

OSI SYSTEMS INC  
Form 10-Q  
May 01, 2009  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

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**FORM 10-Q**

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(Mark one)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended March 31, 2009

OR

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 0-23125

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## OSI SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

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**California**  
(State or other jurisdiction of  
incorporation or organization)

**33-0238801**  
(I.R.S. Employer  
Identification Number)

**12525 Chadron Avenue**

**Hawthorne, California 90250**

(Address of principal executive offices)

**(310) 978-0516**

(Registrant's telephone number, including area code)

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

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

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

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

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As of April 28, 2009, there were 17,392,709 shares of the registrant's common stock outstanding.

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Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. Condensed Consolidated Financial Statements****OSI SYSTEMS, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS****(in thousands, except share amounts)****(Unaudited)**

|  | <b>June 30,<br/>2008</b> | <b>March 31,<br/>2009<br/>(unaudited)</b> |
|--|--------------------------|---|
| <b>ASSETS</b>  |                          |   |
| Current Assets:  |                          |   |
| Cash and cash equivalents  | \$ 18,232                | \$ 28,651                                 |
| Accounts receivable  | 156,781                  | 120,343                                   |
| Other receivables  | 3,258                    | 3,495                                     |
| Inventories  | 144,807                  | 145,951                                   |
| Deferred income taxes  | 19,313                   | 18,999                                    |
| Prepaid expenses and other current assets  | 14,064                   | 14,363                                    |
| Total current assets   | 356,455                  | 331,802                                   |
| Property and equipment, net  | 47,191                   | 44,931                                    |
| Goodwill   | 60,408                   | 59,045                                    |
| Intangible assets, net   | 34,495                   | 31,868                                    |
| Other assets   | 9,092                    | 11,225                                    |
| Total assets   | \$ 507,641               | \$ 478,871                                |
| <b>LIABILITIES AND SHAREHOLDERS EQUITY</b>   |                          |   |
| Current Liabilities:   |                          |   |
| Bank lines of credit   | \$ 18,657                | \$ 9,000                                  |
| Current portion of long-term debt  | 6,593                    | 8,015                                     |
| Accounts payable   | 75,320                   | 76,930                                    |
| Accrued payroll and employee benefits  | 20,896                   | 21,194                                    |
| Advances from customers  | 6,746                    | 8,169                                     |
| Accrued warranties   | 11,597                   | 10,017                                    |
| Deferred revenue   | 7,414                    | 7,615                                     |
| Other accrued expenses and current liabilities   | 14,274                   | 12,977                                    |
| Total current liabilities  | 161,497                  | 153,917                                   |
| Long-term debt   | 49,091                   | 41,448                                    |
| Other long-term liabilities  | 17,804                   | 18,630                                    |
| Total liabilities  | 228,392                  | 213,995                                   |
| Minority interest  | 1,228                    | 1,215                                     |
| Commitment and contingencies (Note 7)  |                          |   |
| Shareholders' Equity:  |                          |   |
| Preferred stock, no par value authorized, 10,000,000 shares; no shares issued or outstanding |                          |   |

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|   |            |            |
|---|------------|------------|
| Common stock, no par value authorized, 100,000,000 shares; issued and outstanding, 17,740,057 and 17,392,709 shares at June 30, 2008 and March 31, 2009, respectively | 224,581    | 224,538    |
| Retained earnings   | 41,972     | 48,839     |
| Accumulated other comprehensive income  | 11,468     | (9,716)    |
| Total shareholders equity   | 278,021    | 263,661    |
| Total liabilities and shareholders equity   | \$ 507,641 | \$ 478,871 |

See accompanying notes to condensed consolidated financial statements.

Table of Contents**OSI SYSTEMS, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

(in thousands, except per share amount data)

(Unaudited)

|   | For the Three Months Ended<br>March 31, |            | For the Nine Months Ended<br>March 31, |            |
|---|---|------------|--|------------|
|   | 2008                                    | 2009       | 2008                                   | 2009       |
| Revenues  | \$ 156,708                              | \$ 144,095 | \$ 451,915                             | \$ 451,298 |
| Cost of goods sold  | 100,322                                 | 94,264     | 292,418                                | 297,413    |
| Gross profit  | 56,386                                  | 49,831     | 159,497                                | 153,885    |
| Operating expenses:   |   |            |  |            |
| Selling, general and administrative expenses                            | 37,629                                  | 34,384     | 112,945                                | 107,648    |
| Research and development  | 12,055                                  | 8,572      | 33,509                                 | 27,454     |
| Impairment, restructuring, and other charges                            | 1,156                                   | 2,401      | 3,355                                  | 6,000      |
| Total operating expenses  | 50,840                                  | 45,357     | 149,809                                | 141,102    |
| Income from operations  | 5,546                                   | 4,474      | 9,688                                  | 12,783     |
| Interest expense, net   | (1,162)                                 | (583)      | (3,419)                                | (2,341)    |
| Income before provision for income taxes and minority interest          | 4,384                                   | 3,891      | 6,269                                  | 10,442     |
| Provision (benefit) for income taxes                                    | (2,643)                                 | 1,296      | (1,977)                                | 3,549      |
| Minority interest of net earnings (losses) of consolidated subsidiaries | 118                                     | 22         | (76)                                   | 26         |
| Net income  | \$ 6,909                                | \$ 2,573   | \$ 8,322                               | \$ 6,867   |
| Earnings per share:   |   |            |  |            |
| Basic   | \$ 0.39                                 | \$ 0.15    | \$ 0.48                                | \$ 0.39    |
| Diluted   | \$ 0.39                                 | \$ 0.15    | \$ 0.47                                | \$ 0.39    |
| Shares used in per share calculation:                                   |   |            |  |            |
| Basic   | 17,624                                  | 17,336     | 17,333                                 | 17,557     |
| Diluted   | 17,922                                  | 17,396     | 17,654                                 | 17,624     |

See accompanying notes to condensed consolidated financial statements.

Table of Contents**OSI SYSTEMS, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(amounts in thousands)

(Unaudited)

|   | <b>For the Nine Months Ended March 31,</b> |                  |
|---|--|------------------|
|   | <b>2008</b>                                | <b>2009</b>      |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>   |  |                  |
| Net income  | \$ 8,322                                   | \$ 6,867         |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: |  |                  |
| Depreciation and amortization   | 14,639                                     | 12,820           |
| Stock based compensation expense  | 3,497                                      | 3,895            |
| Provision for losses on accounts receivable   | 285  | 5,153            |
| Minority interest in net income (loss) of consolidated subsidiaries                         | (76)                                       | 26               |
| Equity in earnings of unconsolidated affiliates   | (334)                                      | (549)            |
| Deferred income taxes   | (6,201)                                    | (880)            |
| Other   | 41   | 107              |
| Changes in operating assets and liabilities net of business acquisitions:                   |  |                  |
| Accounts receivable   | 1,343                                      | 16,892           |
| Other receivables   | (147)                                      | (1,152)          |
| Inventories   | (28,821)                                   | (19,347)         |
| Prepaid expenses and other current assets   | (6,614)                                    | (2,420)          |
| Accounts payable  | 11,877                                     | 9,116            |
| Accrued payroll and related expenses  | 3,931                                      | 1,032            |
| Advances from customers   | (11,545)                                   | 6,524            |
| Accrued warranties  | 1,692                                      | (213)            |
| Deferred revenue  | (675)                                      | 2,694            |
| Other accrued expenses and current liabilities  | (1,117)                                    | (451)            |
| Net cash provided by (used in) operating activities   | (9,903)                                    | 40,114           |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>   |  |                  |
| Acquisition of property and equipment   | (7,852)                                    | (9,354)          |
| Proceeds from the sale of property and equipment  | 137  | 56               |
| Purchase of investments and marketable securities   |  | (407)            |
| Buyback of subsidiary stock   | (15,050)                                   |                  |
| Acquisition of intangible and other assets  | (1,397)                                    | (2,698)          |
| Net cash used in investing activities   | (24,162)                                   | (12,403)         |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>   |  |                  |
| Net proceeds from (repayments of) bank lines of credit                                      | 6,878                                      | (9,353)          |
| Proceeds from long-term debt  | 44,941                                     |                  |
| Payments on long-term debt  | (23,991)                                   | (4,274)          |
| Net payments of capital lease obligations   | (780)                                      | (731)            |
| Proceeds from exercise of stock options, warrants and employee stock purchase plan          | 5,423                                      | 3,255            |
| Repurchase of common shares   |  | (7,388)          |
| Net cash provided by (used in) financing activities   | 32,471                                     | (18,491)         |
| EFFECT OF EXCHANGE RATE CHANGES ON CASH   | 533  | 1,199            |
| <b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>                                 | <b>(1,061)</b>                             | <b>10,419</b>    |
| <b>CASH AND CASH EQUIVALENTS - BEGINNING OF PERIOD</b>                                      | <b>15,980</b>                              | <b>18,232</b>    |
| <b>CASH AND CASH EQUIVALENTS - END OF PERIOD</b>  | <b>\$ 14,919</b>                           | <b>\$ 28,651</b> |
| Supplemental disclosure of cash flow information:   |  |                  |
| Interest  | \$ 3,559                                   | \$ 2,504         |



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|   |    |       |    |       |
|---|----|-------|----|-------|
| Income taxes  | \$ | 2,453 | \$ | 3,769 |
| Supplemental disclosure of non-cash investing activities: |    |       |    |       |
| Buyback of subsidiary stock with common stock             | \$ | 5,898 |    |       |

See accompanying notes to condensed consolidated financial statements.

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**OSI SYSTEMS, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**1. Basis of Presentation**

*Description of Business*

OSI Systems, Inc., together with its subsidiaries (the Company), is a vertically integrated designer and manufacturer of specialized electronic systems and components for critical applications. The Company sells its products in diversified markets, including homeland security, healthcare, defense and aerospace.

