

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549**

**FORM 10-Q**

(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, 2019**

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**

**OSI SYSTEMS, INC.**

(Exact name of registrant as specified in its charter)

**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)

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 has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes  No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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 April 26, 2019, there were 18,104,754 shares of the registrant's common stock outstanding.

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OSI SYSTEMS, INC.

INDEX

	<u>PAGE</u>
<b><u>PART I — FINANCIAL INFORMATION (Unaudited)</u></b>	3
<u>Item 1 — Financial Statements</u>	3
<u>Condensed Consolidated Balance Sheets at June 30, 2018 and March 31, 2019</u>	3
<u>Condensed Consolidated Statements of Operations for the three and nine months ended March 31, 2018 and 2019</u>	4
<u>Condensed Consolidated Statements of Comprehensive Income for the three and nine months ended March 31, 2018 and 2019</u>	5
<u>Condensed Consolidated Statements of Stockholders' Equity for the three and nine months ended March 31, 2018 and 2019</u>	6
<u>Condensed Consolidated Statements of Cash Flows for the nine months ended March 31, 2018 and 2019</u>	8
<u>Notes to Condensed Consolidated Financial Statements</u>	9
<u>Item 2 — Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	26
<u>Item 3 — Quantitative and Qualitative Disclosures about Market Risk</u>	32
<u>Item 4 — Controls and Procedures</u>	32
<b><u>PART II — OTHER INFORMATION</u></b>	34
<u>Item 1 — Legal Proceedings</u>	34
<u>Item 1A — Risk Factors</u>	34
<u>Item 2 — Unregistered Sales of Equity Securities and Use of Proceeds</u>	34
<u>Item 3 — Defaults Upon Senior Securities</u>	34
<u>Item 4 — Mine Safety Disclosures</u>	34
<u>Item 5 — Other Information</u>	34
<u>Item 6 — Exhibits</u>	34
<u>Signatures</u>	35

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## PART I — FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

OSI SYSTEMS, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)  
(amounts in thousands, except share amounts and par value)

	June 30, 2018	March 31, 2019
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 84,814	\$ 107,649
Accounts receivable, net	210,744	218,433
Inventories	313,552	297,704
Prepaid expenses and other current assets	41,587	35,050
Total current assets	650,697	658,836
Property and equipment, net	115,524	124,916
Goodwill	292,213	307,461
Intangible assets, net	142,001	136,432
Other assets	55,256	56,470
Total assets	<u>\$ 1,255,691</u>	<u>\$ 1,284,115</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Bank lines of credit	\$ 113,000	\$ 124,000
Current portion of long-term debt	2,262	1,702
Accounts payable	106,892	89,891
Accrued payroll and related expenses	40,171	36,053
Advances from customers	55,761	60,016
Other accrued expenses and current liabilities	125,236	113,838
Total current liabilities	443,322	425,500
Long-term debt	248,980	255,411
Deferred income taxes	15,002	15,015
Other long-term liabilities	58,951	62,381
Total liabilities	766,255	758,307
Commitments and contingencies (Note 9)		
Stockholders' Equity:		
Preferred stock, \$0.001 par value —10,000,000 shares authorized; no shares issued or outstanding	—	—
Common stock, \$0.001 par value —100,000,000 shares authorized; issued and outstanding, 18,032,374 shares at June 30, 2018 and 18,100,841 shares at March 31, 2019	169,475	160,384
Retained earnings	334,745	382,880
Accumulated other comprehensive loss	(14,784)	(17,456)
Total stockholders' equity	489,436	525,808
Total liabilities and stockholders' equity	<u>\$ 1,255,691</u>	<u>\$ 1,284,115</u>

See accompanying notes to condensed consolidated financial statements.

**OSI SYSTEMS, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)**  
(amounts in thousands, except per share data)

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2018	2019	2018	2019
<b>Net revenues:</b>				
Products	\$ 182,484	\$ 224,778	\$ 529,530	\$ 632,660
Services	84,815	79,506	272,430	241,078
Total net revenues	267,299	304,284	801,960	873,738
<b>Cost of goods sold:</b>				
Products	126,419	147,939	363,063	423,441
Services	43,295	45,029	148,411	132,724
Total cost of goods sold	169,714	192,968	511,474	556,165
Gross profit	97,585	111,316	290,486	317,573
<b>Operating expenses:</b>				
Selling, general and administrative	59,846	67,278	175,591	196,082
Research and development	15,934	13,695	46,122	40,253
Impairment, restructuring and other charges	14,062	(1,777)	23,489	1,154
Total operating expenses	89,842	79,196	245,202	237,489
Income from operations	7,743	32,120	45,284	80,084
Interest expense and other expense, net	(4,625)	(5,595)	(14,156)	(16,546)
Income before income taxes	3,118	26,525	31,128	63,538
Provision for income taxes	(565)	(6,899)	(65,369)	(15,403)
Net income (loss)	\$ 2,553	\$ 19,626	\$ (34,241)	\$ 48,135
<b>Earnings (loss) per share:</b>				
Basic	\$ 0.14	\$ 1.09	\$ (1.82)	\$ 2.66
Diluted	\$ 0.13	\$ 1.05	\$ (1.82)	\$ 2.58
<b>Shares used in per share calculation:</b>				
Basic	18,569	18,079	18,773	18,085
Diluted	19,146	18,671	18,773	18,678

See accompanying notes to condensed consolidated financial statements.

**OSI SYSTEMS, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)**  
**(amounts in thousands)**

	Three Months Ended		Nine Months Ended	
	March 31,		March 31,	
	2018	2019	2018	2019
Net income (loss)	\$ 2,553	\$ 19,626	\$ (34,241)	\$ 48,135
Other comprehensive income (loss):				
Foreign currency translation adjustment	1,366	1,521	3,272	(2,694)
Other	103	7	38	22
Other comprehensive income (loss)	1,469	1,528	3,310	(2,672)
Comprehensive income (loss)	<u>\$ 4,022</u>	<u>\$ 21,154</u>	<u>\$ (30,931)</u>	<u>\$ 45,463</u>

See accompanying notes to condensed consolidated financial statements.

**OSI SYSTEMS, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (UNAUDITED)**  
(amounts in thousands, except share data)

	Three Months Ended March 31, 2018					
	Common		Retained Earnings	Accumulated Other Comprehensive Income (Loss)		Total
	Number of Shares	Amount				
Balance—December 31, 2017	18,978,031	\$ 218,343	\$ 327,078	\$ (15,347)	\$ 530,074	
Exercise of stock options	31,500	708	—	—	708	
Vesting of RSUs	1,435	—	—	—	—	
Shares issued under employee stock purchase program	40,822	2,072	—	—	2,072	
Stock-based compensation	—	6,014	—	—	6,014	
Repurchase of common stock	(972,481)	(59,684)	—	—	(59,684)	
Taxes paid related to net share settlement of equity awards	(13,877)	(820)	—	—	(820)	
Net income	—	—	2,553	—	2,553	
Other comprehensive income	—	—	—	1,469	1,469	
Balance—March 31, 2018	<u>18,065,430</u>	<u>\$ 166,633</u>	<u>\$ 329,631</u>	<u>\$ (13,878)</u>	<u>\$ 482,386</u>	

	Three Months Ended March 31, 2019					
	Common		Retained Earnings	Accumulated Other Comprehensive Income (Loss)		Total
	Number of Shares	Amount				
Balance—December 31, 2018	18,020,907	\$ 151,926	\$ 363,254	\$ (18,984)	\$ 496,196	
Exercise of stock options	58,613	1,196	—	—	1,196	
Vesting of RSUs	1,219	—	—	—	—	
Shares issued under employee stock purchase program	36,020	2,160	—	—	2,160	
Stock-based compensation	—	5,888	—	—	5,888	
Taxes paid related to net share settlement of equity awards	(15,918)	(786)	—	—	(786)	
Net income	—	—	19,626	—	19,626	
Other comprehensive income	—	—	—	1,528	1,528	
Balance—March 31, 2019	<u>18,100,841</u>	<u>\$ 160,384</u>	<u>\$ 382,880</u>	<u>\$ (17,456)</u>	<u>\$ 525,808</u>	

[Table of Contents](#)

