to the exercise of an option.

In general, the term of all other options granted under the 2004 Plan may not exceed ten years. If a participant s service relationship with us, or any affiliate of ours, terminates due to disability or death, the participant, or his or her beneficiary, may exercise any vested options during the one-year period immediately following termination of service, unless such options expire prior to such time. If an optionee s relationship with us, or any affiliate of ours, ceases for any reason other than disability or death, the optionee may exercise any vested options during the 45-day period immediately following the termination of service, unless such options expire prior to such time. In the event a participant s service relationship with us, or any affiliate of ours, terminates other than due to disability or death, we have the right to repurchase from the participant any shares of common stock issued to the participant under the 2004 Plan at a purchase price equal to the fair market value of our common stock as of the date the participant s service terminated. The repurchase right may be exercised at any time during the 90-day period following the date of the participant s termination.

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Applicable forms of consideration for the exercise of options granted under the 2004 Plan will be determined by the Administrator and may include cash or common stock previously owned by the optionee that have been held by the participant for at least six months, or payment through a deferred payment arrangement, a broker-assisted exercise or other legal consideration or arrangements approved by the Administrator.

Options granted under our 2004 Plan are generally not transferable by the optionee, other than by will or the laws of descent and distribution, and each option is exercisable during the lifetime of the optionee only by such optionee.

Stock Purchase Rights. The purchase price of stock purchase rights granted under the 2004 Plan is determined by the Administrator, but in no event may be less than 85% of fair market value unless the person to whom the stock purchase right is granted is a 10% stockholder on the date of grant, in which case the purchase price shall be not less than 100% of the fair market value. Stock shall vest at the rate determined by the Administrator, provided that at least 20% of the shares subject to any stock purchase right shall become exercisable each year over a five-year period. The stock purchase agreement may provide, at the discretion of the Administrator, that for 90 days following termination of a participant s employment with us for any reason, including death or disability, we shall have the right to repurchase at the fair market value, any shares issued to a participant pursuant to the exercise of an option. We have not granted any stock purchase rights under the 2004 Plan.

Change in Control. Under the 2004 Plan and the forms of NSO and ISO agreements, in the event of a change in control of us:

in which the acquiror neither assumes the options outstanding under the 2004 Plan nor issues the 2004 Plan participants substitute stock options under the acquiror s equity plan in exchange for the 2004 Plan stock options, then 50% of the unvested options outstanding under the 2004 Plan shall automatically become fully vested as of prior to the consummation of the change in control. The 2004 Plan participants would be entitled to exercise their vested options at any time prior to the change in control and all options outstanding under the 2004 Plan that are not exercised prior to the change in control would automatically terminate.

in which the acquiror elects to assume the options outstanding under the 2004 Plan, each plan participant s options would continue to be governed by the terms of the 2004 Plan and his or her 2004 Plan option agreements. If, following the change in control, the participant remains employed with us or one of our subsidiaries, or the participant becomes an employee of the acquiror (or one of its affiliates), then 50% of the participant s unvested options outstanding under the 2004 Plan shall automatically become fully vested in the event either the participant is terminated from employment without cause or the participant terminates his or her employment due to a material negative change in job position.

in which the acquiror elects to issue the 2004 Plan participants substitute options under the acquiror s equity plan in exchange for terminating the participant s 2004 Plan stock options, the substitute options would be governed by the terms of the acquiror s equity plan and accompanying form of option agreement. If, following the change in control, the participant remains employed with us or one of our subsidiaries, or the participant becomes an employee of the acquiror (or one of its affiliates), then 50% of the participant s unvested options outstanding under the 2004 Plan shall automatically become fully vested in the event either the participant is terminated from employment without cause or the participant terminates his or her employment due to a material negative change in job position.

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Under the 2004 Plan, a change in control generally includes:

- an acquisition of 80% or more of our outstanding stock by any person or group;
- a merger or consolidation of us after which our own stockholders as of immediately prior to the merger or consolidation own 20% or less of the surviving entity;
- a sale of all or substantially all of our assets; or
- a complete liquidation or dissolution of Masimo.

For purposes of the 2004 Plan, cause means the participant s conviction of a felony, an act of material dishonesty or fraud by the participant against us or our stockholders, or the participant s willful breach of any duty owed by the participant to us or our subsidiaries and material negative change in job position means a reduction in the participant s base compensation or a substantial diminution in the participant s duties and responsibilities.

