

OSI SYSTEMS INC  
Form 10-Q  
January 25, 2013  
Table of Contents

**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 December 31, 2012

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 000-23125

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**OSI SYSTEMS, INC.**

(Exact name of registrant as specified in its charter)

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

**33-0238801**  
(I.R.S. Employer  
Identification No.)

**12525 Chadron Avenue**

**Hawthorne, California 90250**

(Address of principal executive offices) (Zip Code)

**(310) 978-0516**

(Registrant's telephone number, including area code)

**N/A**

(Former name, former address and former fiscal year, if changed since last report)

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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 x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

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.

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Large accelerated filer

Accelerated filer

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

Smaller reporting company

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

As of January 23, 2013, there were 20,053,898 shares of the registrant's common stock outstanding.

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Table of Contents

OSI SYSTEMS, INC.

INDEX

	<b>PAGE</b>
<b><u>PART I FINANCIAL INFORMATION</u></b>	<b>3</b>
<u>Item 1</u>	
<u>Condensed Consolidated Financial Statements</u>	3
<u>Condensed Consolidated Balance Sheets at June 30, 2012 and December 31, 2012</u>	3
<u>Condensed Consolidated Statements of Operations for the three and six months ended December 31, 2011 and 2012</u>	4
<u>Condensed Consolidated Statements of Comprehensive Income for the three and six months ended December 31, 2011 and 2012</u>	5
<u>Condensed Consolidated Statements of Cash Flows for the six months ended December 31, 2011 and 2012</u>	6
<u>Notes to Condensed Consolidated Financial Statements</u>	7
<u>Item 2</u>	
<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	19
<u>Item 3</u>	
<u>Quantitative and Qualitative Disclosures about Market Risk</u>	27
<u>Item 4</u>	
<u>Controls and Procedures</u>	29
<b><u>PART II OTHER INFORMATION</u></b>	<b>30</b>
<u>Item 1</u>	
<u>Legal Proceedings</u>	30
<u>Item 1A</u>	
<u>Risk Factors</u>	30
<u>Item 2</u>	
<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	30
<u>Item 3</u>	
<u>Defaults Upon Senior Securities</u>	30
<u>Item 4</u>	
<u>Mine Safety Disclosures</u>	30
<u>Item 5</u>	
<u>Other Information</u>	30
<u>Item 6</u>	
<u>Exhibits</u>	31
<u>Signatures</u>	32



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)

	June 30, 2012	December 31, 2012
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$ 91,452	\$ 46,850
Accounts receivable, net of allowance for doubtful accounts of \$5,054 and \$5,425 as of June 30, 2012 and December 31, 2012, respectively	156,867	140,023
Inventories	195,178	204,599
Deferred income taxes	19,205	19,002
Prepaid expenses and other current assets	20,411	36,086
Total current assets	483,113	446,560
Property and equipment, net	111,664	223,057
Goodwill	82,149	84,024
Intangible assets, net	37,742	37,460
Other assets	35,228	22,584
Total assets	\$ 749,896	\$ 813,685
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current Liabilities:		
Bank lines of credit	\$	\$ 15,000
Current portion of long term debt	215	1,808
Accounts payable	56,422	95,065
Accrued payroll and employee benefits	24,749	19,974
Advances from customers	22,677	21,959
Accrued warranties	17,562	15,012
Deferred revenue	20,194	16,389
Other accrued expenses and current liabilities	18,830	20,128
Total current liabilities	160,649	205,335

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Long-term debt	2,467	11,700
Advances from customers	100,000	87,500
Other long-term liabilities	52,661	54,074
<b>Total liabilities</b>	<b>315,777</b>	<b>358,609</b>
Commitments and contingencies (Note 7)		
Stockholders' Equity:		
Preferred stock, \$0.001 par value authorized, 10,000,000 shares; no shares issued or outstanding		
Common stock, \$0.001 par value authorized, 100,000,000 shares; issued and outstanding, 19,821,064 at June 30, 2012 and 20,012,872 shares at December 31, 2012	282,756	280,553
Retained earnings	155,651	174,411
Accumulated other comprehensive income (loss)	(4,288)	112
Total stockholders' equity	434,119	455,076
Total liabilities and stockholders' equity	\$ 749,896	\$ 813,685