Nine Months Ended March 31, 2018						
	Common		Retained Earnings	Accumulated Other Comprehensive Income (Loss)		Total
	Number of Shares	Amount				
Balance—June 30, 2017	18,689,568	\$ 222,529	\$ 363,872	\$ (17,188)		\$ 569,213
Exercise of stock options	113,255	2,575	—	—		2,575
Vesting of RSUs	401,773	—	—	—		—
Shares issued under employee stock purchase program	78,310	4,033	—	—		4,033
Stock-based compensation	—	17,754	—	—		17,754
Repurchase of common stock	(972,481)	(59,684)	—	—		(59,684)
Taxes paid for net share settlement of equity awards	(244,995)	(20,574)	—	—		(20,574)
Net loss	—	—	(34,241)	—		(34,241)
Other comprehensive income	—	—	—	3,310		3,310
Balance—March 31, 2018	<u>18,065,430</u>	<u>\$ 166,633</u>	<u>\$ 329,631</u>	<u>\$ (13,878)</u>		<u>\$ 482,386</u>
Nine Months Ended March 31, 2019						
	Common		Retained Earnings	Accumulated Other Comprehensive Income (Loss)		Total
	Number of Shares	Amount				
Balance—June 30, 2018	18,032,374	\$ 169,475	\$ 334,745	\$ (14,784)		\$ 489,436
Exercise of stock options	108,008	1,985	—	—		1,985
Vesting of RSUs	357,924	—	—	—		—
Shares issued under employee stock purchase program	75,313	4,180	—	—		4,180
Stock-based compensation	—	19,514	—	—		19,514
Repurchase of common stock	(288,316)	(21,029)	—	—		(21,029)
Taxes paid for net share settlement of equity awards	(184,462)	(13,741)	—	—		(13,741)
Net income	—	—	48,135	—		48,135
Other comprehensive loss	—	—	—	(2,672)		(2,672)
Balance—March 31, 2019	<u>18,100,841</u>	<u>\$ 160,384</u>	<u>\$ 382,880</u>	<u>\$ (17,456)</u>		<u>\$ 525,808</u>

See accompanying notes to condensed consolidated financial statements.



**OSI SYSTEMS, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)**  
(amounts in thousands)

	Nine Months Ended March 31,	
	2018	2019
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income (loss)	\$ (34,241)	\$ 48,135
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	55,368	42,401
Stock-based compensation expense	17,754	19,514
Deferred income taxes	50,775	(3,220)
Amortization of debt discount and issuance costs	6,426	6,733
Impairment charges	7,181	—
Other	2,125	1,617
Changes in operating assets and liabilities—net of business acquisitions:		
Accounts receivable	7,131	(5,967)
Inventories	(48,703)	16,232
Prepaid expenses and other assets	(22,121)	(6,620)
Accounts payable	19,522	(20,265)
Accrued payroll and related expenses	(1,689)	(4,008)
Advances from customers	32,152	4,258
Other	24,084	(11,066)
Net cash provided by operating activities	<u>115,764</u>	<u>87,744</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Acquisition of property and equipment	(36,432)	(20,905)
Acquisition of businesses, net of cash acquired	(100,567)	(18,271)
Acquisition of intangible and other assets	(2,250)	(1,657)
Net cash used in investing activities	<u>(139,249)</u>	<u>(40,833)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Net borrowings on bank lines of credit	125,000	11,000
Proceeds from long-term debt	626	1,019
Payments on long-term debt	(1,933)	(1,880)
Proceeds from exercise of stock options and employee stock purchase plan	6,608	6,165
Payment of contingent consideration	(2,617)	(4,797)
Repurchase of common stock	(59,684)	(21,029)
Taxes paid related to net share settlement of equity awards	(20,574)	(13,741)
Net cash provided by (used in) financing activities	<u>47,426</u>	<u>(23,263)</u>
Effect of exchange rate changes on cash	410	(813)
Net increase in cash and cash equivalents	24,351	22,835
Cash and cash equivalents—beginning of period	169,650	84,814
Cash and cash equivalents—end of period	<u>\$ 194,001</u>	<u>\$ 107,649</u>
<b>Supplemental disclosure of cash flow information:</b>		
Cash paid, net during the period for:		
Interest	<u>\$ 6,508</u>	<u>\$ 9,394</u>
Income taxes	<u>\$ 21,728</u>	<u>\$ 28,233</u>

See accompanying notes to condensed consolidated financial statements.

**OSI SYSTEMS, INC. AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(Unaudited)**

**1. Basis of Presentation**

*Description of Business*

OSI Systems, Inc., together with our subsidiaries, is 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 reporting segments: (i) Security, providing security inspection systems and related services, and turnkey security screening solutions; (ii) Healthcare, providing patient monitoring, diagnostic cardiology and related services and (iii) Optoelectronics and Manufacturing, providing specialized electronic components and electronic manufacturing services for our Security and Healthcare divisions as well as to external original equipment manufacturer (“OEM”) customers and end users for applications in the defense, aerospace, medical and industrial markets, among others.

Through our Security segment, we provide security screening products and related services globally. These products fall into the following categories: baggage and parcel inspection; cargo and vehicle inspection; hold (checked) baggage screening; people screening; radiation detection; and explosive and narcotics trace detection. In addition to these products, we also provide site design, installation, training and technical support services to our customers. We also provide turnkey security screening solutions, which can include the construction, staffing and long-term operation of security screening checkpoints for our customers.

Through our Healthcare segment, we design, manufacture, market and service patient monitoring and diagnostic cardiology systems and related supplies and accessories worldwide. 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, among others.

Through our Optoelectronics and Manufacturing segment, we design, manufacture and market optoelectronic devices and flex circuits and provide electronics manufacturing services worldwide for use in a broad range of applications, including aerospace and defense electronics, X-ray security and inspection systems and medical imaging, chemistry analysis and diagnostics instruments, telecommunications, scanners and industrial automations, automotive diagnostic systems, internet of things (IoT) and consumer wearable products. This division provides products and services to OEM customers and end users as well as to our Security and Healthcare divisions.

*Basis of Presentation*

The condensed consolidated financial statements include the accounts of OSI Systems, Inc. and our subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation. The condensed consolidated financial statements have been prepared by management in accordance with accounting principles generally accepted in the United States of America (“GAAP”) and in conjunction with the rules and regulations of the Securities and Exchange Commission (“SEC”). Certain information and footnote disclosures required for annual financial statements have been condensed or excluded in accordance with SEC rules and regulations applicable to interim unaudited financial statements. Accordingly, the condensed consolidated financial statements do not include all of the information and footnotes required by GAAP for audited financial statements. In the opinion of management, the condensed consolidated financial statements reflect all adjustments of a normal and recurring nature that are considered necessary for a fair presentation of the results for the interim periods presented. These condensed consolidated financial statements and the accompanying notes should be read in conjunction with the audited consolidated financial statements and accompanying notes included in our Annual Report on Form 10-K for the fiscal year ended June 30, 2018. The results of operations for the nine months ended March 31, 2019 are not necessarily indicative of the operating results to be expected for the full 2019 fiscal year or any future periods.

*Use of Estimates*

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of sales and costs of sales during the reporting period. The most significant of these estimates and assumptions for our company relate to contract revenue, profit and loss recognition, fair values of assets acquired and liabilities assumed in business combinations, values for inventories reported at lower of cost or net realizable value, stock-based compensation expense, income taxes, accrued warranty costs, and the recoverability, useful lives and valuation of recorded amounts of long-lived assets, identifiable intangible assets and goodwill. Changes in estimates are reflected in the periods during which they become known. Actual amounts may differ from these estimates and could differ materially.

[Table of Contents](#)*Per Share Computations*

We compute basic earnings per share by dividing net income available to common stockholders by the weighted average number of common shares outstanding during the period. We compute diluted earnings per share by dividing net income available to common stockholders by the sum of the weighted average number of common shares and dilutive potential common shares outstanding during the period. Potential common shares consist of the shares issuable upon the exercise of stock options and restricted stock unit awards under the treasury stock method. In periods where a net loss is reported, basic and diluted net loss per share are the same since the effect of potential common shares is antidilutive and therefore excluded. The underlying equity component of the 1.25% convertible senior notes due 2022 (the “Notes”) discussed in Note 6 to the condensed consolidated financial statements will have no impact on diluted earnings per share until the average price of our common stock exceeds the conversion price because the principal amount of the Notes is intended to be settled in cash upon conversion.