The Company has three operating divisions: (i) Security, providing security inspection systems; (ii) Healthcare, providing patient monitoring, diagnostic cardiology and anesthesia systems; and (iii) Optoelectronics and Manufacturing, providing specialized electronic components for the Security and Healthcare divisions as well as for applications in the defense and aerospace markets, among others.

Through its Security division, the Company designs, manufactures and markets security and inspection systems worldwide primarily under the Rapiscan Systems trade name. Rapiscan Systems products are used to inspect baggage, cargo, vehicles and other objects for weapons, explosives, drugs and other contraband and to screen people. These products are also used for the safe, accurate and efficient verification of cargo manifests for the purpose of assessing duties and monitoring the export and import of controlled materials. Rapiscan Systems products fall into four categories: baggage and parcel inspection, cargo and vehicle inspection, hold (checked) baggage screening and people screening.

Through its Healthcare division, the Company designs, manufactures and markets patient monitoring, diagnostic cardiology and anesthesia systems worldwide primarily under the Spacelabs trade name. These products are used by care providers in critical care, emergency and perioperative areas within hospitals as well as physicians offices, medical clinics and ambulatory surgery centers. The Company's Healthcare division also offers centralized cardiac safety core laboratory services in connection with clinical trials by or on behalf of pharmaceutical companies and clinical research organizations.

Through its Optoelectronics and Manufacturing division, the Company designs, manufactures and markets optoelectronic devices and value-added manufacturing services worldwide for use in a broad range of applications, including aerospace and defense electronics, security and inspection systems, medical imaging and diagnostics, computed tomography (CT), fiber optics, telecommunications, gaming, office automation, computer peripherals and industrial automation. The Company sells optoelectronic devices primarily under the OSI Optoelectronics trade name and performs value-added manufacturing services primarily under the OSI Electronics trade name. This division provides products and services to original equipment manufacturers as well as to the Company's own Security and Healthcare divisions. The Optoelectronics and Manufacturing division also designs toll and traffic management systems under the OSI LaserScan trade name and systems for measuring bone density under the Osteometer trade name.

*Basis of Presentation*

The condensed consolidated financial statements include the accounts of OSI Systems, Inc. and its subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation. The condensed consolidated financial statements have been prepared by the Company, without audit, pursuant to Accounting Principles Board Opinion No. 28, *Interim Financial Reporting* and the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations. In the opinion of the Company's management, all adjustments, consisting of only normal and recurring adjustments, necessary for a fair presentation of the financial position and the results of operations for the periods presented have been included. These condensed consolidated financial statements and the accompanying notes should be read in conjunction with the audited condensed consolidated financial statements and accompanying notes included in the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2008. The results of operations for the three and nine months ended March 31, 2009 are not necessarily indicative of the operating results to be expected for the full fiscal year or any future periods.

Table of Contents*Per Share Computations*

The Company computes basic earnings per share by dividing net income available to common shareholders by the weighted average number of common shares outstanding during the period. The Company computes diluted earnings per share by dividing net income available to common shareholders by the sum of the weighted average number of common and dilutive potential common shares outstanding. Potential common shares consist of the shares issuable upon the exercise of stock options or warrants under the treasury stock method. Stock options and warrants to purchase a total of 2.1 million common shares for the three months and nine months ended March 31, 2009, respectively, were not included in diluted earnings per share calculations because to do so would have been antidilutive. Stock options and warrants to purchase a total of 1.1 million and 0.4 million shares of common stock for the three months and nine months ended March 31, 2008, respectively, were not included in diluted earnings per share calculations because to do so would have been antidilutive.

The following table sets forth the computation of basic and diluted earnings per share (in thousands, except per share amounts):

|  | Three Months Ended<br>March 31, |          | Nine Months Ended<br>March 31, |          |
|--|---------------------------------|----------|--------------------------------|----------|
|  | 2008                            | 2009     | 2008                           | 2009     |
| Net income available to common shareholders    | \$ 6,909                        | \$ 2,573 | \$ 8,322                       | \$ 6,867 |
| Weighted average shares outstanding basic      | 17,624                          | 17,336   | 17,333                         | 17,557   |
| Dilutive effect of stock options and warrants  | 298                             | 60       | 321                            | 67       |
| Weighted average of shares outstanding diluted | 17,922                          | 17,396   | 17,654                         | 17,624   |
| Basic earnings per share                       | \$ 0.39                         | \$ 0.15  | \$ 0.48                        | \$ 0.39  |
| Diluted earnings per share                     | \$ 0.39                         | \$ 0.15  | \$ 0.47                        | \$ 0.39  |

*Derivative Instruments and Hedging Activities*

The Company's use of derivatives consists primarily of foreign exchange contracts and interest rate swap agreements. As of March 31, 2009, the Company had outstanding foreign currency forward contracts totaling \$7.0 million to sell Taiwanese dollars in anticipation of the settlement in fiscal 2010 of sales denominated in Taiwanese dollars. In addition, to reduce the unpredictability of cash flows from interest payments related to variable, LIBOR-based debt, the Company entered into a three year interest rate swap agreement during the three months ended March 31, 2009, whereby the Company essentially incurs interest expense based upon a fixed 1.69% rate index for a portion of its term loan. The interest rate swap matures in March 2012. Pursuant to SFAS No. 133 Accounting for Derivative Instruments and Hedging Activities (as amended) (SFAS 133), each of these derivative contracts, as well other derivative contracts settled during the nine months ended March 31, 2009, are considered effective cash flow hedges in their entirety. As a result, the net gains or losses on such derivative contracts have been reported as a component of other comprehensive income in the condensed consolidated financial statements and reclassified into net earnings when the hedged transactions settle.

*Comprehensive Income*

Comprehensive income (loss) is computed as follows (in thousands):

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|  | Three Months Ended<br>March 31, |          | Nine Months Ended<br>March 31, |             |
|--|---------------------------------|----------|--------------------------------|-------------|
|  | 2008                            | 2009     | 2008                           | 2009        |
| Net income   | \$ 6,909                        | \$ 2,573 | \$ 8,322                       | \$ 6,867    |
| Foreign currency translation adjustments                               | 2,119                           | (2,199)  | 4,149                          | (21,579)    |
| Net gain (loss) from SFAS 133 derivative contracts                     |                                 | (162)    |                                | (107)       |
| Reclassification of net (gain) loss from SFAS 133 derivative contracts |                                 |          |                                | (55)        |
| Minimum pension liability adjustment                                   | (62)                            | (42)     | (147)                          | 556         |
| Other  |                                 |          | 58                             |             |
| Comprehensive income (loss)  | \$ 8,966                        | \$ 170   | \$ 12,382                      | \$ (14,318) |

*Recent Accounting Pronouncements*

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In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 157, Fair Value Measurements (SFAS 157), which clarifies the definition of fair value whenever another standard requires or permits assets or liabilities to be measured at fair value. Specifically, the standard clarifies that fair value should be based on the assumptions market participants would use when pricing the asset or liability, and establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. SFAS 157 does not expand the use of fair value to any new circumstances, and must be applied on a prospective basis except in certain cases. The standard also requires expanded financial statement disclosures about fair value measurements, including disclosure of the methods used and the effect on earnings.

In February 2008, the FASB issued FASB Staff Position (FSP) FAS No. 157-2, Effective Date of FASB Statement No. 157 (FSP 157-2). FSP 157-2 defers the effective date of SFAS 157 to fiscal years beginning after December 15, 2008, and interim periods within those fiscal years, for all nonfinancial assets and liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). Examples of items within the scope of FSP 157-2 are nonfinancial assets and nonfinancial liabilities initially measured at fair value in a business combination (but not measured at fair value in subsequent periods), and long-lived assets, such as property, plant and equipment and intangible assets measured at fair value for an impairment assessment under SFAS 144.

The partial adoption of SFAS 157 on July 1, 2008, with respect to financial assets and financial liabilities recognized or disclosed at fair value in the financial statements on a recurring basis, did not have a material impact on the Company's condensed consolidated financial statements. The Company is in the process of analyzing the potential impact of SFAS 157 relating to its planned July 1, 2009 adoption of the remainder of the standard.

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51 (SFAS 160). The new standard changes the accounting and reporting of noncontrolling interests, which have historically been referred to as minority interests. SFAS 160 requires that noncontrolling interests be presented in the consolidated balance sheets within shareholders' equity, but separate from the parent's equity, and that the amount of consolidated net income attributable to the parent and to the noncontrolling interest be clearly identified and presented in the consolidated statements of income. Any losses in excess of the noncontrolling interest's equity interest will continue to be allocated to the noncontrolling interest. Purchases or sales of equity interests that do not result in a change of control will be accounted for as equity transactions. Upon a loss of control, the interest sold, as well as any interest retained, will be measured at fair value, with any gain or loss recognized in earnings. In partial acquisitions, when control is obtained, the acquiring company will recognize at fair value, 100% of the assets and liabilities, including goodwill, as if the entire target company had been acquired. SFAS 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008, with early adoption prohibited. The new standard will be applied prospectively, except for the presentation and disclosure requirements, which will be applied retrospectively for all periods presented. The Company has not yet determined the impact, if any, that this statement will have on its condensed consolidated financial statements and will adopt the standard at the beginning of fiscal 2010.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), Business Combinations (SFAS 141(R)). The new standard changes the accounting for business combinations in a number of significant respects. The key changes include the expansion of transactions that will qualify as business combinations, the capitalization of in-process research and development (IPR&D) as an indefinite-lived asset, the recognition of certain acquired contingent assets and liabilities at fair value, the expensing of acquisition costs, the expensing of costs associated with restructuring the acquired company, the recognition of contingent consideration at fair value on the acquisition date, and the recognition of post-acquisition date changes in deferred tax asset valuation allowances and acquired income tax uncertainties as income tax expense or benefit. SFAS 141(R) is effective for business combinations that close in years beginning on or after December 15, 2008, with early adoption prohibited. The Company has not yet determined the impact, if any, that this statement will have on its condensed consolidated financial statements and will adopt the standard at the beginning of fiscal 2010.