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 amounts)

(Unaudited)

	For the Three Months Ended December 31,		For the Six Months Ended December 31,	
	2011	2012	2011	2012
Net revenues:				
Products	\$ 160,892	\$ 145,086	\$ 294,798	\$ 293,950
Services	27,101	48,963	54,512	81,793
Total net revenues	187,993	194,049	349,310	375,743
Cost of goods sold:				
Products	103,212	93,900	193,080	192,832
Services	18,957	30,061	37,549	51,468
Total cost of goods sold	122,169	123,961	230,629	244,300
Gross profit	65,824	70,088	118,681	131,443
Operating expenses:				
Selling, general and administrative	35,979	36,829	70,346	76,754
Research and development	11,546	11,858	22,426	23,174
Impairment, restructuring and other charges		2,723		2,723
Total operating expenses	47,525	51,410	92,772	102,651
Income from operations	18,299	18,678	25,909	28,792
Interest expense and other income, net	(721)	(1,385)	(1,520)	(2,482)
Income before income taxes	17,578	17,293	24,389	26,310
Provision for income taxes	5,277	4,872	7,327	7,550
Net income	\$ 12,301	\$ 12,421	\$ 17,062	\$ 18,760
Net income per share:				
Basic	\$ 0.62	\$ 0.62	\$ 0.87	\$ 0.94
Diluted	\$ 0.61	\$ 0.60	\$ 0.85	\$ 0.91
Shares used in per share calculation:				
Basic	19,685	19,999	19,630	19,952
Diluted	20,237	20,609	20,161	20,589

See accompanying notes to condensed consolidated financial statements.



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

(amounts in thousands)

(Unaudited)

	For the Three Months Ended December 31,		For the Six Months Ended December 31,	
	2011	2012	2011	2012
Net income	\$ 12,301	\$ 12,421	\$ 17,062	\$ 18,760
Other comprehensive income (loss):				
Foreign currency translation adjustment	(2,132)	(571)	(5,393)	4,739
Other	(261)	114	10	(339)
Other comprehensive income (loss)	(2,393)	(457)	(5,383)	4,400
Comprehensive income	\$ 9,908	\$ 11,964	\$ 11,679	\$ 23,160

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)

	For the Six Months Ended December 31,	
	2011	2012
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income	\$ 17,062	\$ 18,760
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	9,741	10,809
Stock based compensation expense	3,462	7,147
Provision for losses on accounts receivable	227	445
Equity in (earnings) loss of unconsolidated affiliates	(119)	51
Deferred income taxes	(168)	212
Other	28	131
Changes in operating assets and liabilities net of business acquisitions:		
Accounts receivable	(10,049)	17,663
Inventories	(38,112)	(6,985)
Prepaid expenses and other current assets	10,537	11,373
Accounts payable	22,415	37,876
Accrued payroll and related expenses	(5,745)	(4,874)
Advances from customers	4,175	(13,900)
Accrued warranties	1,050	(2,728)
Deferred revenue	(717)	(3,567)
Other accrued expenses and current liabilities	(1,303)	(9,597)
Net cash provided by operating activities	12,484	62,816
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Acquisition of property and equipment	(9,083)	(117,616)
Acquisition of businesses, net of cash acquired	(3,189)	(5,787)
Acquisition of intangible and other assets	(1,794)	(2,039)
Net cash used in investing activities	(14,066)	(125,442)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Net borrowings of bank lines of credit		15,000
Proceeds from long-term debt		11,100
Payments on long-term debt	(108)	(375)
Proceeds from exercise of stock options and employee stock purchase plan	2,194	2,974
Repurchase of common shares	(1,770)	(12,325)
Net cash provided by financing activities	316	16,374
EFFECT OF EXCHANGE RATE CHANGES ON CASH	(1,485)	1,650
NET DECREASE IN CASH AND CASH EQUIVALENTS	(2,751)	(44,602)
CASH AND CASH EQUIVALENTS - BEGINNING OF PERIOD	55,619	91,452
CASH AND CASH EQUIVALENTS - END OF PERIOD	\$ 52,868	\$ 46,850

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Supplemental disclosure of cash flow information:

Interest paid	\$	1,559	\$	1,858
Income taxes paid	\$	1,125	\$	5,615

See accompanying notes to condensed consolidated financial statements.