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

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2018	2019	2018	2019
Net income (loss) available to common stockholders	\$ 2,553	\$ 19,626	\$ (34,241)	\$ 48,135
Weighted average shares outstanding—basic	18,569	18,079	18,773	18,085
Dilutive effect of equity awards	577	592	—	593
Weighted average shares outstanding—diluted	19,146	18,671	18,773	18,678
Basic earnings (loss) per share	\$ 0.14	\$ 1.09	\$ (1.82)	\$ 2.66
Diluted earnings (loss) per share	\$ 0.13	\$ 1.05	\$ (1.82)	\$ 2.58
Weighted average shares excluded from diluted earnings (loss) per share due to their anti-dilutive effect (in thousands)	288	44	753	46

*Cash Equivalents*

We consider all highly liquid investments with maturities of three months or less as of the acquisition date to be cash equivalents.

Our cash and cash equivalents totaled \$107.6 million at March 31, 2019. These funds were held primarily by us and our subsidiaries in the United States, United Kingdom, Singapore, Malaysia, and Mexico, and to a lesser extent in India, Canada and Germany among others. We have cash holdings that exceed insured limits for financial institutions; however, we mitigate this risk by utilizing high credit quality financial institutions throughout the world.

*Fair Value of Financial Instruments*

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

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. “Level 1” category includes assets and liabilities at quoted prices in active markets for identical assets and liabilities. “Level 2” category includes assets and liabilities from observable inputs other than quoted market prices. “Level 3” category includes assets and liabilities for which valuation techniques are unobservable and significant to the fair value measurement. As of June 30, 2018 and March 31, 2019, there were no assets where “Level 3” valuation techniques were used. Our contingent payment obligations related to acquisitions, which are further discussed in Note 9 to the condensed consolidated financial statements, are in the “Level 3” category for valuation purposes.

[Table of Contents](#)

The fair values of our financial assets and liabilities as of June 30, 2018 and March 31, 2019 are categorized as follows (in thousands):

	June 30, 2018				March 31, 2019			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
<b>Assets:</b>								
Insurance company contracts	\$ —	\$ 31,897	\$ —	\$ 31,897	\$ —	\$ 34,647	\$ —	\$ 34,647
Interest rate contract	—	18	—	18	—	4	—	4
<b>Total assets</b>	<b>\$ —</b>	<b>\$ 31,915</b>	<b>\$ —</b>	<b>\$ 31,915</b>	<b>\$ —</b>	<b>\$ 34,651</b>	<b>\$ —</b>	<b>\$ 34,651</b>
<b>Liabilities—contingent consideration</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ 15,713</b>	<b>\$ 15,713</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ 16,869</b>	<b>\$ 16,869</b>

*Derivative Instruments and Hedging Activity*

Our use of derivatives consists of an interest rate swap agreement. The 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 described in Note 6. The interest rate swap matures in October 2019. The interest rate swap 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 (loss) in the consolidated financial statements and are reclassified as net income when the hedge transaction settles.

*Revenue Recognition*

*ASU 2014-09, Revenue from Contracts with Customers (Topic 606).* In May 2014, the FASB issued Accounting Standards Update (“ASU”) 2014-09 and related amendments (“ASC 606”), which superseded all prior revenue recognition methods and industry-specific guidance. The core principle of ASC 606 is that an entity should recognize revenue to depict the transfer of control for promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In applying the revenue principles, an entity is required to identify the contract(s) with a customer, identify the performance obligations, determine the transaction price, allocate the transaction price to the performance obligations and recognize revenue when the performance obligation is satisfied (i.e., either over time or at a point in time). ASC 606 further requires that companies disclose sufficient information to enable users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. On July 1, 2018, we adopted ASC 606 using the modified retrospective method, whereby the adoption does not impact any prior periods. We identified contracts not yet completed as of July 1, 2018 and applied the new guidance on a prospective basis.

*Product Sales.* We recognize revenue from sales of products upon shipment or delivery when control of the product transfers to the customer, depending on the terms of each sale, and when collection is probable. In the circumstance where terms of a product sale include subjective customer acceptance criteria, revenue is deferred until we have achieved the acceptance criteria unless the customer acceptance criteria are perfunctory or inconsequential. We generally offer customers payment terms of less than one year. In cases when payment terms extend beyond one year, we consider whether the contract has a significant financing component.

*Service Revenue.* Revenue from services includes installation and implementation of products and turnkey security screening services and after-market services. Generally, revenue from services is recognized over time as the services are performed. Revenues from out of warranty service maintenance contracts are recognized ratably over the respective terms of such contracts. Deferred revenue for such services arises from payments received from customers for services not yet performed.

*Contract Revenue.* Sales agreements with customers can be project specific, cover a period of time, and can be renewable periodically. The contracts may contain terms and conditions with respect to payment, delivery, installation, services, warranty and other rights. In certain instances, we consider an accepted customer order, governed by a master sales agreement, to be the contract with the customer when legal rights and obligations exist. Contracts with customers may include the sale of products and services, as discussed in the paragraphs above. In certain instances, contracts can contain multiple performance obligations as discussed in the paragraph below. According to the terms of a sale contract, we may receive consideration from a customer prior to transferring goods to the customer, and we record these prepayments as a contract liability. We also record deferred revenue, typically related to service contracts, when consideration is received before the services have been performed. We recognize customer deposits and deferred revenue as net sales after all revenue recognition criteria are met.

When determining revenue recognition for contracts, we use judgment based on our understanding of the obligations within each contract. We determine 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 recognition. 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](#)

*Multiple Performance Obligations.* Certain agreements with customers include the sale of capital equipment involving multiple elements that may include civil works to prepare a site for the installation of equipment, manufacture and delivery of equipment, installation and integration of equipment, training of customer personnel to operate the equipment and after-market service of the equipment. We generally separate multiple elements in a contract into separate performance obligations if those elements are distinct, both individually and in the context of the contract. If multiple promises comprise a series of distinct services which are substantially the same and have the same pattern of transfer, they are combined and accounted for as a single performance obligation.

In cases where obligations in a contract are distinct and thus require separation into multiple performance obligations, revenue recognition guidance requires that contract consideration be allocated to each distinct performance obligation based on its relative standalone selling price. The value allocated to each performance obligation is then recognized as revenue when the revenue recognition criteria for each distinct promise or bundle of promises has been met.

The standalone selling price for each performance obligation is an amount that depicts the amount of consideration to which the entity expects to be entitled in exchange for transferring the good or service. When there is only one performance obligation associated with a contract, the entire sale value is attributed to that obligation. When a contract contains multiple performance obligations the transaction value is first allocated using the observable price, which is generally a list price net of applicable discount or the price used to sell in similar circumstances. In circumstances when a selling price is not directly observable, we will estimate the standalone selling price using information available to us including our market assessment and expected cost plus margin.

The timetable for fulfilment of each of the distinct performance obligations can range from completion in a short amount of time and entirely within a single reporting period to completion over several reporting periods. The timing of revenue recognition for each performance obligation may be dependent upon several milestones, including physical delivery of equipment, completion of factory acceptance test, completion of site acceptance test, installation and connectivity of equipment, certification of training of personnel and, in the case of after-market service deliverables, the passage of time (typically evenly over the post-warranty period of the service deliverable).

We often provide a guarantee to support our performance under multiple-deliverable arrangements. In the event that customers are permitted to terminate such arrangements, the underlying contract typically requires payment for deliverables and reimbursement of costs incurred through the date of termination.

*Effect of Adopting ASC 606.* Adopting ASC 606 did not require any cumulative effect adjustment to retained earnings as of July 1, 2018 because the impact on retained earnings was immaterial. The impact to our condensed consolidated statements of operations is shown below for the three and nine month periods ended March 31, 2019 and for the balance sheet as of March 31, 2019.

**Statement of Operations (in thousands)**

	Three Months Ended March 31, 2019			Nine Months Ended March 31, 2019		
	Results as Reported	Results without Adoption of ASC 606		Results as Reported	Results without Adoption of ASC 606	
			Effect of Change			Effect of Change
Revenue	\$ 304,284	\$ 293,254	\$ 11,030	\$ 873,738	\$ 843,815	\$ 29,923
Cost of goods sold	192,968	187,111	5,857	556,165	541,402	14,763
Operating expenses	79,196	75,508	3,688	237,489	227,144	10,345
Income from operations	32,120	30,635	1,485	80,084	75,269	4,815
Interest and other expense, net	(5,595)	(5,595)	—	(16,546)	(16,546)	—
Income tax provision	(6,899)	(6,625)	(274)	(15,403)	(14,593)	(810)
Net income	\$ 19,626	\$ 18,415	\$ 1,211	\$ 48,135	\$ 44,130	\$ 4,005

**Balance Sheet (in thousands)**

	March 31, 2019		
	Balances as Reported	Balances without Adoption of ASC 606	Effect of Change
<b>Assets</b>			
Accounts receivable, net	\$ 218,433	\$ 202,266	\$ 16,167
Inventories	297,704	312,494	(14,790)
Other assets	767,978	768,789	(811)
<b>Liabilities</b>			
Current liabilities	425,500	428,939	(3,439)
Other liabilities	332,807	332,807	—
<b>Stockholders' Equity</b>			
Retained earnings	382,880	378,875	4,005

## [Table of Contents](#)

We disaggregate revenue by reporting segment (Security, Optoelectronics and Manufacturing, and Healthcare) to depict the nature of revenue in a manner consistent with our business operations and to be consistent with other communications and public filings. Refer to Note 11 to our condensed consolidated financial statements for additional details of revenues by reporting segment.