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In May 2008, the FASB issued SFAS No. 162, Hierarchy of Generally Accepted Accounting Principles (SFAS 162). This statement is intended to improve financial reporting by identifying a consistent framework, or hierarchy, for selecting accounting principles to be used in preparing financial statements of nongovernmental entities that are presented in conformity with GAAP. This statement will be effective 60 days following the Securities and Exchange Commission's approval of the Public Company Accounting Oversight Board amendment to AU Section 411, The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles. The Company believes that SFAS 162 will have no material effect on its condensed consolidated financial statements.

### 2. Balance Sheet Details

The following tables provide details of selected balance sheet accounts (in thousands):

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|   | June 30,<br>2008  | March 31,<br>2009 |
|---|-------------------|-------------------|
| <b>Accounts receivable</b>                              |                   |                   |
| Trade receivables                                       | \$ 158,326        | \$ 125,132        |
| Receivables related to long term contracts<br>completed | 758               | 1,949             |
| <b>Total</b>  | <b>159,084</b>    | <b>127,081</b>    |
| Less: allowance for doubtful accounts                   | (2,303)           | (6,738)           |
| <b>Accounts receivable, net</b>                         | <b>\$ 156,781</b> | <b>\$ 120,343</b> |
| <b>Inventories, net</b>                                 |                   |                   |
| Raw materials   | \$ 70,339         | \$ 69,459         |
| Work-in-process   | 35,326            | 29,924            |
| Finished goods  | 39,142            | 46,568            |
| <b>Total</b>  | <b>\$ 144,807</b> | <b>\$ 145,951</b> |
| <b>Property and equipment</b>                           |                   |                   |
| Land  | \$ 6,246          | \$ 4,895          |
| Buildings and leasehold improvements                    | 18,301            | 20,426            |
| Equipment and tooling                                   | 51,280            | 51,551            |
| Furniture and fixtures                                  | 5,243             | 4,596             |
| Computer equipment                                      | 15,856            | 16,534            |
| Software  | 11,500            | 11,736            |
| <b>Total</b>  | <b>\$ 108,426</b> | <b>\$ 109,738</b> |
| Less: accumulated depreciation and amortization         | (61,235)          | (64,807)          |
| <b>Property and equipment, net</b>                      | <b>\$ 47,191</b>  | <b>\$ 44,931</b>  |

**3. Goodwill and Intangible Assets**

The changes in the carrying value of goodwill for the nine month period ended March 31, 2009, are as follows (in thousands):

|   | Security  | Healthcare | Optoelectronics<br>and<br>Manufacturing | Consolidated |
|---|-----------|------------|---|--------------|
| Balance as of June 30, 2008             | \$ 17,692 | \$ 35,569  | \$ 7,147                                | \$ 60,408    |
| Goodwill adjusted during the period     |           | 929        | (118)                                   | 811          |
| Foreign currency translation adjustment | (858)     | (1,268)    | (48)                                    | (2,174)      |
| Balance as of March 31, 2009            | \$ 16,834 | \$ 35,230  | \$ 6,981                                | \$ 59,045    |

In fiscal 2008, the Company repurchased all minority interests in its Spacelabs Healthcare subsidiary. In conjunction with the repurchase activities, a preliminary allocation of the purchase price in excess of the book value of the minority interest was recorded as of June 30, 2008. As of September 30, 2008, the Company completed its evaluation, resulting in the following purchase price allocation (in thousands):

|                        | Preliminary<br>Allocation | Adjustments | Final<br>Allocation |
|------------------------|---------------------------|-------------|---------------------|
| Goodwill               | \$ 9,155                  | 929         | \$ 10,084           |
| Developed technology   | 2,219                     | 355         | 2,574               |
| Customer relationships | 1,442                     | 11          | 1,453               |
| Trademarks             | 3,994                     | (1,697)     | 2,297               |



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|                             |    |         |     |         |
|-----------------------------|----|---------|-----|---------|
| Deferred taxes              |    | (2,679) | 402 | (2,277) |
| Total excess purchase price | \$ | 14,131  | \$  | 14,131  |

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Intangible assets consisted of the following (in thousands):

|                                 | Weighted<br>Average<br>Lives | Gross<br>Carrying<br>Value | June 30, 2008               |                    | March 31, 2009             |                             |                    |
|---------------------------------|------------------------------|----------------------------|-----------------------------|--------------------|----------------------------|-----------------------------|--------------------|
|                                 |                              |                            | Accumulated<br>Amortization | Intangibles<br>Net | Gross<br>Carrying<br>Value | Accumulated<br>Amortization | Intangibles<br>Net |
| <b>Amortizable assets:</b>      |                              |                            |                             |                    |                            |                             |                    |
| Software development costs      | 5 years                      | \$ 6,265                   | \$ 2,634                    | \$ 3,631           | \$ 8,951                   | \$ 3,057                    | \$ 5,894           |
| Patents                         | 10 years                     | 451                        | 298                         | 153                | 645                        | 320                         | 325                |
| Core technology                 | 10 years                     | 2,684                      | 911                         | 1,773              | 1,926                      | 798                         | 1,128              |
| Developed technology            | 12 years                     | 17,276                     | 5,430                       | 11,846             | 17,186                     | 6,658                       | 10,528             |
| Customer relationships/ backlog | 7 years                      | 9,582                      | 3,697                       | 5,885              | 9,367                      | 4,521                       | 4,846              |
| <b>Total amortizable assets</b> |                              | <b>36,258</b>              | <b>12,970</b>               | <b>23,288</b>      | <b>38,075</b>              | <b>15,354</b>               | <b>22,721</b>      |
| <b>Non-amortizable assets:</b>  |                              |                            |                             |                    |                            |                             |                    |
| Trademarks                      |                              | 11,207                     |                             | 11,207             | 9,147                      |                             | 9,147              |
| <b>Total intangible assets</b>  |                              | <b>\$ 47,465</b>           | <b>\$ 12,970</b>            | <b>\$ 34,495</b>   | <b>\$ 47,222</b>           | <b>\$ 15,354</b>            | <b>\$ 31,868</b>   |

Amortization expense related to intangibles assets was \$2.7 million and \$2.9 million for the nine months ended March 31, 2008 and 2009, respectively. At March 31, 2009, the estimated future amortization expense was as follows (in thousands):

|                           |           |               |
|---------------------------|-----------|---------------|
| 2009 (remaining 3 months) | \$        | 951           |
| 2010                      |           | 3,760         |
| 2011                      |           | 3,734         |
| 2012                      |           | 3,701         |
| 2013                      |           | 3,443         |
| 2014                      |           | 2,172         |
| 2015 and thereafter       |           | 4,960         |
| <b>Total</b>              | <b>\$</b> | <b>22,721</b> |

#### **4. Borrowings**

The Company maintains a credit agreement with certain lenders allowing for borrowings of up to \$124.5 million. The credit agreement consists of a \$74.5 million, five-year, revolving credit facility (including a \$45 million sub-limit for letters-of-credit) and a \$50 million five-year term loan. Borrowings under the agreement bear interest at either (i) the London Interbank Offered Rate (LIBOR) plus between 2.00% and 2.50% or (ii) the bank's prime rate plus between 1.00% and 1.50%. The rates are determined based on the Company's consolidated leverage ratio. As of March 31, 2009, the weighted-average interest rate under the credit agreement was 2.65%. The Company's borrowings under the credit agreement are guaranteed by the Company's domestic subsidiaries and are secured by substantially all of the Company's and its subsidiary guarantors' assets. The agreement contains various representations, warranties, affirmative, negative and financial covenants, and conditions of default customary for financing agreements of this type. As of March 31, 2009, \$44.0 million was outstanding under the term loan, \$9.0 million was outstanding under the revolving credit facility, and \$18.9 million was outstanding under the letter-of-credit facility.

Several of the Company's foreign subsidiaries maintain bank lines-of-credit, denominated in local currencies, to meet short-term working capital requirements and for the issuance of letters-of-credit. As of March 31, 2009, \$12.7 million was outstanding under these letter-of-credit facilities, while no debt was outstanding. As of March 31, 2009, the total amount available under these credit facilities was \$27.7 million, with a total cash borrowing sub-limit of \$6.7 million.

In fiscal 2005, the Company entered into a bank loan of \$5.3 million to fund the acquisition of land and buildings in the U.K. The loan is payable over a 20-year period, with quarterly installments of £34,500 (approximately \$49,000 as of March 31, 2009). The loan bears interest at British pound-based LIBOR plus 1.2%, payable on a quarterly basis. As of March 31, 2009, \$3.1 million remained outstanding under this loan at an interest rate of 2.7% per annum.

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Long-term debt consisted of the following (in thousands):

|  | June 30,<br>2008 | March 31,<br>2009 |
|--|------------------|-------------------|
| Five-year term loan due in fiscal 2013   | \$ 47,763        | \$ 44,013         |
| Twenty-year term loan due in fiscal 2025 | 4,539            | 3,110             |
| Capital leases                           | 2,193            | 1,519             |
| Other                                    | 1,189            | 821               |
|  | 55,684           | 49,463            |
| Less: current portion of long-term debt  | (6,593)          | (8,015)           |
| Long-term portion of debt                | \$ 49,091        | \$ 41,448         |

**5. Stock-based Compensation**

As of March 31, 2009, the Company maintained an equity participation plan and an employee stock purchase plan.

The Company recorded stock-based-compensation expense in accordance with SFAS No. 123(R) Share-Based Payment in the condensed consolidated statement of operations as follows (in thousands):

|                                     | Three Months Ended March 31, |          | Nine Months Ended March 31, |          |
|-------------------------------------|------------------------------|----------|-----------------------------|----------|
|                                     | 2008                         | 2009     | 2008                        | 2009     |
| Cost of goods sold                  | \$ 35                        | \$ 123   | \$ 129                      | \$ 231   |
| Selling, general and administrative | 1,123                        | 1,320    | 3,220                       | 3,477    |
| Research and development            | 40                           | 60       | 148                         | 187      |
|                                     | \$ 1,198                     | \$ 1,503 | \$ 3,497                    | \$ 3,895 |

As of March 31, 2009, total unrecognized compensation cost related to non-vested share-based compensation arrangements granted was approximately \$7.0 million. The Company expects to recognize these costs over a weighted-average period of 2.5 years.