Registration Statements on Form S-8. We intend to file one or more registration statements on Form S-8 under the Securities Act promptly following the completion of this offering to register the shares of our common stock subject to outstanding stock options and reserved for issuance under our 2004 Plan. These registration statements are expected to become effective upon filing. Shares covered by these registration statements will then be eligible for sale in the public markets, subject to any applicable lock-up agreements and to Rule 144 limitations applicable to affiliates.

2007 Stock Incentive Plan

Our board of directors adopted our 2007 Stock Incentive Plan, or 2007 Plan, in November 2006. Subject to stockholder approval, the 2007 Plan will become effective in connection with this offering. The 2007 Plan will terminate ten years from the date of this offering, unless our board of directors terminates it earlier. Upon the effectiveness of our 2007 Plan, no further equity awards will be made under our 2004 Plan. However, any options outstanding under our 2004 Plan will continue to be governed by their existing terms.

Awards. The 2007 Plan provides for the grant of the following awards:

- ISOs, which may be granted solely to our employees, including our executive officers; and
- NSOs, stock appreciation rights, restricted stock awards, unrestricted stock awards, restricted stock unit awards and performance awards, which may be granted to our directors, consultants or employees, including our executive officers.

Purpose. The purpose of our 2007 Plan is to encourage and enable our directors, consultants and employees, including our executive officers, to acquire or increase their holdings of common stock and other interests in us in order to promote a closer identification of their interests with those of us and our stockholders, thereby further stimulating their efforts to enhance our efficiency, soundness, profitability, growth and stockholder value.

Administration. The 2007 Plan will be administered by the compensation committee of our board of directors, provided that our board of directors may act in lieu of the compensation committee on any matter. In this discussion, we refer to our board of directors and the compensation committee collectively as the Administrator. Subject to the terms and conditions of the 2007 Plan, the Administrator is authorized to select participants, determine the type and number of awards to be granted and the number of shares to which awards will relate or the amount of a performance award, specify dates at which awards will be exercisable or settled, including performance conditions that may be required as a condition thereof, set other terms and conditions of such awards, prescribe forms of award agreements, interpret and specify rules and regulations relating to the 2007 Plan, and make all other determinations

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that may be necessary or advisable for the administration of the 2007 Plan. Acceptable forms of consideration for the purchase of our common stock issued under the 2007 Plan will be determined by the administrator and may include cash, common stock previously owned by the participant, payment through a broker-assisted exercise or any combination of the foregoing. In addition, the Administrator may delegate its authority under the 2007 Plan to the extent permitted by the Delaware General Corporation Law, except delegation is limited where necessary to meet requirements under Rule 16(b)-3 under the Exchange Act, or Section 162(m) of the Code. Neither we nor the Administrator may reprice any stock option or stock appreciation right granted under the 2007 Plan without first obtaining the approval of our stockholders.

Share Reserve. Our 2007 Plan authorizes an aggregate of 1,500,000 shares of our common stock (before giving effect to the forward stock split of our common stock to be effected prior to the closing of this offering), plus the number of shares of our common stock available for issuance under our 2004 Plan that are not subject to options outstanding as of the effective time of the 2007 Plan. There are no awards currently outstanding under the 2007 Plan. The share reserve under the 2007 Plan will be automatically increased from time to time by the number of shares of our common stock that are issuable pursuant to options outstanding under our 2004 Plan as of the completion of this offering that thereafter would have become available for future grant under the 2004 Plan. In addition, this amount will be automatically increased annually on January 1st of each year beginning in 2008 by three percent of the aggregate number of shares of our common stock outstanding on December 31st of the immediately preceding year. Shares of our common stock subject to options and other stock awards that have expired or otherwise terminate under the 2007 Plan without having been exercised in full will again become available for grant under the 2007 Plan. Shares of our common stock issued under the 2007 Plan may include previously unissued shares or reacquired shares bought on the market or otherwise. If any shares of our common stock subject to a stock award are not delivered to a participant because such shares are withheld for the payment of taxes or the stock award is exercised through a net exercise, then the number of shares that are not delivered to participants shall again become available for grant under the 2007 Plan. In addition, if the exercise of any stock award is satisfied by tendering shares of our common stock held by the participant, then the number of shares tendered shall become available for grant under the 2007 Plan. The maximum number of stock options and stock appreciation rights that may be issued to a single participant in any calendar year under our 2007 Plan is 1,500,000 shares.