During the three and nine months ended March 31, 2019, we recognized additional revenue as a result of adopting ASC 606. This is primarily due to sales within our Security division where we met certain contractual performance obligations. As a result, this increased net income and accounts receivable and reduced inventories.

*Contract Assets and Liabilities.* We enter into contracts to sell products and provide services, and we recognize contract assets and liabilities that arise from these transactions. We recognize revenue and corresponding accounts receivable according to ASC 606 and, at times, recognize revenue in advance of the time when contracts give us the right to invoice a customer. We may also receive consideration, per the terms of a contract, from customers prior to transferring goods to the customer. We record customer deposits as a contract liability. Additionally, we may receive payments, most typically for service and warranty contracts, at the onset of the contract and before the services have been performed. In such instances, we record a deferred revenue liability. We recognize these contract liabilities as sales after all revenue recognition criteria are met. The table below shows the balance of contract assets and liabilities as of June 30, 2018 and March 31, 2019, including the change between the periods.

### **Contract Assets (in thousands)**

	June 30, 2018	March 31, 2019	Change	% Change
Unbilled revenue	\$ 13,087	\$ 25,590	\$ 12,503	96%

### **Contract Liabilities (in thousands)**

	June 30, 2018	March 31, 2019	Change	% Change
Advances from customers	\$ 55,761	\$ 60,016	\$ 4,225	8%
Deferred revenue—current	28,899	34,710	5,811	20%
Deferred revenue—long-term	9,562	8,864	(698)	(7)%

*Remaining Performance Obligations.* Remaining performance obligations related to ASC 606 represent the aggregate transaction price allocated to performance obligations under an original contract with a term greater than one year which are fully or partially unsatisfied at the end of the period. As of March 31, 2019, the aggregate amount of the transaction price allocated to remaining performance obligations was approximately \$178.4 million. We expect to recognize revenue on approximately 44% of the remaining performance obligations over the next 12 months, and the remainder is expected to be recognized thereafter.

*Practical Expedients.* In cases where we are responsible for shipping after the customer has obtained control of the goods, we have elected to treat the shipping activities as fulfillment activities rather than as a separate performance obligation. Additionally, we have elected to capitalize the cost to obtain a contract only if the period of amortization would be longer than one year. We only give consideration to whether a customer agreement has a financing component if the period of time between transfer of goods and services and customer payment is greater than one year.

### *Recently Adopted Accounting Pronouncements*

#### **Revenue Recognition**

As discussed above, we adopted ASC 606 on July 1, 2018 using the modified retrospective method, whereby the adoption does not impact any prior periods.

### **Statement of Cash Flows**

In August 2016, the FASB issued ASU 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments*. The update was issued with the objective of reducing the existing diversity in practice in how certain cash receipts and cash payments are presented and classified in the statement of cash flows under Topic 230 and other topics. We adopted this ASU effective July 1, 2018 using the retrospective approach and the initial adoption had no material effect on our condensed consolidated statement of cash flows.

### **Income Taxes**

In October 2016, the FASB issued ASU 2016-16, *Income Taxes (Topic 740): Intra-Entity Asset Transfers of Assets Other than Inventory*. The new guidance eliminates the exception for intra-entity transfers other than inventory and requires the recognition of current and deferred income taxes resulting from such a transfer when the transfer occurs. We adopted this ASU effective July 1, 2018 using the modified retrospective transition method resulting in a reclassification in the balance sheet of \$3 million to decrease prepaid expenses and other assets and increase deferred tax assets.

### *Recently Issued Accounting Pronouncements Not Yet Adopted*

### **Leases**

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. This guidance requires lessees to recognize assets and liabilities on the balance sheet for the rights and obligations created by leases with terms of more than 12 months. The ASU also will require qualitative and quantitative disclosures designed to give financial statement readers information on the amount, timing, and uncertainty of cash flows arising from leases. This ASU is effective for us in the first quarter of fiscal 2020 with early adoption permitted. We plan to adopt the new lease standard effective July 1, 2019, and apply it using the new transition method, under which an entity initially applies the new standard at the adoption date, versus at the beginning of the earliest period presented, and recognizes a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. We continue to assess and have not yet made a determination on whether to elect the package of transition practical expedients. In preparation for implementation, we plan to use a software solution to assist with the new reporting requirements and continue to assess the effect of the guidance on existing accounting policies and the consolidated financial statements. We expect the valuation of our right-of-use assets and lease liabilities, previously described as operating leases, to approximate the present value of our forecasted future lease commitments. We are currently implementing processes to comply with the measurement and disclosure requirements.

### **Retirement Benefit Plans**

In August 2018, the FASB issued authoritative guidance under ASU 2018-14, *Compensation—Retirement Benefits—Defined Benefit Plans—General: Disclosure Framework—Changes to the Disclosure Requirements for Defined Benefit Plans*. This ASU eliminates requirements for certain disclosures and requires additional disclosures under defined benefit pension plans and other post-retirement plans. We are required to adopt this new guidance in the first quarter of fiscal 2021. We are currently evaluating the potential impact of the adoption of this guidance on our consolidated financial statements.

### **Intangibles**

In August 2018, the FASB issued authoritative guidance under ASU 2018-15, *Intangibles—Goodwill and Other—Internal-Use Software: Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement that is a Service Contract*. This ASU requires implementation costs incurred by customers in cloud computing arrangements (i.e., hosting arrangements) to be capitalized under the same premises of authoritative guidance for internal-use software, and deferred over the noncancellable term of the cloud computing arrangements plus any option renewal periods that are reasonably certain to be exercised by the customer or for which the exercise is controlled by the service provider. We are required to adopt this new guidance in the first quarter of fiscal 2021. We are currently evaluating the potential impact of adoption of this guidance on our consolidated financial statements.

## **2. Business Combinations**

Under ASU 805, *Business Combinations* the acquisition method of accounting requires us to record assets acquired less liabilities assumed in an acquisition at their estimated fair values at the date of acquisition. Any excess of the total estimated purchase price over the estimated fair value of the assets acquired less liabilities assumed should be recorded as goodwill. Such valuations require management to make significant estimates and assumptions, especially with respect to intangible assets. Significant estimates in valuing certain intangible assets include, but are not limited to, future expected cash flows from acquired customers, acquired technology, trade names, useful lives and discount rates. Management's estimates of fair value are based upon assumptions believed to be reasonable but which are inherently uncertain and unpredictable and, as a result, actual results may differ from estimates. We may record adjustments to the assets acquired and liabilities assumed, with corresponding adjustments to goodwill, during the one-year post-acquisition measurement period as additional information becomes available. Upon the conclusion of the measurement period, any subsequent adjustments are reflected in reported earnings.

[Table of Contents](#)*Fiscal Year 2019 Business Acquisitions*

In July 2018, we (through our Optoelectronics and Manufacturing division) acquired an optoelectronics solutions business for \$17.5 million, plus up to \$1 million in potential contingent consideration, which may be earned over an 18-month period. The acquisition was financed with cash on hand and borrowings under our existing revolving bank line of credit. The goodwill recognized for this business is expected to be deductible for income tax purposes.

In August 2018, we (through our Security division) completed an acquisition of a privately held services company for approximately \$0.8 million, plus up to approximately \$5 million in contingent consideration, which may be earned over a five-year period. The acquisition was financed with cash on hand. The goodwill recognized for this business is not expected to be deductible for income tax purposes.

In January 2019, we (through our Security division) completed an acquisition of a privately held sales and services company. The acquisition was financed with cash on hand and was in an amount determined to be insignificant by management.

These business acquisitions, individually and in the aggregate, were not material to our consolidated financial statements. Accordingly, pro-forma historical results of operations related to these businesses have not been presented.