**6. Retirement Benefit Plans**

The Company sponsors a number of qualified and nonqualified defined benefit pension plans for its employees. The benefits under these plans are based on years of service and an employee's highest twelve months compensation during the last five years of employment.

The components of net periodic pension expense are as follows (in thousands):

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|                                | Three Months Ended March 31, |        | Nine Months Ended March 31, |        |
|--------------------------------|------------------------------|--------|-----------------------------|--------|
|                                | 2008                         | 2009   | 2008                        | 2009   |
| Service cost                   | \$ 76                        | \$ 183 | \$ 223                      | \$ 534 |
| Interest cost                  | 72                           | 54     | 316                         | 191    |
| Expected return on plan assets | (54)                         | (39)   | (242)                       | (111)  |
| Amortization of net loss       | 22                           | 20     | 100                         | 67     |
| Net periodic pension expense   | \$ 116                       | \$ 218 | \$ 397                      | \$ 681 |

For the three months ended March 31, 2008 and 2009, the Company made contributions of \$0.1 million and \$0.1 million, respectively, to these defined benefit plans. For the nine months ended March 31, 2008 and 2009, the Company made contributions of \$0.3 million and \$0.3 million, respectively, to these defined benefit plans.

In addition, the Company maintains various defined contribution plans. For the three months ended March 31, 2008 and 2009, the Company made contributions of \$0.5 million and \$0.6 million, respectively, to these defined contribution plans. For the nine months ended March 31, 2008 and 2009, the Company made contributions of \$1.5 million and \$2.1 million, respectively, to these defined contribution plans.

## 7. Commitments and Contingencies

### *Legal Proceedings*

In November 2002, L-3 Communications Corporation brought suit against the Company seeking a declaratory judgment that L-3 Communications Corporation had not breached its obligations to us concerning the acquisition of PerkinElmer's Security Detection Systems Business. The Company asserted counterclaims for, among other things, fraud and breach of fiduciary duty. In December 2006,

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judgment was entered in the Company's favor. However, on appeal the judgment was reversed in part and vacated in part. The Court of Appeals has remanded the case to the trial court, where it is currently pending for retrial. In conjunction with this vacated judgment, L-3 asserted that it is entitled to reimbursement by the Company of certain costs related to the original judgment. On April 27, 2009, L-3's assertion was upheld by the court requiring the Company to reimburse L-3 for such costs of approximately \$2 million. As such, a provision for this amount has been made in the condensed consolidated financial statements as impairment, restructuring and other charges.

The Company is also involved in various other claims and legal proceedings arising out of the ordinary course of business. In the Company's opinion after consultation with legal counsel, the ultimate disposition of such proceedings is not likely to have a material adverse effect on its financial position, future results of operations, or cash flows. In accordance with SFAS No. 5, Accounting for Contingencies, the Company has not accrued for loss contingencies relating to such matters because the Company believes that, although unfavorable outcomes in the proceedings may be possible, they are not considered by management to be probable or reasonably estimable. If one or more of these matters are resolved in a manner adverse to the Company, the impact on the Company's results of operations, financial position and/or liquidity could be material.

*Contingent Acquisition Obligations*

Under the terms and conditions of the purchase agreements associated with the following acquisitions, the Company may be obligated to make additional payments.

In fiscal 2003, the Company purchased a minority equity interest in CXR Limited. In June 2004, the Company increased its equity interest to approximately 75% and in December 2004, the Company acquired the remaining 25%. As compensation to the selling shareholders for this remaining interest, the Company agreed to make certain royalty payments during the 18 years following the acquisition of this remaining interest. Royalty payments are based on the license of, or sales of products containing, technology owned by CXR Limited. As of March 31, 2009, no royalty payments have been earned.

In fiscal 2004, the Company acquired Advanced Research & Applications Corp. During the seven years following the acquisition, contingent consideration is payable based on its net revenues, provided certain requirements are met. The contingent consideration is capped at \$30.0 million. As of March 31, 2009, no contingent consideration has been earned.

In fiscal 2006, the Company acquired certain assets of InnerStep, B.S.E., Inc. During the seven years following the acquisition, contingent consideration is payable based on its profits before interest and taxes, provided certain requirements are met. The contingent consideration is capped at \$6.0 million. As of March 31, 2009, no contingent consideration has been earned.

In fiscal 2009, the Company acquired a security company. Contingent consideration is payable based on net receipts generated from new business during the three years following the acquisition, provided certain requirements are met. The contingent consideration is capped at \$10.0 million. As of March 31, 2009, no contingent consideration has been earned.

*Environmental Contingencies*

The Company is subject to various environmental laws. The Company's practice is to ensure that Phase I environmental site assessments are conducted for each of its properties in the United States at which the Company manufactures products in order to identify, as of the date of such report, potential areas of environmental concern related to past and present activities or from nearby operations. In certain cases, the Company has conducted further environmental assessments consisting of soil and groundwater testing and other investigations deemed appropriate by independent environmental consultants.

During one investigation, the Company discovered soil and groundwater contamination at its Hawthorne, California facility. The Company filed the requisite reports concerning this problem with the appropriate environmental authorities in fiscal 2001. The Company has not yet received any response to such reports, and no agency action or litigation is presently pending or threatened. The Company's site was previously used by other companies for semiconductor manufacturing similar to that presently conducted on the site by us, and it is not presently known who is responsible for the contamination or, if required, the remediation. The groundwater contamination is a known regional problem, not limited to the Company's premises or its immediate surroundings.

The Company has also been informed of soil and groundwater evaluation efforts at a facility that its Ferson Technologies subsidiary previously leased in Ocean Springs, Mississippi. Ferson Technologies occupied the facility until October 2003. The Company believes that the owner and previous occupants of the facility have primary responsibility for any remediation that may be required and have an agreement with the facility's owner under which the owner is responsible for remediation of pre-existing conditions. However, as site evaluation efforts are still in progress, and may be for some time, the Company is unable at this time to ascertain whether Ferson Technologies bears any exposure for remediation costs under applicable environmental regulations.

The Company has not accrued for loss contingencies relating to the above environmental matters because it believes that, although unfavorable outcomes may be possible, they are not considered by the Company's management to be probable and reasonably estimable.

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If one or more of these matters are resolved in a manner adverse to the Company, the impact on the Company's results of operations, financial position and/or liquidity could be material.

*Product Warranties*

The Company offers its customers warranties on many of the products that it sells. These warranties typically provide for repairs and maintenance of the products if problems arise during a specified time period after original shipment. Concurrent with the sale of products, the Company records a provision for estimated warranty expenses with a corresponding increase in cost of goods sold. The Company periodically adjusts this provision based on historical and anticipated experience. The Company charges actual expenses of repairs under warranty, including parts and labor, to this provision when incurred.

The following table presents changes in warranty provisions (in thousands):

|                                      | Three Months Ended March 31, |           | Nine Months Ended March 31, |           |
|--------------------------------------|------------------------------|-----------|-----------------------------|-----------|
|                                      | 2008                         | 2009      | 2008                        | 2009      |
| Balance at beginning of period       | \$ 9,158                     | \$ 9,708  | \$ 7,443                    | \$ 11,597 |
| Additions                            | 785                          | 1,065     | 4,451                       | 3,269     |
| Reductions for warranty repair costs | (726)                        | (756)     | (2,677)                     | (4,849)   |
| Balance at end of period             | \$ 9,217                     | \$ 10,017 | \$ 9,217                    | \$ 10,017 |

**8. Income Taxes**

The provision for income taxes is determined using an effective tax rate that is subject to fluctuations during the year as new information is obtained, which may affect the assumptions used to estimate the annual effective tax rate, including factors such as the mix of pre-tax earnings in the various tax jurisdictions in which the Company operates, valuation allowances against deferred tax assets, the recognition or derecognition of tax benefits related to uncertain tax positions, utilization of R&D tax credits and changes in or the interpretation of tax laws in jurisdictions where the Company conducts business. The Company recognizes deferred tax assets and liabilities for temporary differences between the financial reporting basis and the tax basis of its assets and liabilities along with net operating loss and tax credit carryovers. The Company records a valuation allowance against its deferred tax assets to reduce the net carrying value to an amount that it believes is more likely than not to be realized. When the Company establishes or reduces the valuation allowance against its deferred tax assets, the provision for income taxes will increase or decrease, respectively, in the period such determination is made.

Included within the tax benefit for the three and nine months ended March 31, 2008 is a net tax benefit of \$4.0 million as a result of discrete items impacting the tax provision, the largest of which was a \$4.3 million tax benefit associated with the repurchase of the minority interest of Spacelabs Healthcare, which the Company completed during the second quarter of fiscal 2008.

**9. Segment Information**



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The Company operates in three identifiable industry segments: (i) Security, providing security and inspection systems; (ii) Healthcare, providing medical monitoring, diagnostic cardiology and anesthesia systems; and (iii) Optoelectronics and Manufacturing, providing specialized electronic components for affiliated end-products divisions, as well as for applications in the defense and aerospace markets, among others. The Company also has a Corporate segment that includes executive compensation and certain other general and administrative expenses. Interest expense, and certain expenses related to legal, audit and other professional service fees are not allocated to the industry segments. Both the Security and Healthcare divisions comprise primarily end-product businesses whereas the Optoelectronics and Manufacturing division comprises businesses that primarily supply components and subsystems to original equipment manufacturers, including to the businesses of the Security and Healthcare divisions. All intersegment sales are eliminated in consolidation.