Stock Options. Stock options will be granted pursuant to stock option agreements. The exercise price for stock options cannot be less than 100% of the fair market value of our common stock on the date of grant. Options granted under the 2007 Plan will vest at the rate specified in the option agreement. A stock option agreement may provide for early exercise of NSOs prior to vesting. Unvested shares of our common stock issued in connection with an early exercise may be repurchased by us upon termination of the participant s service. In general, the term of stock options granted under the 2007 Plan may not exceed ten years. Unless the terms of a participant s stock option agreement provide for earlier or later termination, if a participant s service relationship with us, or any affiliate of ours, ceases for any reason other than for cause, disability or death, the participant may exercise any vested options for up to 90 days after the date the service relationship ends, unless the terms of the stock option agreement provide for a longer or shorter period to exercise the option. If a participant s service relationship with us, or any affiliate of ours, ceases due to disability, the participant may exercise any vested options for up to one year after the date the service relationship ends. If a participant s service relationship with us, or any affiliate of ours, ceases due to death, or the participant dies within 30 days following the date the service relationship ends other than for cause, the participant s beneficiary may exercise any vested options for up to one year following the date of death. If a participant s relationship with us, or any affiliate of ours, ceases due to termination for cause, the option will terminate at the time the participant s relationship with us, or an affiliate of ours, terminates. In no event may an option be exercised after its expiration date.

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Incentive stock options may be granted only to our employees, including executive officers. The aggregate fair market value, determined at the time of grant, of shares of our common stock with respect to ISOs that are exercisable for the first time by a participant during any calendar year under all of our equity plans may not exceed $100,000. The options or portions of options that exceed this limit are automatically treated as NSOs. No ISO may be granted to any person who, at the time of the grant, owns or is deemed to own stock possessing more than 10% of the total combined voting power of us or any affiliate of ours unless the following conditions are satisfied:

- the option exercise price is at least 110% of the fair market value of our common stock on the date of grant; and
- the term of the ISO does not exceed five years from the date of grant.

Stock Appreciation Rights. Stock appreciation rights will be granted through a stock appreciation rights agreement. Each stock appreciation right is denominated in common stock equivalents. The exercise price of each stock appreciation right will be determined by the Administrator at the time of grant and will not be less than 100% of the fair market value of the common stock underlying the right. In general, the term of a stock appreciation right may not exceed ten years. Upon exercise of a stock appreciation right, we will pay the participant an amount equal to the excess of (i) the aggregate fair market value of our common stock on the date of exercise, over (ii) the aggregate exercise price determined by the Administrator on the date of grant. Stock appreciation rights will be paid either in cash, in shares of our common stock or partly in cash and partly in shares. Unless otherwise provided in a stock appreciation rights agreement, all stock appreciation rights will be settled in shares of our common stock, with cash paid for fractional shares. The administrator may also impose any restrictions or conditions upon the vesting of stock appreciation rights that it deems appropriate. A recipient s stock appreciation rights agreement shall specify the terms upon which the recipient may exercise a stock appreciation right in the event the recipient s relationship with us, or any affiliate of ours, ceases for any reason. Absent this disclosure, a stock appreciation right shall be governed by the same post-termination provisions applicable to options granted under the 2007 Plan, as discussed above. Stock appreciation rights carry no voting or dividend rights or other rights associated with stock ownership.

Restricted and Unrestricted Stock Awards. Restricted stock awards will be granted pursuant to restricted stock award agreements. A restricted stock award may be issued for nominal or no cost and may be granted in consideration for the recipient s past or future services performed for us or an affiliate of ours. Participants receiving a restricted stock award generally have all of the rights of a stockholder with respect to such stock including rights to vote the shares and receive dividends. Shares of our common stock acquired under a restricted stock award will be subject to forfeiture to us in accordance with vesting conditions based upon a schedule or performance criteria established by the Administrator. Generally, except as otherwise provided in the applicable restricted stock award agreement, restricted stock awards that have not vested will be forfeited upon the participant s termination of continuous service with us or an affiliate of ours for any reason. We will return the purchase price for a forfeited restricted stock award only if set forth in the participant s restricted stock award agreement.

Unrestricted stock awards are similar to restricted stock awards, provided that shares of our common stock acquired under an unrestricted stock award will be fully vested on the date of grant.