*Fiscal Year 2018 Business Acquisitions**Acquisition of Explosive Trace Detection Business*

On July 7, 2017, we acquired the global explosive trace detection business (“ETD”) from Smiths Group plc. This acquisition was a carve out from a larger entity. We financed the total purchase price of \$80.5 million with a combination of cash on hand and borrowings under our revolving bank line of credit. Pro-forma results were not presented because, based on the date of the acquisition, there was not a material difference between pro-forma and actual results in the condensed consolidated financial statements of operations for the nine months ended March 31, 2018 and 2019.

The valuation of certain assets and liabilities of ETD were performed by a third party valuation specialist. The final allocation was as follows:

Cash and cash equivalents	\$	4
Accounts receivable		15,517
Inventories		11,678
Property and equipment		1,599
Intangible assets		30,370
Deferred tax asset		2,738
Other long-term assets		297
Accounts payable		(4,784)
Accrued payroll and related expenses		(2,116)
Deferred revenues—current		(924)
Accrued warranties		(2,068)
Advances from customers		(670)
Other accrued expenses and current liabilities		(1,074)
Deferred revenues—long term		(232)
Net assets acquired		50,335
Goodwill		30,132
Total consideration	\$	80,467



[Table of Contents](#)

The goodwill is largely attributable to expected growth, intellectual capital and the assembled workforce of the ETD business. Intangible assets were recorded at fair value, as determined by management based on available information, with assistance from a third party. The fair value attributed to the intangible assets acquired was based on estimates, assumptions and other information compiled by management, and valuations resulting from established valuation techniques. The value attributed to goodwill and intangible assets is partially non-deductible for income tax purposes. The following table summarizes the fair value of acquired identifiable intangible assets as of the acquisition date (amounts in thousands):

	<u>Weighted Average Estimated Lives</u>	<u>Fair Value</u>
Developed technology	10 years	\$ 14,210
Customer relationships/backlog	7 years	16,070
In-process research and development ("IPR&D")		90
Total intangible assets		<u>\$ 30,370</u>

*Other Fiscal Year 2018 Business Acquisitions*

In July 2017, we (through our Security division) completed an acquisition of a privately held technology company. The acquisition was financed with cash on hand and was in an amount including potential earnout consideration determined to be insignificant by management.

In January 2018, we (through our Optoelectronics and Manufacturing division) acquired an electronics component designer and manufacturer for approximately \$22 million, plus up to \$6 million in contingent consideration, which may be earned over a three-year period. The goodwill recognized for this business is not expected to be deductible for income tax purposes. The acquisition was financed with cash on hand and borrowings under our revolving bank line of credit.

**3. Balance Sheet Details**

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

	<u>June 30, 2018</u>	<u>March 31, 2019</u>
Accounts receivable	\$ 225,336	\$ 234,411
Less allowance for doubtful accounts	(14,592)	(15,978)
Total	<u>\$ 210,744</u>	<u>\$ 218,433</u>

  

	<u>June 30, 2018</u>	<u>March 31, 2019</u>
Raw materials	\$ 156,612	\$ 151,383
Work-in-process	89,468	79,188
Finished goods	67,472	67,133
Total	<u>\$ 313,552</u>	<u>\$ 297,704</u>

[Table of Contents](#)

	June 30, 2018	March 31, 2019
Land	\$ 16,569	\$ 16,561
Buildings, civil works and improvements	56,585	55,322
Leasehold improvements	9,681	7,903
Equipment and tooling	117,294	127,579
Furniture and fixtures	3,331	3,202
Computer equipment	18,759	18,199
Computer software	19,509	19,647
Computer software implementation in process	4,318	7,747
Construction in process	790	4,682
Total	246,836	260,842
Less accumulated depreciation and amortization	(131,312)	(135,926)
Property and equipment, net	<u>\$ 115,524</u>	<u>\$ 124,916</u>

Depreciation expense was \$5.4 million and \$5.1 million for the three months ended March 31, 2018 and 2019, respectively, and approximately \$38.4 million and \$15.4 million for the nine months ended March 31, 2018 and 2019, respectively. The year-over-year decrease in depreciation for the nine months ended March 31, 2019 is due to certain assets becoming fully depreciated in fiscal year 2018, as well as the transfer of certain assets as discussed below.

In January 2018, we entered into a two-year agreement with the Mexican government to continue providing security screening services. Upon inception of the contract, we transferred certain fixed assets with a net book value of \$29.5 million to the customer, and this remaining cost to obtain the contract is amortized on a straightline basis over the term of the contract as corresponding revenues are recognized. During the three and nine months ended March 31, 2019, we recognized \$3.6 million and \$10.7 million, respectively, of amortization expense related to such assets. For the three and nine months ended March 31, 2018, we recognized \$3.2 million of amortization expense related to such assets. As of March 31, 2019, \$11.1 million was recorded within Prepaid expenses and other current assets.

#### 4. Goodwill and Intangible Assets

The changes in the carrying value of goodwill for the nine month period ended March 31, 2019 are as follows (in thousands):

	Security Division	Healthcare Division	Optoelectronics and Manufacturing Division	Consolidated
Balance as of June 30, 2018	\$ 191,810	\$ 40,157	\$ 60,246	\$ 292,213
Goodwill acquired or adjusted during the period	7,992	—	7,472	15,464
Foreign currency translation adjustment	(135)	6	(87)	(216)
Balance as of March 31, 2019	<u>\$ 199,667</u>	<u>\$ 40,163</u>	<u>\$ 67,631</u>	<u>\$ 307,461</u>

Intangible assets consisted of the following (in thousands):

	Weighted Average Lives	June 30, 2018			March 31, 2019		
		Gross Carrying Value	Accumulated Amortization	Intangibles Net	Gross Carrying Value	Accumulated Amortization	Intangibles Net
Amortizable assets:							
Software development costs	8 years	\$ 28,174	\$ (9,423)	\$ 18,751	\$ 28,706	\$ (11,730)	\$ 16,976
Patents	19 years	8,401	(1,618)	6,783	8,456	(1,785)	6,671
Developed technology	10 years	52,780	(9,706)	43,074	54,604	(13,861)	40,743
Customer relationships/ backlog	7 years	63,398	(17,891)	45,507	66,085	(22,842)	43,243
Total amortizable assets		152,753	(38,638)	114,115	157,851	(50,218)	107,633
Non-amortizable assets:							
Trademarks and trade names		25,596	—	25,596	26,509	—	26,509
IPR&D		2,290	—	2,290	2,290	—	2,290
Total intangible assets		<u>\$ 180,639</u>	<u>\$ (38,638)</u>	<u>\$ 142,001</u>	<u>\$ 186,650</u>	<u>\$ (50,218)</u>	<u>\$ 136,432</u>

[Table of Contents](#)

Amortization expense related to intangible assets was \$5.1 million and \$5.4 million for the three months ended March 31, 2018 and 2019, respectively. For the nine months ended March 31, 2018 and 2019, amortization expense was \$13.8 million and \$16.3 million, respectively. At March 31, 2019, the estimated future amortization expense of intangible assets was as follows (in thousands):

2019 (remaining 3 months)	\$	5,329
2020		20,022
2021		18,732
2022		14,832
2023		13,750
Thereafter, including assets that have not yet begun to be amortized		34,968
<b>Total</b>	<b>\$</b>	<b>107,633</b>

Software development costs for software products incurred before establishing technological feasibility are charged to operations. Software development costs incurred after establishing technological feasibility are capitalized on a product-by-product basis until the product is available for general release to customers at which time amortization begins. Annual amortization, charged to cost of goods sold, is the amount computed using the ratio that current revenues for a product bear to the total current and anticipated future revenues for that product. In the event that future revenues are not estimable, such costs are amortized on a straight line basis over the remaining estimated economic life of the product. Amortizable assets that have not yet begun to be amortized are included in Thereafter in the table above. For the three months ended March 31, 2018 and 2019, we capitalized software development costs in the amounts of \$1.0 million and \$0.8 million, respectively. For the nine months ended March 31, 2018 and 2019, we capitalized software development costs in the amounts of \$1.3 million and \$1.8 million, respectively.

**5. Impairment, restructuring and other charges**

*Impairment*

During the three and nine months ended March 31, 2019, there were no impairment charges. During the nine months ended March 31, 2018, we (i) abandoned a product line in our Security division that became redundant as a result of the ETD acquisition, (ii) abandoned a non-core product line in our Healthcare division, and (iii) abandoned certain trademarks in our Optoelectronics and Manufacturing division that were no longer used. As a result, \$7.1 million of assets, including intangible and fixed assets, were written off as we determined that these assets had no value and were permanently impaired.