The following table presents segment information (in thousands):

|   | Three Months Ended<br>March 31, |                   | Nine Months Ended<br>March 31, |                   |
|---|---------------------------------|-------------------|--------------------------------|-------------------|
|   | 2008                            | 2009              | 2008                           | 2009              |
| <b>Revenues by Segment:</b>   |                                 |                   |                                |                   |
| Security division   | \$ 51,395                       | \$ 56,495         | \$ 164,075                     | \$ 182,247        |
| Healthcare division   | 63,589                          | 50,376            | 188,051                        | 164,898           |
| Optoelectronics and Manufacturing division, including intersegment revenues | 53,430                          | 48,811            | 134,494                        | 138,438           |
| Intersegment revenues elimination   | (11,706)                        | (11,587)          | (34,705)                       | (34,285)          |
| <b>Total</b>  | <b>\$ 156,708</b>               | <b>\$ 144,095</b> | <b>\$ 451,915</b>              | <b>\$ 451,298</b> |
| <b>Revenues by Geography:</b>   |                                 |                   |                                |                   |
| North America   | \$ 98,033                       | \$ 107,586        | \$ 268,018                     | \$ 324,491        |
| Europe  | 43,475                          | 29,307            | 137,187                        | 101,568           |
| Asia  | 26,906                          | 18,789            | 81,415                         | 59,524            |
| Intersegment revenues elimination   | (11,706)                        | (11,587)          | (34,705)                       | (34,285)          |
| <b>Total</b>  | <b>\$ 156,708</b>               | <b>\$ 144,095</b> | <b>\$ 451,915</b>              | <b>\$ 451,298</b> |
| <b>Operating income(loss) by Segment:</b>                                   |                                 |                   |                                |                   |
| Security division   | \$ 1,466                        | \$ 3,248          | \$ 1,640                       | \$ 11,142         |
| Healthcare division   | 2,268                           | 2,226             | 9,561                          | 2,687             |
| Optoelectronics and Manufacturing division                                  | 4,093                           | 4,185             | 8,547                          | 11,243            |
| Corporate   | (2,461)                         | (4,930)           | (9,927)                        | (11,823)          |
| Eliminations (1)  | 180                             | (255)             | (133)                          | (466)             |
| <b>Total</b>  | <b>\$ 5,546</b>                 | <b>\$ 4,474</b>   | <b>\$ 9,688</b>                | <b>\$ 12,783</b>  |

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|  | June 30, 2008     | March 31, 2009    |
|--|-------------------|-------------------|
| <b>Assets by Segment:</b>                  |                   |                   |
| Security division                          | \$ 199,884        | \$ 183,179        |
| Healthcare division                        | 172,038           | 153,712           |
| Optoelectronics and Manufacturing division | 95,615            | 95,021            |
| Corporate                                  | 43,313            | 50,634            |
| Eliminations (1)                           | (3,209)           | (3,675)           |
| <b>Total</b>                               | <b>\$ 507,641</b> | <b>\$ 478,871</b> |

(1) Eliminations primarily reflect the elimination of intercompany inventory profit not-yet-realized. This profit will be realized when inventory is shipped to the Security and Healthcare divisions external customers.

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

*Certain statements contained in this quarterly report on Form 10-Q that are not related to historical results, including, without limitation, statements regarding our business strategy, objectives and future financial position, are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and involve risks and uncertainties. These forward-looking statements may be identified by the use of forward-looking terms such as anticipate, believe, expect, may, could, likely to, should, or will, or by discussions of strategy that involve predictions which are based upon a number of future conditions that ultimately may prove to be inaccurate. Statements in this quarterly report on Form 10-Q that are forward-looking are based on current expectations and actual results may differ materially. Forward-looking statements involve numerous risks and uncertainties described in this quarterly report on Form 10-Q, our Annual Report on Form 10-K and other documents previously filed or hereafter filed by us from time to time with the Securities and Exchange Commission. Such factors, of course, do not include all factors that might affect our business and financial condition. Although we believe that the assumptions upon which our forward-looking statements are based are reasonable, such assumptions could prove to be inaccurate and actual results could differ materially from those expressed in or implied by the forward-looking statements. All forward-looking statements contained in this quarterly report on Form 10-Q are qualified in their entirety by this statement. We undertake no obligation other than as may be required under securities laws to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.*

**Critical Accounting Policies and Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires us to make estimates and assumptions and select accounting policies that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, as well as the reported amounts of revenues and expenses during

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the reporting period. Actual results could differ from those estimates. Our critical accounting policies are detailed in our Annual Report on Form 10-K for the year ended June 30, 2008. We have made no material changes to our accounting policies during the current year.

**Recent Accounting Pronouncements**

We describe recent accounting pronouncements in Item 1 Condensed Consolidated Financial Statements Notes to Condensed Consolidated Financial Statements.

**Executive Summary**

We are a vertically integrated designer and manufacturer of specialized electronic systems and components for critical applications. We sell our products in diversified markets, including homeland security, healthcare, defense and aerospace. We have three operating divisions: (i) Security, providing security and inspection systems; (ii) Healthcare, providing patient monitoring, diagnostic cardiology and anesthesia systems; and (iii) Optoelectronics and Manufacturing, providing specialized electronic components for affiliated end-products divisions as well as for applications in the defense and aerospace markets, among others.

*Security Division.* Through our Security division, we design, manufacture and market security and inspection systems worldwide for sale primarily to U.S. federal, state and local government agencies as well as to foreign governments. These products are used to inspect baggage, cargo, vehicles and other objects for weapons, explosives, drugs and other contraband as well as to screen people. Revenues from our Security division accounted for 40% and 36% of our total consolidated revenues for the nine months ended March 31, 2009 and 2008, respectively.

Following the September 11, 2001 terrorist attacks, government spending in the U.S. and internationally for the development and acquisition of security and inspection systems increased and has continued at high levels. This spending has had a favorable impact on our business. However, future levels of such spending could decrease as a result of changing budgetary priorities or could shift to products that we do not provide. Additionally, competition for contracts with the U.S. Government and other governments has become more intense in recent years as new competitors and technologies have entered this market.

*Healthcare Division.* Through our Healthcare division, we design, manufacture and market patient monitoring, diagnostic cardiology and anesthesia systems for sale primarily to hospitals and medical centers. Our products monitor patients in critical, emergency and perioperative care areas of the hospital and provide such information, through wired and wireless networks, to physicians and nurses who may be at the patient's bedside, in another area of the hospital or even outside the hospital. Revenues from our Healthcare division accounted for 37% and 42% of our total consolidated revenues for the nine months ended March 31, 2009 and 2008, respectively.

The healthcare markets in which we operate are highly competitive. We believe that our customers choose among competing products on the basis of product performance, functionality, value and service. During the current fiscal year, many hospitals and medical centers in the U.S. have elected to delay spending on new medical equipment acquisitions, primarily due to concerns they hold about the overall health of the U.S.

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economy and tighter credit markets. These decisions to delay spending have negatively impacted our sales. In response, we have elected to extend certain restructuring activities that we originally initiated for this division in fiscal 2007, including headcount reductions.

*Optoelectronics and Manufacturing Division.* Through our Optoelectronics and Manufacturing division, we design, manufacture and market optoelectronic devices and value-added manufacturing services worldwide for use in a broad range of applications, including aerospace and defense electronics, security and inspection systems, medical imaging and diagnostics, computed tomography, fiber optics, telecommunications, gaming, office automation, computer peripherals and industrial automation. We also provide our optoelectronic devices and value-added manufacturing services to our own Security and Healthcare divisions. Revenues from our Optoelectronics and Manufacturing division accounted for 23% and 22% of our total consolidated revenues for the nine months ended March 31, 2009 and 2008, respectively.

*Consolidated Results.* We reported a consolidated operating profit of \$4.5 million for the three months ended March 31, 2009, a reduction from the \$5.5 million operating profit reported for the three months ended March 31, 2008. This \$1.0 million decrease was primarily the result of the \$2.0 charge recorded in the third quarter of the current fiscal year related to a non-recurring cost associated with litigation. During the three months ended March 31, 2009, gross profit decreased \$6.6 million as sales declined by 8% coupled with a 1.4% decrease in gross margin primarily due to the product mix. This decrease in gross profit was offset by a \$6.8 million reduction in operating expenses consistent with our cost containment and restructuring initiatives.

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For the nine months ended March 31, 2009, we reported a consolidated operating profit of \$12.8 million as compared to an operating profit of \$9.7 million for the comparable prior year period, which represents a 32% improvement over the prior year performance. This \$3.1 million improvement was driven primarily by an \$11.3 million reduction in SG&A and R&D expenses following restructuring initiatives we have undertaken in the last year, as well as various other efficiencies. This reduction in operating expenses more than offset a \$5.6 million decrease in gross profit resulting primarily from a 1.2% decrease in gross margin, primarily due to product mix. In addition, we incurred non-recurring restructuring and other charges of \$6.0 million in the nine months ended March 31, 2009, as compared to a \$3.4 million in the prior year.

**Results of Operations**

*Three Months Ended March 31, 2008 Compared to Three Months Ended March 31, 2009.*

**Net Revenues**

The table below and the discussion that follows are based upon the way in which we analyze our business. See Note 9 to the condensed consolidated financial statements for additional information about our business segments.

| (in millions)                              | Q3<br>2008 | % of<br>Net Sales | Q3<br>2009 | % of<br>Net Sales | \$ Change | % Change |
|--|------------|-------------------|------------|-------------------|-----------|----------|
| Security division                          | \$ 51.4    | 33%               | \$ 56.5    | 39%               | \$ 5.1    | 10%      |
| Healthcare division                        | 63.6       | 41%               | 50.4       | 35%               | (13.2)    | (21)%    |
| Optoelectronics and Manufacturing division | 53.4       | 34%               | 48.8       | 34%               | (4.6)     | (9)%     |
| Intersegment revenues                      | (11.7)     | (8)%              | (11.6)     | (8)%              | 0.1       | (1)%     |
| Total revenues                             | \$ 156.7   | 100%              | \$ 144.1   | 100%              | \$ (12.6) | (8)%     |

Net revenues for the three months ended March 31, 2009, decreased \$12.6 million, or 8% to \$144.1 million from \$156.7 million for the comparable prior year period.