Restricted Stock Unit Awards. Restricted stock unit awards will be granted pursuant to restricted stock unit award agreements. Restricted stock units are denominated in common stock equivalents. They are typically awarded to participants without payment of consideration, but are subject to vesting conditions based upon a schedule or performance criteria established by the Administrator. Unlike restricted stock, the stock underlying restricted stock units will not be issued until the stock units have vested. Prior to settlement, restricted stock unit awards carry no voting or dividend rights or other rights associated with stock ownership, but unless otherwise provided in a participant s restricted stock unit award agreement,

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dividend equivalents will accrue from the date the award is granted until the date the shares underlying a restricted stock unit are issued. Except as otherwise provided in the applicable restricted stock unit award agreement, restricted stock units that have not vested will be forfeited upon the participant s termination of continuous service with us or an affiliate of ours for any reason.

Performance Awards. Performance awards may be granted, vest or be exercised based upon the attainment of certain performance goals during a certain period of time. The performance awards may be issued as performance-based compensation that is not subject to the income tax deductibility limitations imposed by Section 162(m) of the Code if the grant or vesting of one or more stock awards and the delivery of cash is tied solely to the attainment of certain performance goals during a designated performance period. The length of any performance period, the performance goals to be achieved during the performance period and the measure of whether and to what degree such performance goals have been attained shall be determined by the Administrator. The maximum amount to be received by any individual in any performance period, which shall not be less than one fiscal year, under performance awards issued under the 2007 Plan may not exceed 1,500,000 shares of our common stock and $1,000,000 in cash.

*Internal Revenue Code Section 409A Requirements***.** Certain awards under the 2007 Plan may be considered nonqualified deferred compensation for purposes of Section 409A of the Code, or Section 409A, which imposes certain requirements on compensation that is deemed under Section 409A to involve nonqualified deferred compensation. Among other things, the requirements relate to the timing of elections to defer, the timing of distributions and prohibitions on the acceleration of distributions. Failure to comply with these requirements (or an exception from such requirements) may result in the immediate taxation of all amounts deferred under the nonqualified deferred compensation plan for the taxable year and all preceding taxable years, by or for any participant with respect to whom the failure relates , the imposition of an additional 20% income tax on the participant for the amounts required to be included in gross income and the possible imposition of penalty interest on the unpaid tax. Generally, Section 409A does not apply to incentive awards that are paid at the time the award vests. Likewise, Section 409A typically does not apply to restricted stock. Section 409A may, however, apply to incentive awards the payment of which is delayed beyond the calendar year in which the award vests. Treasury regulations generally provide that the type of awards provided under the 2007 Plan will not be considered nonqualified deferred compensation. However, to the extent that Section 409A applies to an award issued under the 2007 Plan, the 2007 Plan and all such awards will, to the extent practicable, be construed in accordance with Section 409A. Under the 2007 Plan, the Administrator has the discretion to grant or to unilaterally modify any award issued under the 2007 Plan in a manner that conforms with the requirements of Section 409A with respect to deferred compensation or voids any participant election to the extent it would violate Section 409A. The Administrator also has sole discretion to interpret the requirements of the Code, including Section 409A, for purposes of the 2007 Plan and all awards issued under the 2007 Plan.

Transferability of Awards. Generally, a participant may not transfer an award granted under the 2007 Plan other than by will or the laws of descent and distribution. However, a participant may transfer an NSO pursuant to a domestic relations order. In addition, if provided in an award agreement, NSOs, stock appreciation rights settled in shares, restricted stock awards and performance awards granted under the 2007 Plan may be transferred by instrument to the participant s immediate family or an inter vivos or testamentary trust or by gift to charitable institutions.

Changes to Capital Structure. In the event there is a specified type of change in our capital structure not involving the receipt of consideration by us, such as a stock split, stock dividend, combination, recapitalization or reclassification, the number of shares reserved under the 2007 Plan and the number of shares and exercise price, if applicable, of all outstanding stock awards will be appropriately adjusted.

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Change in Control. In the event of a change in control of us, the Administrator may take one or more of the following actions without the consent of any 2007 Plan participant or stockholder of ours:

- arrange for all outstanding stock awards under the 2007 Plan to be assumed, continued or substituted for by any entity surviving the change in control;
- accelerate in part or in full the vesting provisions of stock awards held by participants;
- arrange or otherwise provide for the payment of cash or other consideration to participants in exchange for the satisfaction or cancellation of such stock awards; or
- generally make such other modifications, adjustments or amendments to outstanding awards or the 2007 Plan as the Administrator deems necessary or appropriate.