Table of Contents

**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, and a provider of security screening services. The Company sells its products and services in diversified markets, including homeland security, healthcare, defense and aerospace.

The Company has three operating divisions: (i) Security, providing security and inspection systems, turnkey security screening solutions and related services; (ii) Healthcare, providing patient monitoring, diagnostic cardiology and anesthesia systems, and related services; and (iii) Optoelectronics and Manufacturing, providing specialized electronic components and electronic manufacturing services for the Security and Healthcare divisions, as well as to external original equipment manufacturer clients for applications in the defense, aerospace, medical and industrial markets, among others.

Through its Security division, the Company designs, manufactures, markets and services security and inspection systems globally, and provides turnkey security screening solutions. The Security division's products are used to inspect baggage, cargo, vehicles and other objects for weapons, explosives, drugs and other contraband, and to screen people. These products and services 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.

Through its Healthcare division, the Company designs, manufactures, markets and services patient monitoring, diagnostic cardiology and anesthesia delivery and ventilation systems globally. 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.

Through its Optoelectronics and Manufacturing division, the Company designs, manufactures and markets optoelectronic devices and provides electronics manufacturing services globally for use in a broad range of applications, including aerospace and defense electronics, security and inspection systems, medical imaging and diagnostic products, telecommunications, test and measurement devices, industrial automation systems, automotive diagnostic products and renewable energy technologies. This division provides products and services to original equipment manufacturers and end users as well as to the Company's own Security and Healthcare divisions.



Table of Contents

*Basis of Presentation*

The unaudited 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. These condensed consolidated financial statements have been prepared by the Company, without audit, pursuant to interim financial reporting guidelines 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 the unaudited condensed consolidated financial statements include all adjustments, consisting of only normal and recurring adjustments, necessary for a fair presentation of the financial position and the results of operations as of the dates and for the periods presented. These unaudited quarterly condensed consolidated financial statements and the accompanying notes should be read in conjunction with the audited consolidated financial statements and accompanying notes included in the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2012 filed with the Securities and Exchange Commission on August 13, 2012. The results of operations for the three and six months ended December 31, 2012 are not necessarily indicative of the operating results to be expected for the full fiscal year or any future periods.

*Per Share Computations*

The Company computes basic earnings per share by dividing net income available to common stockholders 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 stockholders 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 under the treasury stock method. Stock options to purchase a total of 0.2 million shares of common stock for the six months ended December 31, 2011 were not included in diluted earnings per share calculations because to do so would have been antidilutive, while no such shares were excluded from the calculations for the six months ended December 31, 2012 or from the calculations for the three month periods ended December 31, 2012 and 2011, respectively.

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### Table of Contents

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

	Three Months Ended December 31,				Six Months Ended December 31,			
	2011		2012		2011		2012	
Net income available to common stockholders	\$	12,301	\$	12,421	\$	17,062	\$	18,760
Weighted average shares outstanding		19,685		19,999		19,630		19,952
Dilutive effect of stock options		552		610		531		637
Weighted average shares outstanding		20,237		20,609		20,161		20,589
Basic net income per share	\$	0.62	\$	0.62	\$	0.87	\$	0.94
Diluted net income per share	\$	0.61	\$	0.60	\$	0.85	\$	0.91

### *Cash Equivalents*

The Company considers all highly liquid investments purchased with maturities of approximately three months or less as of the acquisition date to be cash equivalents.