Revenues for the Security division for the three months ended March 31, 2009, increased \$5.1 million or 10%, to \$56.5 million from \$51.4 million for the comparable prior year period. The increase in revenues for our Security division was primarily attributable to a \$6.1 million, or 23%, increase in sales of baggage and parcel inspection, people screening and hold baggage screening equipment and to a \$1.5 million, or 15% increase in service revenue, partially offset by a \$2.5 million, or 16%, decrease in sales of cargo and vehicle inspection systems equipment.

Revenues for the Healthcare division for the three months ended March 31, 2009, decreased \$13.2 million or 21%, to \$50.4 million from \$63.6 million for the comparable prior year period. This decrease in revenues for our Healthcare division was primarily attributable to decreased patient monitoring equipment sales of \$7.5 million in North America, lower cardiology equipment sales of \$3.1 million, lower clinical trials services revenue of \$1.2 million and a reduction in service, supplies and accessories sales of \$1.3 million.

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Revenues for the Optoelectronics and Manufacturing division for the three months ended March 31, 2009, decreased \$4.6 million or 9%, to \$48.8 million from \$53.4 million for the comparable prior year period. The decrease in revenues for our Optoelectronics and Manufacturing division was primarily attributable to lower commercial optoelectronics and weapons simulation sales of \$4.4 million while contract manufacturing sales and intersegment sales were virtually flat. Intersegment sales are eliminated in consolidation.

### Gross Profit

| (in millions) | Q3<br>2008 | % of Net<br>Sales | Q3<br>2009 | % of Net<br>Sales | \$ Change | % Change |
|---------------|------------|-------------------|------------|-------------------|-----------|----------|
| Gross profit  | \$ 56.4    | 36.0%             | \$ 49.8    | 34.6%             | \$ (6.6)  | (12)%    |

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Gross profit decreased \$6.6 million, or 12%, to \$49.8 million for the three months ended March 31, 2009, from \$56.4 million for the comparable prior year period. The gross margin decreased to 34.0%, from the comparable prior year period of 35.9%. The decrease in gross profit is primarily a result of the 21% decrease in revenues in our Healthcare division, which generally carry higher gross margins than our other divisions.

**Operating Expenses**

| (in millions)                                | Q3<br>2008 | % of Net<br>Sales | Q3<br>2009 | % of Net<br>Sales | \$ Change | %<br>Change |
|--|------------|-------------------|------------|-------------------|-----------|-------------|
| Selling, general and administrative          | \$ 37.6    | 24.0%             | \$ 34.4    | 23.9%             | \$ (3.2)  | (9)%        |
| Research and development                     | 12.1       | 7.7%              | 8.5        | 5.9%              | (3.6)     | (30)%       |
| Impairment, restructuring, and other charges | 1.2        | 0.8%              | 2.4        | 1.7%              | 1.2       | 100%        |
| Total operating expenses                     | \$ 50.9    | 32.5%             | \$ 45.3    | 31.5%             | \$ (5.6)  | (11)%       |

**Selling, general and administrative expenses.** SG&A expenses consist primarily of compensation paid to sales, marketing and administrative personnel, professional service fees and marketing expenses. For the three months ended March 31, 2009, SG&A expenses decreased by \$3.2 million, or 9%, to \$34.4 million, from \$37.6 million for the comparable prior-year period. This reduction in spending was a direct result of our ongoing cost containment initiatives and restructuring activities throughout the Company, which were heavily focused in our Healthcare division.

**Research and development.** Research and development expenses include research related to new product development and product enhancement expenditures. For the three months ended March 31, 2009, such expenses decreased \$3.6 million, or 30%, to \$8.5 million, from \$12.1 million for the comparable prior-year period. The decrease in research and development expenses for the three-month period ended March 31, 2009, was primarily attributable to cost reduction efforts in our Healthcare and Security divisions and the receipt of off-setting third-party grants.

**Impairment, restructuring, and other charges.** In fiscal 2007, we initiated a series of restructuring activities, which were intended to align our global capacity and infrastructure with demand by our customers and thereby improve our operating efficiencies. During the three months ended March 31, 2009, we continued this initiative and realigned our operations to further increase our operating efficiency. As a result, we recorded \$0.4 million in restructuring charges. These charges included \$0.2 million in the Security division and \$0.2 million in our Healthcare division. Such charges primarily consist of severance and costs associated with the closure of certain facilities. In addition, we recorded a non-recurring charge as a result of litigation of \$2.0 million during the quarter. During the three months ended March 31, 2008, we incurred \$1.2 million in restructuring charges. These charges included \$0.2 million in the Security division, \$0.7 million in our Healthcare division and \$0.2 million in our Optoelectronics and Manufacturing division, also consisting of severance and costs associated with the closure of certain facilities.

**Interest Expense.** For the three months ended March 31, 2009, we incurred net interest expense of \$0.6 million, which was 50% lower than the comparable prior-year period. The decrease in net interest expense was due to a lower cost of borrowing as a result of lower market-driven interest rates.

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**Income taxes.** For the three months ended March 31, 2009, our income tax provision was \$1.3 million compared to an income tax benefit of \$2.6 million for the comparable prior-year period. Included within the prior year's tax benefit is a net tax benefit of \$4.0 million as a result of discrete items impacting the tax provision, the largest of which was a \$4.3 million tax benefit associated with the repurchase of the minority interest of Spacelabs Healthcare. Our effective income tax rate for the three months ended March 31, 2009, was 33.3% compared to a benefit of (60.1)% in the comparable prior year period. However, excluding the impact of the discrete tax benefits noted above, the effective tax rate for the three months ended March 31, 2008, was 31.7%. Our provision for income taxes is dependent on the mix of income from U.S. and foreign locations due to tax rate differences among such countries as well as due to the impact of permanent taxable differences.



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*Nine Months Ended March 31, 2008 Compared to Nine Months Ended March 31, 2009.*

**Net Revenues**

The table below and the discussion that follows are based upon the way in which we analyze our business. See Note 9 to the condensed consolidated financial statements for additional information about our business segments.

| (in millions)                              | YTD Q3<br>2008 | % of<br>Net Sales | YTD Q3<br>2009 | % of<br>Net Sales | \$ Change | % Change |
|--|----------------|-------------------|----------------|-------------------|-----------|----------|
| Security division                          | \$ 164.1       | 36%               | \$ 182.2       | 40%               | \$ 18.1   | 11%      |
| Healthcare division                        | 188.0          | 42%               | 164.9          | 37%               | (23.1)    | (12)%    |
| Optoelectronics and Manufacturing division | 134.5          | 30%               | 138.4          | 31%               | 3.9       | 3%       |
| Intersegment revenues                      | (34.7)         | (8)%              | (34.2)         | (8)%              | 0.5       | (1)%     |
| Total revenues                             | \$ 451.9       | 100%              | \$ 451.3       | 100%              | \$ (0.6)  | %        |

Net revenues for the nine months ended March 31, 2009, were \$451.3 million, virtually unchanged from the prior year period, when the revenues were \$451.9 million.

Revenues for the Security division for the nine months ended March 31, 2009, increased by \$18.1 million, or 11%, to \$182.2 million from \$164.1 million for the comparable prior year period. The increase in revenues for our Security division was primarily attributable to a \$18.5 million, or 24%, increase in sales of baggage and parcel inspection, people screening and hold baggage screening equipment, and to a \$7.0 million, or 25%, increase in service revenue, partially offset by a \$7.4 million, or 13%, decrease in sales of cargo and vehicle inspection systems equipment.

Revenues for the Healthcare division for the nine months ended March 31, 2009, decreased by \$23.1 million, or 12%, to \$164.9 million from \$188.0 million for the comparable prior year period. The decrease in revenues for our Healthcare division was primarily attributable to: (i) decreased patient monitoring equipment sales of \$17.1 million in North America, (ii) decreased clinical trials services sales of approximately \$4.0 million, (iii) lower cardiology equipment sales of \$3.1 million, and (iv) lower service, supplies and accessories sales of \$0.6 million. These decreases were partially offset by growth in anesthesia equipment sales of \$1.9 million.

Revenues for the Optoelectronics and Manufacturing division for the nine months ended March 31, 2009, increased \$3.9 million, or 3%, to \$138.4 million from \$134.5 million for the comparable prior year period. The increase in revenues for our Optoelectronics and Manufacturing division was primarily attributable to an increase in contract manufacturing sales of \$11.5 million, partially offset by decreases in commercial optoelectronics sales and weapons simulation sales of \$3.2 million and \$4.4 million, respectively. The increase in contract manufacturing revenues is primarily due to the fulfillment of a significant defense-industry related contract that is expected to continue through the end of fiscal 2009 and into fiscal 2010. In addition, for the nine months ended March 31, 2009, the Optoelectronics and Manufacturing division recorded intersegment sales of \$34.2 million, compared to \$34.7 million in the comparable prior-year period. Such sales are eliminated in consolidation.

**Gross Profit**

| (in millions) |    | YTD Q3<br>2008 | % of Net<br>Sales |    | YTD Q3<br>2009 | % of Net<br>Sales | \$ Change | % Change |
|---------------|----|----------------|-------------------|----|----------------|-------------------|-----------|----------|
| Gross profit  | \$ | 159.5          | 35.3%             | \$ | 153.9          | 34.1%             | \$ (5.6)  | (4)%     |

Gross profit decreased \$5.6 million, or 4%, to \$153.9 million for the nine months ended March 31, 2009, from \$159.5 million for the comparable prior year period. The gross margin decreased to 34.1%, from 35.3% over the comparable prior year period. The decrease in gross profit is primarily a result of a 12% decrease in revenues in our Healthcare division, which generally carry higher gross margins than our other divisions, and an increase in contract manufacturing sales by our Optoelectronics and Manufacturing division, which generally carry lower gross margins than most of our other product offerings.