*Restructuring and Other Charges*

We endeavor to align our global capacity and infrastructure with demand by our customers and also to fully integrate acquisitions, and thereby improve operational efficiency.

The following table summarizes impairment, restructuring and other charges for the periods set forth below (in thousands):

	<b>Three Months Ended March 31, 2018</b>				
	<b>Security Division</b>	<b>Healthcare Division</b>	<b>Optoelectronics and Manufacturing Division</b>	<b>Corporate</b>	<b>Total</b>
Impairment charges	\$ 91	\$ 3,946	\$ —	\$ —	\$ 4,037
Acquisition-related costs	—	—	—	77	77
Employee termination costs	18	3	269	—	290
Facility closures/consolidation	117	(8)	—	—	109
Legal and accrued settlement costs, net	—	5,766	—	3,783	9,549
<b>Total expensed</b>	<b>\$ 226</b>	<b>\$ 9,707</b>	<b>\$ 269</b>	<b>\$ 3,860</b>	<b>\$ 14,062</b>

	<b>Three Months Ended March 31, 2019</b>				
	<b>Security Division</b>	<b>Healthcare Division</b>	<b>Optoelectronics and Manufacturing Division</b>	<b>Corporate</b>	<b>Total</b>
Acquisition-related costs	\$ —	\$ —	\$ —	\$ —	\$ —
Employee termination costs	—	—	—	—	—
Facility closures/consolidation	—	—	—	—	—
Legal and accrued settlement costs, net	—	—	—	(1,777)	(1,777)
<b>Total expensed</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ (1,777)</b>	<b>\$ (1,777)</b>

Nine Months Ended March 31, 2018					
	Security Division	Healthcare Division	Optoelectronics and Manufacturing Division	Corporate	Total
Impairment charges	\$ 1,581	\$ 4,525	\$ 1,075	\$ —	\$ 7,181
Acquisition-related costs	—	—	—	1,258	1,258
Employee termination costs	348	3	415	—	766
Facility closures/consolidation	198	235	—	—	433
Legal and accrued settlement costs, net	—	9,966	—	3,885	13,851
Total expensed	<u>\$ 2,127</u>	<u>\$ 14,729</u>	<u>\$ 1,490</u>	<u>\$ 5,143</u>	<u>\$ 23,489</u>
Nine Months Ended March 31, 2019					
	Security Division	Healthcare Division	Optoelectronics and Manufacturing Division	Corporate	Total
Acquisition-related costs	\$ —	\$ —	\$ 287	\$ —	\$ 287
Employee termination costs	—	1,442	133	—	1,575
Facility closures/consolidation	—	2,084	—	—	2,084
Legal and accrued settlement costs, net	—	—	—	(2,792)	(2,792)
Total expensed	<u>\$ —</u>	<u>\$ 3,526</u>	<u>\$ 420</u>	<u>\$ (2,792)</u>	<u>\$ 1,154</u>

The changes in the accrued liability for restructuring and other charges for the nine month period ended March 31, 2019 were as follows (in thousands):

	Acquisition-related Costs	Employee Termination Costs	Facility Closure/Consolidation Cost	Legal and Settlement Charges	Total
Balance as of June 30, 2018	\$ —	\$ 837	\$ 399	\$ 14,065	\$ 15,301
Restructuring and other charges, net	287	1,575	2,084	(2,792)	1,154
Payments and other adjustments	(287)	(2,147)	(2,163)	(1,195)	(5,792)
Balance as of March 31, 2019	<u>\$ —</u>	<u>\$ 265</u>	<u>\$ 320</u>	<u>\$ 10,078</u>	<u>\$ 10,663</u>

## 6. Borrowings

### *Revolving Credit Facility*

In December 2016, we entered into an amendment to our revolving credit facility, which, among other things, increased the aggregate committed amount available to us from \$450 million to \$525 million and extended the maturity date to December 2021. The credit facility includes a \$300 million sub limit for letters of credit. Under certain circumstances, we have the ability to increase the facility by the greater of \$250 million or such amount as would not cause our secured leverage ratio to exceed a specified level. Borrowings under this facility bear interest at LIBOR, or a comparable rate in accordance with the terms of the credit agreement, plus a margin of 1.50% as of March 31, 2019 (which margin can range from 1.25% to 2.0% based on our consolidated net leverage ratio as defined in the credit facility). Letters of credit reduce the amount available to borrow by their face value. The unused portion of the facility bears a commitment fee of 0.20% as of March 31, 2019, but this fee can range from 0.20% to 0.30% based on our consolidated net leverage ratio as defined in the credit facility. Our borrowings under the credit agreement are guaranteed by certain of our U.S. based subsidiaries and are secured by substantially all of our assets and the assets of certain of our subsidiaries. The credit agreement contains various representations and warranties, affirmative, negative and financial covenants and conditions of default. As of March 31, 2019, there was \$124.0 million of borrowings outstanding under the revolving credit facility and \$59.1 million outstanding under the letters of credit sub-facility. The amount available to borrow under the credit facility as of March 31, 2019 was \$341.9 million. Loan amounts under the revolving credit facility may be borrowed, repaid and re-borrowed during the term. Although the principal amount of each revolving loan is due and payable in full on the maturity date, we have the right to repay each revolving loan in whole or in part from time to time without penalty. It is our practice to routinely borrow and repay several times per year under this revolving credit facility. Therefore, borrowings under the credit facility are included in current liabilities. As of March 31, 2019, we are in compliance with all covenants under this credit facility.

## [Table of Contents](#)

On April 23, 2019, we entered into an amendment to our revolving credit facility, which, among other things (i) increases the size of the credit facility to \$535 million, (ii) extends the maturity date to April 2024, (iii) reduces the margin rate by 0.25% for each pricing tier and (iv) reduces the unused commitment fee.

### *1.25% Convertible Senior Notes Due 2022*

In February 2017, we issued \$287.5 million of the Notes in a private offering. The Notes are governed by an indenture dated February 22, 2017. The maturity for the payment of principal is September 1, 2022. The Notes bear interest at the rate of 1.25% payable in cash semiannually in arrears on each March 1 and September 1. The Notes are senior unsecured obligations and rank senior in right of payment to any of our indebtedness that is expressly subordinated in right of payment to the Notes; equal in right of payment to any of our unsecured indebtedness that is not so subordinated; effectively junior in right of payment to any of our secured indebtedness to the extent of the value of the assets securing such indebtedness; and structurally junior to all indebtedness and other liabilities (including trade payables) of our subsidiaries, as well as any of our existing and future indebtedness that may be guaranteed by our subsidiaries to the extent of such guarantees (including the guarantees of certain of our subsidiaries under our existing revolving credit facility).

The Notes are convertible prior to March 1, 2022 only upon specified events and during specified periods and are, thereafter convertible, at any time, in each case at an initial conversion rate of 9.3056 per \$1,000 principal amount of the Notes, which is equal to an initial conversion price of approximately \$107.46 per share or a 38.5% premium to our stock price at the time of the issuance. The conversion rate is subject to adjustment upon certain events. Upon conversion, the Notes may be settled, at our election, in shares of our common stock, cash or a combination of cash and shares of common stock. We have initially elected a combination settlement method to satisfy the conversion obligation, which allows us to settle the principal amount of the Notes in cash and to settle the excess conversion value, if any, in shares of common stock, and cash in lieu of fractional shares.

We may not redeem the Notes prior to March 6, 2020. Thereafter, we may redeem the Notes if the last reported sale price of our common stock has been at least 130% of the conversion price then in effect for at least 20 trading days (whether or not consecutive) during any period of 30 consecutive trading days. If we undergo a fundamental change, as defined in the indenture for the Notes, subject to certain conditions, holders of the Notes may require us to repurchase all or part of the Notes for cash at a price equal to 100% of the principal amount of the Notes to be repurchased, plus any accrued and unpaid interest to, but excluding, the fundamental change repurchase date. The occurrence of a fundamental change will also result in the Notes becoming immediately convertible.