In the event that an award outstanding under the 2007 Plan is not exercised in full prior to consummation of a change in control in which the award is not being assumed or substituted for, the award shall automatically terminate as of immediately prior to the consummation of the transaction. In addition, the 2007 Plan provides that in the event a participant is involuntarily terminated in connection with, or within 12 months after, a change in control of us, each of the participant s stock awards outstanding under the 2007 Plan that are assumed, continued or substituted for by a surviving entity in connection with the change in control will become fully vested.

Involuntary termination includes (i) a discharge without cause or (ii) voluntary resignation by the participant within 60 days following a material reduction in the participant s job responsibilities, an involuntarily relocation of participant s work site to a location more than 50 miles from the participant s work site as of immediately prior to the change in control or a material reduction in the participant s total compensation other than as part of a reduction by the same percentage amount of the compensation of all other similarly-situated employees. A change in control generally includes:

- a merger or consolidation of us after which our own stockholders as of immediately prior to the merger or consolidation own 50% or less of the surviving entity;
- a sale of all or substantially all of our assets;
- a complete liquidation or dissolution of us; or
- an acquisition of 50% or more of our outstanding stock by any person or group.

Plan Amendments. Our board of directors will have the authority to amend or terminate the 2007 Plan. However, no amendment or termination of the plan will adversely affect any rights under outstanding awards unless agreed to in writing by the affected participant. We will obtain stockholder approval of any amendments to the 2007 Plan as required by applicable law.

Registration Statements on Form S-8. We intend to file one or more registration statements on Form S-8 under the Securities Act promptly following the completion of this offering to register the shares of our common stock subject to outstanding stock options and reserved for issuance under our 2007 Plan. These registration statements are expected to become effective upon filing. Shares covered by these registration statements will then be eligible for sale in the public markets, subject to any applicable lock-up agreements and to Rule 144 limitations applicable to affiliates.

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Potential Payments upon Termination or Change in Control

The tables below estimate amounts of (i) the continuation of salary and benefits and (ii) the acceleration of options outstanding for each of our named executive officers, in each case upon a termination or upon a change in control, as if such event occurred on April 30, 2007. There was no public market for our common stock on April 30, 2007. Accordingly, we have estimated the market value of the stock options in the tables below based on an assumed initial public offering price of $ per share, the midpoint of the range listed on the cover page of this prospectus. See also Employment Contracts and Employee Benefit Plans.

Joe E. Kiani

Executive Benefits and Payments Upon Termination	Termination by Us Without Cause	Termination by Mr. Kiani for Good Reason	Termination for Death or Disability
Base Salary	$ 822,824	$ 822,824	$ 617,118
Continuation of Benefits[1]	43,026	43,026	43,026

(1) Comprised of the continuation of standard employee benefits, including health and dental insurance, for 36 months.

Acceleration of Vesting of Options upon Change in Control	Change in Control in Which Options are Assumed by Acquiror	Change in Control in Which Options are Not Assumed by Acquiror	Upon Termination
Number of Option Shares Accelerated[2]			
Value of Option Shares Accelerated	$	$	$

(2) Mr. Kiani did not hold any options on April 30, 2007.

Other Named Executive Officers

	Acceleration of Vesting of Options upon Change in Control			
	Change in Control in Which Options are Assumed by Acquiror		Change in Control in Which Options are Not Assumed by Acquiror	
Name	Number of Option Shares Accelerated	Value of Option Shares Accelerated	Number of Option Shares Accelerated	Value of Option Shares Accelerated
Mark P. de Raad		$	45,000	$
Bradley Langdale	3,640		16,445	
Ammar Al-Ali	2,900		18,890	
Yongsam Lee	9,820		21,820	
Christopher Kilpatrick	16,100		16,100	

401(k) Plan

We maintain a retirement plan, the 401(k) Plan, which is intended to be a tax-qualified retirement plan. The 401(k) Plan covers substantially all of our employees. Participants may elect to defer a percentage of their eligible pretax earnings each year up to the maximum contribution permitted by the Code. Each participant s interests in his or her deferrals are 100% vested when contributed. The 401(k) Plan permits us to make matching contributions if we choose and we have historically provided matching contributions of up to three percent. The 401(k) Plan is intended to qualify under Sections 401(a) and 501(a) of the Code. As such, contributions to the 401(k) Plan and earnings on those contributions are not taxable to participants until distributed from the 401(k) Plan, and all contributions are deductible by us when made.