Table of Contents**Operating Expenses**

| (in millions)                                | YTD Q3<br>2008 | % of Net<br>Sales | YTD Q3<br>2009 | % of Net<br>Sales | \$ Change | %<br>Change |
|--|----------------|-------------------|----------------|-------------------|-----------|-------------|
| Selling, general and administrative          | \$ 112.9       | 25.0%             | \$ 107.6       | 23.8%             | \$ (5.3)  | (5)%        |
| Research and development                     | 33.5           | 7.4%              | 27.5           | 6.1%              | (6.0)     | (18)%       |
| Impairment, restructuring, and other charges | 3.4            | 0.7%              | 6.0            | 1.4%              | 2.6       | 76%         |
| Total operating expenses                     | \$ 149.8       | 33.1%             | \$ 141.1       | 31.3%             | \$ (8.7)  | (6)%        |

**Selling, general and administrative expenses.** For the nine months ended March 31, 2009, SG&A expenses decreased by \$5.3 million, or 5%, to \$107.6 million, from \$112.9 million for the comparable prior-year period. As a percentage of revenues, SG&A expenses for the nine months ended March 31, 2009, decreased to 23.8%, from 25.0% for the prior year. This reduction in spending was a direct result of our ongoing cost containment initiatives and restructuring activities throughout the Company, which were heavily focused in our healthcare division.

**Research and development.** Research and development expenses include research related to new product development and product enhancement expenditures. For the nine months ended March 31, 2009, such expenses decreased \$6.0 million, or 18%, to \$27.5 million, from \$33.5 million for the prior year. The decrease in research and development expenses for the nine month period ended March 31, 2009, was primarily attributable to cost reduction efforts in our Healthcare and Security divisions and the receipt of off-setting third-party grants.

**Impairment, restructuring, and other charges.** In fiscal 2007, we initiated a series of restructuring activities that were intended to align our global capacity and infrastructure with demand by our customers and thereby improve our operating efficiencies. During the nine months ended March 31, 2009, we continued this initiative to further increase our operating efficiency. As a result, we recorded total restructuring charges of \$4.0 million. These charges included \$0.4 million in the Security division, \$3.2 million in our Healthcare division, \$0.1 million in our Optoelectronics and Manufacturing division and \$0.3 million in our Corporate segment, primarily relating to facility closure and employee severance costs. In addition, we recorded a non-recurring charge as a result of litigation of \$2 million during the period. During the nine months ended March 31, 2008, we recorded restructuring charges of \$3.4 million. These charges included \$2.1 million in the Security division, \$0.9 million in our Healthcare division and \$0.3 million in our Optoelectronics and Manufacturing division, primarily relating to severance, manufacturing relocation costs and costs associated with the closure of certain facilities.

**Interest Expense.** For the nine months ended March 31, 2009, we incurred net interest expense of \$2.4 million, compared to \$3.4 million for the comparable prior-year period. The decrease in interest expense was primarily attributable to a lower cost of borrowing, as a result of lower market-driven interest rates, which was partially offset by higher average levels of debt. We incurred higher levels of debt in connection with the repurchase of all outstanding shares of Spacelabs Healthcare for \$15.8 million during fiscal 2008, as well as repurchasing \$7.4 million of our common stock during the nine months ended March 31, 2009.

**Income taxes.** For the nine months ended March 31, 2009, our income tax provision was \$3.5 million, compared to a tax benefit of \$2.0 million for the comparable prior-year period. Included within the prior year tax benefit is a net tax benefit of \$4.0 million as a result of discrete items impacting the tax provision, the largest of which was a \$4.3 million tax benefit associated with the repurchase of the minority interest of Spacelabs Healthcare. The effective income tax rate for the nine months ended March 31, 2009 was 34.0% as compared to a benefit of (31.5)% in the comparable prior year period. However, excluding the impact of the discrete tax benefits noted above, the effective tax rate for the prior year was 32.8%. Our provision for income taxes is dependent on the mix of income from U.S. and foreign locations due to tax rate differences among such countries as well as due to the impact of permanent taxable differences.

**Liquidity and Capital Resources**

To date, we have financed our operations primarily through cash flow from operations, proceeds from equity issuances and our credit facilities. Cash and cash equivalents totaled \$28.7 million at March 31, 2009, an increase of \$10.5 million from \$18.2 million at June 30, 2008. The changes in our working capital and cash and cash equivalent balances during the nine months ended are described below.

| (in millions)             | June 30, 2008 | March 31, 2009 | \$ Change | % Change |
|---------------------------|---------------|----------------|-----------|----------|
| Working capital           | \$ 195.0      | \$ 177.9       | \$ (17.1) | (9)%     |
| Cash and cash equivalents | 18.2          | 28.7           | 10.5      | 58%      |

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*Working Capital.* The decrease in working capital is primarily due to decreases in accounts receivable of \$36.4 million, partially as a result of our ongoing focus on collections. This decrease in working capital was partially offset by: (i) a \$10.5 million increase in cash and (ii) a \$9.7 million decrease in our bank lines of credit.

| (in millions)                         | YTD Q3<br>2008 |        | YTD Q3<br>2009 |        | \$ Change |
|---------------------------------------|----------------|--------|----------------|--------|-----------|
| Cash used in operating activities     | \$             | (9.9)  | \$             | 40.1   | \$ 50.0   |
| Cash used in investing activities     |                | (24.2) |                | (12.4) | 11.8      |
| Cash provided by financing activities |                | 32.5   |                | (18.5) | (51.0)    |

*Cash Used in Operating Activities.* Cash flows from operating activities can fluctuate significantly from period to period, as net income, tax timing differences, and other items can significantly impact cash flows. Net cash provided by operations for the nine months ended March 31, 2009 was \$40.1 million, an increase of \$50.0 million from the \$9.9 million used in the comparable prior-year period. This improvement was partially due to an increase in our net income, after giving consideration to non-cash operating items including depreciation and amortization, stock-based compensation, deferred taxes and provisions for losses on accounts receivable, among others for both periods, of \$7.3 million for the nine months ended March 31, 2009,. This improvement was also due to increased emphasis on better working capital management during the nine months ended March 31, 2009, as compared to the nine months ended March 31, 2008, resulting in: (i) an \$18.1 million increase in change from advances from customers; (ii) a \$15.5 million reduction in the change in accounts receivables, due to an ongoing focus on collections; (iii) a \$9.5 million decrease in the change in inventory; and (iv) decreases in the changes from prepaid expenses and other current assets of \$4.2 million. These cash generating improvements were partially offset by: (i) decreases in accrued payroll and related expenses of \$2.9 million and (ii) decreases in accounts payable of \$2.8 million.

*Cash Used in Investing Activities.* Net cash used in investing activities was \$12.4 million for the nine months ended March 31, 2009, a decrease of \$11.8 million in cash used as compared to the \$24.2 million used in investing activities during the nine months ended March 31, 2008. For the nine months ended March 31, 2009, the primary investing activity involved \$9.4 million of capital expenditures as compared to \$7.9 million during the comparable prior year period. In addition, during the nine months ended March 31, 2009, we acquired intangible and other assets of \$2.7 million, as compared to \$1.4 million during the comparable prior year period. Finally, during the nine months ended March 31, 2008, we used \$15.1 million of cash to repurchase shares of Spacelabs Healthcare stock.

*Cash Provided by Financing Activities.* Net cash used in financing activities was \$18.5 million for the nine months ended March 31, 2009, compared to net cash provided by financing activity of \$32.5 million for the nine months ended March 31, 2008. During the first nine months of fiscal 2009, we used \$7.4 million in cash to repurchase 619,768 shares of our common stock. We also paid down our ongoing scheduled debt and capital leases by an additional \$5.0 million and our revolving lines of credit by \$9.4 million. In the prior year period, we received net proceeds of \$20.2 million when we entered into a new credit agreement while simultaneously paying down the preceding credit facility, less the ongoing repayment of our new credit agreement as well as all other scheduled debt and capital lease payments. Also during the nine months ended March 31, 2008, we received net proceeds of \$6.9 million from our revolving lines of credit to support the repurchase of shares of Spacelabs Healthcare stock.

**Borrowings**

We maintain a credit agreement with certain lenders allowing for borrowings of up to \$124.5 million. The credit agreement consists of a \$74.5 million, five-year, revolving credit facility (including a \$45 million sub-limit for letters-of-credit) and a \$50 million five-year term loan.

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Borrowings under the agreement bear interest at either (i) the London Interbank Offered Rate (LIBOR) plus between 2.00% and 2.50% or (ii) the bank's prime rate plus between 1.00% and 1.50%. The rates are determined based on our consolidated leverage ratio. As of March 31, 2009, the weighted-average interest rate under the credit agreement was 2.65%. Our borrowings under the credit agreement are guaranteed by the Company's domestic subsidiaries and are secured by substantially all of the Company's and its subsidiary guarantors' assets. The agreement contains various representations, warranties, affirmative, negative and financial covenants, and conditions of default customary for financing agreements of this type. As of March 31, 2009, \$44.0 million was outstanding under the term loan, \$9.0 million was outstanding under the revolving credit facility, and \$18.9 million was outstanding under the letter-of-credit facility.

Several of our foreign subsidiaries maintain bank lines-of-credit, denominated in local currencies, to meet short-term working capital requirements and for the issuance of letters-of-credit. As of March 31, 2009, \$12.7 million was outstanding under these letter-of-credit

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facilities, while no debt was outstanding. As of March 31, 2009, the total amount available under these credit facilities was \$27.7 million, with a total cash borrowing sub-limit of \$6.7 million.

In fiscal 2005, we entered into a bank loan of \$5.3 million to fund the acquisition of land and buildings in the U.K. The loan is payable over a 20-year period, with quarterly installments of £34,500 (approximately \$49,000 as of March 31, 2009). The loan bears interest at British pound-based LIBOR plus 1.2%, payable on a quarterly basis. As of March 31, 2009, \$3.1 million remained outstanding under this loan at an interest rate of 2.7% per annum.