Pursuant to ASC 470-20, we allocated the \$287.5 million gross proceeds of the Notes between liability and equity components. The initial \$242.4 million liability component was determined based on the fair value of similar debt instruments excluding the conversion feature for similar terms and priced on the same day the Notes were issued. The initial \$45.1 million equity component represents the debt discount and was calculated as the difference between the fair value of the debt and the gross proceeds of the Notes. Issuance costs of \$7.7 million were allocated between debt (\$6.5 million) and equity (\$1.2 million) components with the portion allocated to the debt presented as an offset against long term debt in the consolidated balance sheet and amortized as interest expense over the life of the Notes using the effective interest method. The total interest expense related to the Notes for the three and nine months ended March 31, 2019 was \$3.2 million and \$9.4 million, respectively, which consisted of \$0.9 million and \$2.7 million of contractual interest expense, \$2.0 million and \$5.8 million of debt discount amortization, and \$0.3 million and \$0.9 million of amortization of debt issuance costs. The total interest expense related to the Notes for the three and nine months ended March 31, 2018 was \$3.1 million and \$9.2 million, respectively, which consisted of \$0.9 million and \$2.7 million of contractual interest expense, \$1.9 million and \$5.6 million of debt discount amortization, and \$0.3 million and \$0.9 million of amortization of debt issuance costs. As of March 31, 2019, the unamortized debt discount was \$29.3 million which is being amortized over the remaining contractual term to maturity of the Notes using an effective interest rate of 4.50%. The unamortized debt issuance cost of \$4.0 million as of March 31, 2019 is amortized on a straight-line basis, which approximates the effective interest method, over the life of the Notes. Based on our March 31, 2019 stock price of \$87.60 per share, the "if-converted" value of the Notes did not exceed the principal amount.

### *Other Borrowings*

Several of our foreign subsidiaries maintain bank lines of credit, denominated in local currencies and U.S. dollars, primarily for the issuance of letters of credit. As of March 31, 2019, \$53.3 million of letters of credit were outstanding under these credit facilities. As of March 31, 2019, the total amount available under these credit facilities was \$15.1 million.

In September 2012, we entered into a seven year term loan agreement for \$11.1 million to fund the acquisition of land and a building in the state of Washington. The principal on the loan, together with interest at LIBOR plus 1.25%, is payable on a monthly basis over seven years. The outstanding balance on this loan as of March 31, 2019 was \$0.9 million compared to a balance of \$2.1 million as of June 30, 2018. Concurrent with entering into the floating rate loan, we entered into an interest rate swap agreement that effectively locks the interest rate of the loan at 2.2% per annum for the term of the loan.

[Table of Contents](#)

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

	June 30, 2018	March 31, 2019
1.25% convertible notes due 2022:		
Principal amount	\$ 287,500	\$ 287,500
Unamortized discount	(35,133)	(29,281)
Unamortized debt issuance costs	(4,897)	(4,016)
1.25% convertible notes due 2022, net of unamortized discount and debt issuance costs	247,470	254,203
Term loans	2,114	925
Other long-term debt	1,658	1,985
	251,242	257,113
Less current portion of long-term debt	(2,262)	(1,702)
Long-term portion of debt	<u>\$ 248,980</u>	<u>\$ 255,411</u>

## 7. Stockholders' Equity

### Stock-based Compensation

As of March 31, 2019, we maintained the Amended and Restated 2012 Incentive Award Plan (the "2012 Plan") and the Amended and Restated 2006 Equity Participation Plan ("2006 Plan") as stock-based employee compensation plans. No further grants may be made under the 2006 Plan. In addition, pursuant to the acquisition of American Science and Engineering, Inc. ("AS&E"), we assumed two stock-based employee compensation plans: the AS&E 2005 Equity and Incentive Plan and the AS&E 2014 Equity and Incentive Plan (collectively the "AS&E Plans"). No new equity grants will be made under the AS&E Plans. The 2012 Plan, the 2006 Plan, and the AS&E Plans are collectively referred to as the "OSI Plans".

We recorded stock-based compensation expense in the condensed consolidated statements of operations as follows (in thousands):

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2018	2019	2018	2019
Cost of goods sold	\$ 251	\$ 182	\$ 739	\$ 539
Selling, general and administrative	5,614	5,543	16,574	18,487
Research and development	149	163	441	488
Stock-based compensation expense	<u>\$ 6,014</u>	<u>\$ 5,888</u>	<u>\$ 17,754</u>	<u>\$ 19,514</u>

As of March 31, 2019, total unrecognized compensation cost related to stock-based compensation grants under the OSI Plans were estimated at \$0.6 million for stock options and \$19.4 million for RSUs. We expect to recognize these costs over a weighted average period of 2.0 years with respect to the stock options and 1.9 years for grants of RSUs.

The following summarizes stock option activity during the nine months ended March 31, 2019:

	Number of Options	Weighted Average Exercise Price	Weighted- Average Remaining Contractual Term	Aggregate Intrinsic Value (in thousands)
Outstanding at June 30, 2018	677,525	\$ 32.80		
Granted	18,135	\$ 72.39		
Exercised	(108,008)	\$ 22.82		
Expired or forfeited	(9,618)	\$ 70.28		
Outstanding at March 31, 2019	<u>578,034</u>	<u>\$ 35.29</u>	2.6 years	\$ 30,247
Exercisable at March 31, 2019	<u>540,646</u>	<u>\$ 32.37</u>	2.1 years	<u>\$ 29,865</u>

[Table of Contents](#)

The following summarizes RSU award activity during the nine months ended March 31, 2019:

	Shares	Weighted-Average Fair Value
Nonvested at June 30, 2018	526,377	\$ 71.56
Granted	362,025	73.80
Vested	(357,924)	71.01
Forfeited	(13,669)	73.74
Nonvested at March 31, 2019	<u>516,809</u>	<u>\$ 73.45</u>

As of March 31, 2019, there were approximately 1.6 million shares available for grant under the 2012 Plan. Under the terms of the 2012 Plan, RSUs granted from the pool of shares available for grant reduce the pool by 1.87 shares for each award granted. RSUs forfeited and returned to the pool of shares available for grant increase the pool by 1.87 shares for each award forfeited.

We granted 117,346 and 97,514 performance-based RSUs during the nine months ended March 31, 2018 and 2019, respectively. These performance based RSU awards are contingent on the achievement of certain performance metrics. The payout related to these awards can range from zero to 280% of the original number of shares or units awarded.

#### *Share Repurchase Program*

In March 2018, our Board of Directors authorized a share repurchase program of up to 1,000,000 shares. This program does not expire unless our Board of Directors acts to terminate the program. The timing and actual number of shares purchased depend on a variety of factors, including stock price, general business and market conditions and other investment opportunities and may be purchased through the open market. Upon repurchase, the shares are restored to the status of authorized but unissued, and we record them as a reduction in the number of shares of common stock issued and outstanding in our consolidated financial statements.

We did not repurchase any shares during the three months ended March 31, 2019. During the nine months ended March 31, 2019, we repurchased 288,316 shares of our common stock, and as of March 31, 2019, there were 562,707 shares available to repurchase under the program.

#### **8. Retirement Benefit Plans**

We sponsor various retirement benefit plans including qualified and nonqualified defined benefit pension plans for our employees. The components of net periodic pension expense are as follows (in thousands):

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2018	2019	2018	2019
Service cost	\$ 216	\$ 98	\$ 648	\$ 295
Interest cost	9	8	25	25
Amortization of prior service cost	70	14	210	42
Net periodic pension expense	<u>\$ 295</u>	<u>\$ 120</u>	<u>\$ 883</u>	<u>\$ 362</u>

For each of the three months ended March 31, 2018 and 2019, we made no contributions to these defined benefit plans. For each of the nine months ended March 31, 2018 and 2019, we made contributions of \$1.0 million to these defined benefit plans.

We also maintain various defined contribution plans. For each of the three months ended March 31, 2018 and 2019, we made contributions of \$1.6 million to these defined contribution plans. For the nine months ended March 31, 2018 and 2019, we made contributions of \$4.6 million and \$4.7 million, respectively, to these defined contribution plans.

#### **9. Commitments and Contingencies**

##### *Contingent Acquisition Obligations*

Under the terms and conditions of the purchase agreements associated with certain acquisitions, we may be obligated to make additional payments based on the achievement of certain sales or profitability milestones through the acquired operations. For agreements that contain contingent consideration caps, the maximum amount of such potential future payments is \$28.7 million as of March 31, 2019. In addition, we are required to make royalty payments through 2022 based on the license of, or sales of products containing, the technology of CXR Limited, a company acquired in 2004.

We account for such contingent payments for acquisitions which occurred through the end of fiscal year 2009 as additions to the purchase price of the acquired business; and we made \$1.3 million of such payments during the nine months ended March 31, 2019.