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Loans to Directors and Executive Officers

In January 2006, we made loans to certain of our directors, executive officers and other employees in connection with their exercise of stock options. Each loan was evidenced by a promissory note and secured by shares our common stock acquired in connection with the loan. All of the loans were repaid in full with interest in March 2006. See Certain Relationships and Related Party Transactions Loans to Directors and Executive Officers.

Non-Employee Director Compensation

We have adopted a non-employee director compensation policy. Under this policy, our audit committee chairperson receives an annual cash retainer of $40,000, payable on a quarterly basis in arrears. No other non-employee director is entitled to receive any cash compensation for their service on our board of directors or any committee thereof. However, our non-employee directors are entitled to reimbursement for their reasonable expenses incurred in connection with attending meetings of our board of directors and committees thereof and performing their functions and duties as directors.

Our board of directors has adopted the following policy with respect to granting stock options to non-employee directors. Our audit committee chairperson received a stock option grant for 50,000 shares of common stock, which vests at a rate of 20% per year. Upon first becoming a member of our board of directors, each non-employee director other than our audit committee chairperson shall receive either (a) an option to purchase 50,000 shares of our common stock that vests at a rate of 20% per year, with the first 20% vesting upon completion of the first year of service, or (b) an option to purchase 10,000 shares of our common stock that fully vest upon completion of the first year of service. Our compensation committee will determine which of the two awards will be made. Upon the full vesting of the previous option award to our audit committee chairperson and other outside directors, our compensation committee will have the discretion to provide additional option grants to our non-employee directors of either 10,000 shares or 50,000 shares with the same vesting schedule set forth above.

Through April 30, 2007, we granted to our current non-employee directors options to purchase an aggregate of 395,000 shares of common stock under our Third Amended and Restated 1996 Incentive Stock Option, Nonqualified Stock Option and Restricted Stock Purchase Plan, and our 2004 Incentive Stock Option, Nonqualified Stock Option and Restricted Stock Purchase Plan, or 2004 Plan. All awards made to our non-employee directors after the completion of this offering will be made under our 2007 Stock Incentive Plan. For a more detailed description of this plan, see Compensation Employee Benefit Plans 2007 Stock Incentive Plan.

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The following table sets forth summary information concerning compensation paid or accrued for services rendered to us in all capacities to the members of our board of directors (other than Mr. Kiani who is a named executive officer) for the fiscal year ended December 31, 2006.

Name	Fees Earned or Paid in Cash	Option Awards[1]$	All Other Compensation	Total
Steven Barker, M.D., Ph.D.	$	$ 30,034	$	$ 30,034
Edward L. Cahill		30,034		30,034
Robert Coleman, Ph.D.		30,034	10,255[2]	40,289
Mohamed Diab[3]			414,652[4]	414,652
Sanford Fitch	6,667	23,507		30,174
Jack Lasersohn		30,034		30,034
Thomas Weatherford[5]				

(1) The value reported above in the Option Awards column is the amount we expensed during 2006 for each director s option award calculated in accordance with SFAS No. 123(R). All awards were granted under our 2004 Plan. See Note 12 to the Notes to Consolidated Financial Statements for a discussion of assumptions made in determining the grant date fair value and compensation expense of our stock options.

(2) Represents an incentive trip.

(3) Mr. Diab is an employee of ours and resigned from our board of directors effective April 2007.

(4) This amount is comprised of the following compensation earned by Mr. Diab as an employee of ours in 2006: $273,428 in base salary; $113,614 in a cash bonus; $16,404 for incentive trips; and $11,206 in medical insurance premiums. Mr. Diab did not earn any compensation as a director of ours in 2006.

(5) Mr. Weatherford s term as a director ended on April 19, 2006.