Components of cash and cash equivalents consisted of:

	June 30, 2012		December 31, 2012	
Cash in bank	\$	47,402	\$	46,739
Money market		34,063		111
Commercial paper		9,987		
Total	\$	91,452	\$	46,850

### *Fair Value of Financial Instruments*

The Company's financial instruments consist primarily of cash, marketable securities, derivative instruments, accounts receivable, accounts payable and debt instruments. The carrying values of financial instruments, other than debt instruments, are representative of their fair values due to their short-term maturities. The carrying values of the Company's long-term debt instruments are considered to approximate their fair values because the interest rates of these instruments are variable or comparable to current interest rates available to the Company.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The Company has determined that all of its marketable securities fall into the Level 1 category, which values assets and liabilities at the quoted prices in active markets for identical assets and liabilities; while the Company's derivative instruments fall into the Level 2 category, which values assets and liabilities from observable inputs other than quoted market prices. There were no assets or liabilities where Level 3 valuation techniques were used, and there were no assets and liabilities measured at fair value on a non-recurring basis.

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The fair values of the Company's assets (liabilities) were:

	<b>June 30, 2012</b>	<b>December 31, 2012</b>
Level 1	\$ 10,955	\$ 12,794
Level 2	13	(90)
Total	\$ 10,968	\$ 12,704



Table of Contents

*Derivative Instruments and Hedging Activity*

The Company's use of derivatives consists primarily of foreign exchange contracts and interest rate swap agreements. As of December 31, 2012, the Company had outstanding foreign currency forward contracts of approximately \$6.2 million. The foreign exchange contracts do not meet the criteria as effective cash flow hedges. Therefore, the net gain (loss) from these contracts is reported in Interest expense and other income, net in the condensed consolidated statement of operations. An interest rate swap agreement was entered into to improve the predictability of cash flows from interest payments related to variable, LIBOR-based debt for the duration of the term loan.

The interest rate swap matures in October 2019. It is considered an effective cash flow hedge, and, as a result, the net gains or losses on such instrument were reported as a component of other comprehensive income in the condensed consolidated financial statements and are reclassified as net earnings when the hedge transaction settles.

*Revenue Recognition*

The Company recognizes revenue from sales of products upon shipment when title and risk of loss passes, and when terms are fixed and collection is probable. Revenue from services includes after-market services, installation and implementation of products, and turnkey security screening services. The portion of revenue for the sale attributable to installation is deferred and recognized when the installation service is provided. In an instance where terms of sale include subjective customer acceptance criteria, revenue is deferred until the Company has achieved the acceptance criteria. Concurrent with the shipment of the product, the Company accrues estimated product return reserves and warranty expenses. Critical judgments made by management related to revenue recognition include the determination of whether or not customer acceptance criteria are perfunctory or inconsequential. The determination of whether or not customer acceptance terms are perfunctory or inconsequential impacts the amount and timing of revenue recognized. Critical judgments also include estimates of warranty reserves, which are established based on historical experience and knowledge of the product under warranty.

Table of Contents

Revenue from certain fixed-fee turnkey services agreements is recognized based upon proportional performance, measured by the actual number of hours incurred divided by the total estimated number of hours for the project. The impact of changes in the estimated hours to service the agreement is reflected in the period during which the change becomes known.

Revenues from out-of-warranty service maintenance contracts are recognized ratably over the term of such contract. For services not derived from specific maintenance contracts, revenues are recognized as the services are performed. Deferred revenue for such services arises from payments received from customers for services not yet performed.

*Business Combinations*

During the normal course of business the Company makes acquisitions. In the event that an individual acquisition (or an aggregate of acquisitions) is material, appropriate disclosure of such acquisition activity is disclosed.

**2. Balance Sheet Details**

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

	June 30, 2012	December 31, 2012
<b>Inventories, net</b>		
Raw materials	\$ 103,747	\$ 110,809
Work-in-process	28,096	34,970
Finished goods	63,335	58,820
Total	\$ 195,178	\$ 204,599

	June 30, 2012	December 31, 2012
<b>Property and equipment</b>		
Land	\$ 5,193	\$ 8,569
Buildings and improvements	13,597	26,517
Leasehold improvements	12,385	9,644
Equipment and tooling	74,789	129,379
Furniture and fixtures	3,982	4,479
Computer equipment	13,937	16,851
Software	15,245	15,770
Construction in process	52,269	95,988
Total	191,397	307,197
Less: accumulated depreciation and amortization	(79,733)	(84,140)
Property and equipment, net	\$ 111,664	\$ 223,057

Construction in process consists primarily of costs related to infrastructure in Mexico.