Long-term debt consisted of the following (in thousands):

|  | June 30,<br>2008 | March 31,<br>2009 |
|--|------------------|-------------------|
| Five-year term loan due in fiscal 2013   | \$ 47,763        | \$ 44,013         |
| Twenty-year term loan due in fiscal 2025 | 4,539            | 3,110             |
| Capital leases                           | 2,193            | 1,519             |
| Other                                    | 1,189            | 821               |
|  | 55,684           | 49,463            |
| Less: current portion of long-term debt  | (6,593)          | (8,015)           |
| Long-term portion of debt                | \$ 49,091        | \$ 41,448         |

We anticipate that existing cash borrowing arrangements and future access to capital markets should be sufficient to meet our cash requirements for the foreseeable future. However, our future capital requirements and the adequacy of available funds will depend on many factors, including future business acquisitions, litigation, stock repurchases and levels of research and development spending.

**Stock Repurchase Program**

Our Board of Directors has authorized a stock repurchase program under which we can repurchase up to 3,000,000 shares of our common stock. During the three and nine months ended March 31, 2009, we repurchased 15,640 and 619,768 shares, respectively, under this program and 711,205 shares were available for additional repurchase under the program as of March 31, 2009. Upon repurchase, the shares are restored to the status of authorized but unissued shares and we record them as a reduction in the number of shares of common stock issued and outstanding in our condensed consolidated financial statements.

**Dividend Policy**

We have never paid cash dividends on our common stock and have no plans to do so in the foreseeable future.

**Contractual Obligations**

Under the terms and conditions of the purchase agreements associated with the following acquisitions, we may be obligated to make additional payments:

In fiscal 2003, we purchased a minority equity interest in CXR Limited. In June 2004, we increased our equity interest to approximately 75% and in December 2004, we acquired the remaining 25%. As compensation to the selling shareholders for this remaining interest, we agreed to make certain royalty payments during the 18 years following the acquisition of this remaining interest. Royalty payments are based on the license of, or sales of products containing, technology owned by CXR Limited. As of March 31, 2009, no royalty payments have been earned.

In fiscal 2004, we acquired Advanced Research & Applications Corp. During the seven years following the acquisition, contingent consideration is payable based on its net revenues, provided certain requirements are met. The contingent consideration is capped at \$30.0 million. As of March 31, 2009, no contingent consideration has been earned.

In fiscal 2006, we acquired certain assets of InnerStep, B.S.E., Inc. During the seven years following the acquisition, contingent consideration is payable based on its profits before interest and taxes, provided certain requirements are met. The contingent consideration is capped at \$6.0 million. As of March 31, 2009, no contingent consideration has been earned.

In fiscal 2009, we acquired a security company. Contingent consideration is payable based on net receipts generated from new business during the three years following the acquisition, provided certain requirements are met. The contingent consideration is capped at \$10.0 million. As of March 31, 2009, no contingent consideration has been earned.



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**Off Balance Sheet Arrangements**

As of March 31, 2009, we did not have any significant off balance sheet arrangements as defined in Item 303(a)(4) of Regulation S-K.

**Item 3. Quantitative and Qualitative Disclosures about Market Risk**

For the nine months ended March 31, 2009, no material changes occurred with respect to market risk as disclosed in our Annual Report on Form 10-K for the fiscal year ended June 30, 2008.

**Market Risk**

We are exposed to certain market risks, which are inherent in our financial instruments and arise from transactions entered into in the normal course of business. We may enter into derivative financial instrument transactions in order to manage or reduce market risk in connection with specific foreign-currency-denominated transactions. We do not enter into derivative financial instrument transactions for speculative purposes.

We are subject to interest rate risk on our short-term borrowings under our bank lines of credit. Borrowings under these lines of credit do not give rise to significant interest rate risk because these borrowings have short maturities and are borrowed at variable interest rates. Historically, we have not experienced material gains or losses due to interest rate changes.

**Foreign Currency**

We maintain the accounts of our operations in each of the following countries in the following currencies: Finland, France, Germany, Italy and Greece (Euros), Singapore (Singapore dollars and U.S. dollars), Malaysia (Malaysian ringgits), United Kingdom (U.K. pounds), Norway (Norwegian kroners), India (Indian rupees), Indonesia (Indonesian rupiah), Hong Kong (Hong Kong dollars), China (Chinese renminbi), Canada (Canadian dollars), Australia (Australian dollars) and Cyprus (Cypriot pounds). Foreign currency financial statements are translated into U.S. dollars at period-end rates, with the exception of revenues, costs and expenses, which are translated at average rates during the reporting period. We include gains and losses resulting from foreign currency transactions in income, while we those resulting from translation of financial statements as a component of accumulated other comprehensive income (AOCI). Transaction gains and losses, which were included in our condensed consolidated statement of operations, amounted to a gain of approximately \$0.3 million and \$0.5 million during the three months ended March 31, 2008 and 2009, respectively; and gains of \$0.5 million and \$1.0 million for the nine months ended March 31, 2008 and 2009, respectively. Furthermore, a 10% appreciation of the U.S. dollar relative to the local currency exchange rates would have resulted in a net increase in our operating income of approximately \$2 million in third quarter of fiscal 2009. Conversely, a 10% depreciation of the U.S. dollar relative to the local currency exchange rates would have resulted in a net decrease in our operating income of approximately \$2 million in third quarter of fiscal 2009.

### **Use of Derivatives**

Our use of derivatives consists primarily of foreign exchange contracts and interest rate swap agreements. As discussed in Note 1 to the condensed consolidated financial statements, as of March 31, 2009, we had outstanding foreign currency forward contracts and an interest rate swap agreement, which were considered effective cash flow hedges in their entirety. As a result, the net losses on such derivative contracts have been reported as a component of other comprehensive income in the condensed consolidated financial statements and will be reclassified into net earnings when the hedged transactions settle.

### **Importance of International Markets**

International markets provide us with significant growth opportunities. However, the following events, among others, could adversely affect our financial results in subsequent periods: periodic economic downturns in different regions of the world, changes in trade policies or tariffs, and wars and other forms of political instability. We continue to perform ongoing credit evaluations of our customers' financial condition and, if deemed necessary, we require advance payments for sales. We monitor economic and currency conditions around the world to evaluate whether there may be any significant effect on our international sales in the future. Due to our overseas investments and the necessity of dealing in local currencies in many foreign business transactions, we are at risk with respect to foreign currency fluctuations.

### **Inflation**

We do not believe that inflation had a material impact on our results of operations during the three and nine months ended March 31, 2009.

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**Interest Rate Risk**

We utilize short-term and long-term financing and may use interest rate hedges to manage the effect of interest rate changes on our existing debt. As of March 31, 2009, we had an interest rate swap agreement outstanding as discussed above under *Use of Derivatives*. There has been no material change in the interest rate risk discussed in Item 7A of our 10-K.

**Item 4. Controls and Procedures**

(a) *Evaluation of Disclosure Controls and Procedures*

As of March 31, 2009, the end of the period covered by this report, our management, including our Chief Executive Officer and our Chief Financial Officer, reviewed and evaluated the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended). Such disclosure controls and procedures are designed to ensure that material information we must disclose in this report is recorded, processed, summarized and filed or submitted on a timely basis. Based upon that evaluation our management, Chief Executive Officer and Chief Financial Officer, concluded that our disclosure controls and procedures were effective as of March 31, 2009.

(b) *Changes in Internal Control over Financial Reporting.*

There were no changes in our internal control over financial reporting during the third quarter of fiscal 2009 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**PART II OTHER INFORMATION**

**Item 1. Legal Proceedings**

We are involved in various claims and legal proceedings which have been previously disclosed in our quarterly and annual reports. The results of such legal proceedings cannot be predicted with certainty. Should we fail to prevail in any of these legal matters or should several of these legal matters be resolved against us in the same reporting period, the operating results of a particular reporting period could be materially adversely affected.

We are also involved in various other claims and legal proceedings arising out of the ordinary course of business which have not been previously disclosed in our quarterly and annual reports. In our opinion, after consultation with legal counsel, the ultimate disposition of such proceedings will not have a material adverse effect on our financial position, future results of operations or cash flows.

**Item 1A. Risk Factors**

The discussion of our business and operations in this Quarterly Report on form 10-Q should be read together with the risk factors contained in our Annual Report on Form 10-K for the fiscal year ended June 30, 2008, filed with the Securities and Exchange Commission, which describe various risks and uncertainties to which we are or may become subject. These risks and uncertainties have the potential to affect our business, financial condition, results of operations, cash flows, strategies or prospects in a material and adverse manner.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

In March 1999, our Board of Directors authorized a stock repurchase program (for up to 2 million shares of our common stock) and in September 2004, they increased the number of shares available for repurchase under the program by an additional 1 million shares. There is no timeframe to complete the repurchase program. Upon repurchase, shares are restored to the status of authorized but unissued shares.

During the three months ended March 31, 2009, pursuant to this program, we repurchased a total of 15,640 shares of our common stock in open market transactions. The following table provides a monthly summary of such stock repurchase activity:

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|               | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plan | Maximum Number of Shares that May Yet Be Purchased Under the Plan (1) |
|---------------|----------------------------------|------------------------------|---|---|
| January 2009  |                                  | n/a                          |   | 726,845   |
| February 2009 |                                  | n/a                          |   | 726,845   |
| March 2009    | 15,640                           | \$ 13.95                     | 15,640  | 711,205   |
| <b>Total</b>  | <b>15,640</b>                    | <b>\$ 13.95</b>              | <b>15,640</b>   |   |

**Item 6. Exhibits**

- 31.1 Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 32.2 Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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**Signatures**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized, in the City of Hawthorne, State of California on the 1st day of May 2009.

**OSI SYSTEMS, INC.**

By: /s/ Deepak Chopra  
Deepak Chopra  
President and Chief Executive Officer

By: /s/ Alan Edrick  
Alan Edrick  
Executive Vice President and  
Chief Financial Officer