Limitation of Liability and Indemnification

We are incorporated under the laws of the State of Delaware. Section 145 of the Delaware General Corporation Law, or DGCL, provides that a Delaware corporation may indemnify any persons who are, or are threatened to be made, parties to any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative (other than an action by or in the right of such corporation), by reason of the fact that such person was an officer, director, employee or agent of such corporation, or is or was serving at the request of such person as an officer, director, employee or agent of another corporation or enterprise. The indemnity may include expenses (including attorneys fees), judgments, fines and amounts paid in settlement actually and reasonably incurred by such person in connection with such action, suit or proceeding, provided that such person acted in good faith and in a manner he or she reasonably believed to be in or not opposed to the corporation s best interests and, with respect to any criminal action or proceeding, had no reasonable cause to believe that his or her conduct was illegal. A Delaware corporation may indemnify any persons who are, or are threatened to be made, a party to any threatened, pending or completed action or suit by or in the right of the corporation by reason of the fact that such person was a director, officer, employee or agent of such corporation, or is or was serving at the request of such corporation as a director, officer, employee or agent of another corporation or enterprise. The indemnity may include expenses (including attorneys fees) actually and reasonably incurred by such person in connection with the defense or settlement of such action or suit provided such person acted in good faith and in a manner he or she reasonably believed to be in or not opposed to the corporation s best interests except that no indemnification is permitted without judicial approval if the officer or director is adjudged to be liable to the corporation. Where an officer or director is successful on the merits or otherwise in the defense of any action referred to above, the corporation must indemnify him or her against the expenses which such officer or director has actually and reasonably incurred. Our amended and restated certificate of incorporation and amended and restated bylaws provide for the indemnification of our directors and officers to the fullest extent permitted under the DGCL.

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Section 102(b)(7) of the DGCL permits a corporation to provide in its certificate of incorporation that a director of the corporation shall not be personally liable to the corporation or its stockholders for monetary damages for breach of fiduciary duties as a director, except for liability:

- for any transaction from which the director derives an improper personal benefit;
- for acts or omissions not in good faith or that involve intentional misconduct or a knowing violation of law;
- for improper payment of dividends or redemptions of shares; or
- for any breach of a director s duty of loyalty to the corporation or its stockholders.

Our amended and restated certificate of incorporation and amended and restated bylaws include such a provision. Expenses incurred by any officer or director in defending any such action, suit or proceeding in advance of its final disposition shall be paid by us upon delivery to us of an undertaking, by or on behalf of such director or officer, to repay all amounts so advanced if it shall ultimately be determined that such director or officer is not entitled to be indemnified by us.

As permitted by Delaware law, we have entered into indemnity agreements with each of our directors and executive officers that require us to indemnify such persons against any and all expenses including attorneys fees, witness fees, damages, judgments, fines, settlements and other amounts incurred in connection with any action, suit or proceeding, whether actual or threatened, to which any such person may be made a party by reason of the fact that such person is or was a director, an officer or an employee of our or any of our affiliated enterprises, provided that such person acted in good faith and in a manner such person reasonably believed to be in or not opposed to our best interests and, with respect to any criminal proceeding, had no reasonable cause to believe his or her conduct was unlawful. The indemnification agreements also set forth certain procedures that will apply in the event of a claim for indemnification thereunder.

At present, there is no pending litigation or proceeding involving a director or executive officer as to which indemnification is being sought and we are not aware of any threatened litigation that may result in claims for indemnification by any of our directors or executive officers.

We have an insurance policy covering our directors and executive officers with respect to certain liabilities, including liabilities arising under the Securities Act or otherwise.

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CERTAIN RELATIONSHIPS AND RELATED PARTY TRANSACTIONS

The following is a description of transactions from January 1, 2004 to the date of the prospectus in which we were or are a party, in which the amount involved in the transaction exceeded or exceeds $120,000, and in which any of our directors, executive officers or holders of more than five percent of our capital stock had or will have a direct or indirect material interest, other than compensation and employment arrangements that are described under Compensation. We believe the terms obtained or consideration that we paid or received, as applicable, in connection with the transactions described below were comparable to terms available or the amounts that would have been paid or received, as applicable, in arm s-length transactions.

Stock Issuances

Common Stock

Since January 1, 2004, we issued 2,043,550 shares of common stock upon exercise of stock options by current and former directors and executive officers.

Preferred Stock

We have not issued any preferred stock since January 1, 2004.

Option Grants

Since January 1, 2004, we granted options to purchase an aggregate of 976,590 shares of our common stock, with a weighted-average exercise price of $20.08 per share, to our current and former directors and executive officers.

Loans to Directors and Executive Officers

In January, February and March 2006, we made the following loans to certain of our directors and executive officers and one of our former directors in connection with their exercise of stock options:

Name	Total Loan Amount	Shares of Common Stock Pledged as Collateral
Joe E. Kiani	$ 6,849,965	1,060,180
Ammar Al-Ali		