## [Table of Contents](#)

No payments were made during the three months ended March 31, 2019. For acquisitions completed after fiscal 2009, pursuant to Financial Accounting Standard 141R, which was codified into ASC 805, the estimated fair value of these obligations is recorded as a liability at the time of the acquisition with subsequent revisions recorded in Selling, general and administrative expense in the consolidated financial statements. The estimated fair value measurements of contingent earn-out obligations are primarily based on unobservable inputs, which may include projected revenues, gross margins, operating income, and the estimated probability of achieving the earn-outs.

These projections and probabilities are used to estimate future contingent earnout payments, which are discounted back to present value to compute contingent earnout liabilities. The following table provides a roll-forward from June 30, 2018 to March 31, 2019 of the contingent consideration liability, which is included in Other accrued expenses and current liabilities, and Other long-term liabilities in our consolidated balance sheets:

Beginning fair value, June 30, 2018	\$	15,713
Additions		5,173
Change in fair value		(512)
Payments		(3,505)
Ending fair value, March 31, 2019	\$	<u>16,869</u>

### *Environmental Contingencies*

We are subject to various environmental laws. Our practice is to conduct appropriate environmental investigations at our manufacturing facilities in North America, Asia Pacific, and Europe, and, to the extent practicable, on all new properties in order to identify, as of the date of such investigation, potential areas of environmental concern related to past and present activities or from nearby operations. In certain cases, we have conducted further environmental assessments consisting of soil and groundwater testing and other investigations deemed appropriate by independent environmental consultants.

We continue to investigate contamination of the soil and groundwater beneath our Hawthorne, California facility that resulted from unspecified on and off site releases occurring prior to our occupancy. We believe the releases are of a historical nature and not uncommon to the region in general. We continue to take voluntary actions, in cooperation with the local governing agency, to investigate the site in order to develop appropriate remedial actions. We have not accrued for loss contingencies relating to the Hawthorne facility or any other environmental matters because we believe that, although unfavorable outcomes are possible, they are not considered by our management to be probable and reasonably estimable. If one or more of these environmental matters are resolved in a manner adverse to us, the impact on our business, financial condition, results of operations and cash flow could be material.

### *Indemnifications and Certain Employment-Related Contingencies*

In the normal course of business, we have agreed to indemnify certain parties with respect to certain matters. We have agreed to hold certain parties harmless against losses arising from a breach of representations and warranties or covenants, or intellectual property infringement or other claims made by third parties. These agreements may limit the time within which an indemnification claim can be made and the amount of the claim. In addition, we have entered into indemnification agreements with our directors and certain of our officers. It is not possible to determine the maximum potential indemnification amount under these indemnification agreements due to a limited history of prior indemnification claims and the unique facts and circumstances involved in each particular agreement. We have not recorded any liability for costs related to contingent indemnification obligations as of March 31, 2019.

On December 31, 2017, we and Deepak Chopra, our Chief Executive Officer, entered into an amendment to Mr. Chopra's employment agreement that, among other things, provides for a \$13.5 million bonus payment to Mr. Chopra on or within 45 days of January 1, 2024 contingent upon Mr. Chopra's continued employment with us through that date, subject to accelerated payout terms in the event of Mr. Chopra's death or disability. The bonus is recorded in the financial statements over the remaining term of the employment agreement and is included in Other long-term liabilities.

### *Product Warranties*

We offer our customers warranties on many of the products that we sell. 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, we record a provision for estimated warranty expenses with a corresponding increase in cost of goods sold. The warranty provision also includes estimated warranty expenses assumed as part of business acquisitions. We periodically adjust this provision based on historical experience and anticipated expenses. We charge actual expenses of repairs under warranty, including parts and labor, to this provision when incurred. The warranty provision is included in Other accrued expenses and current liabilities in the consolidated balance sheets.



## [Table of Contents](#)

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

	Nine Months Ended March 31,	
	2018	2019
Balance at beginning of period	\$ 15,178	\$ 21,819
Additions	9,191	7,365
Acquisitions and adjustments	1,240	(230)
Reductions for warranty repair costs	(5,219)	(6,545)
Balance at end of period	\$ 20,390	\$ 22,409

### *Legal Proceedings*

In December 2017, a short seller released a report regarding our compliance with the FCPA. Following that report, we and certain of our executive officers have been named as defendants in several lawsuits in the United States District Court for the Central District of California (the “District Court”) that were filed in December 2017 and February 2018. Each of the complaints closely tracks the allegations set forth in the short seller’s report. All of the actions, which were consolidated by the District Court in March 2018 in an action captioned *Arkansas Teacher Retirement System et al. v. OSI Systems, Inc. et al.*, No. 17 cv 08841, allege violations of Sections 10(b) and 20(a) of Exchange Act, relating to certain of our public statements and filings with the SEC, and seek damages and other relief based upon the allegations in the complaints. In April and May 2018, two shareholder derivative complaints were filed purportedly on behalf of the Company against the current members of our Board of Directors (as individual defendants), a former member of our Board of Directors, and certain members of management. The first, captioned *Riley v. Chopra et al.*, No. 18 cv 03371, was filed in the District Court, and the second, captioned *Genesee County Employees’ Retirement System v. Chopra, et al.*, No. BC705958, was filed in the Superior Court of the State of California, County of Los Angeles. In March 2019, a third shareholder derivative complaint captioned *Kocen v. Chopra et al.*, No. 19 cv 01741 was filed in the District Court purportedly on behalf of the Company against the current members of our Board of Directors (as individual defendants) and one former member of our Board of Directors. The complaints allege, among other things, breach of fiduciary duties relating to the allegations contained in the above-mentioned short seller report. The complaints seek damages, restitution, injunctive relief, attorneys’ and experts’ fees, costs, expenses, and other unspecified relief. We believe that these actions are without merit and intend to defend them vigorously, and we expect to incur costs associated with defending against these actions. At this early stage of the litigations, the ultimate outcomes are uncertain and we cannot reasonably predict the timing or outcomes, or estimate the amount of loss, if any, or their effect, if any, on our financial statements.

Following the short seller report, both the SEC and the DOJ commenced investigations into our compliance with the FCPA. The SEC has subpoenaed documents from the Company, and we are responding to that subpoena and providing the same documents to the DOJ. At this time, we are unable to predict what, if any, action may be taken by the DOJ or SEC as a result of these FCPA related investigations, or any penalties or remedial measures these agencies may seek. In an unrelated matter, the SEC and DOJ are also conducting an investigation of trading in our securities and have each subpoenaed information regarding trading by executives, directors, and employees, as well as our operations and disclosures in and around the time of certain trades. With respect to these trading related matters, we have taken action with respect to a senior level employee. At this time, we are unable to predict what, if any, action may be taken by the DOJ or SEC as a result of these trading related investigations, or any penalties or remedial measures these agencies may seek. We place a high priority on compliance with our anti corruption and securities trading policies and are cooperating with each of the government investigations.

We are involved in various other claims and legal proceedings arising in the ordinary course of business. In our opinion after consultation with legal counsel, the ultimate disposition of such proceedings is not likely to have a material adverse effect on our business, financial condition, results of operations or cash flows. We have not accrued for loss contingencies relating to any such matters because we believe that, although unfavorable outcomes in the proceedings are possible, they are not considered by management to be probable and reasonably estimable. If one or more of these matters are resolved in a manner adverse to our company, the impact on our business, financial condition, results of operations and cash flows could be material.

### **10. Income Taxes**

The Tax Cuts and Jobs Act (the “Tax Act”) enacted in 2017 resulted in the U.S. Federal income tax rate being reduced from 35% to 21% effective January 1, 2018. During the measurement period, which is one year from the date of enactment, or the completion of all estimates made in connection with the Tax Act, companies are permitted to make additional income tax adjustments and revisions of estimates related to the Tax Act. During the quarter ended December 31, 2018, we concluded our analysis of the impact of the Tax Act and made no adjustments to the provisional amounts previously recorded. While our accounting for the recorded impact of the Tax Act as of December 31, 2018 was deemed to be complete, this amount was based on prevailing regulations and available information as of December 31, 2018. Additional guidance issued by the Internal Revenue Service (IRS) and changes to State laws may continue to impact our recorded amounts after December 31, 2018.

[Table of Contents](#)

The Tax Act subjects a U.S. corporation to tax on its GILTI (Global Intangible Low Income Tax), FDII (Foreign-Derived Tangible Income Taxes), and BEAT (Base Erosion Anti-abuse Tax). We included the impact of these taxes in our forecast effective tax rate. Interpretive guidance on the accounting for GILTI states that an entity can make an accounting policy election to either recognize deferred taxes for temporary basis differences expected to reverse as GILTI in future years or provide for the tax expense related to GILTI in the year the tax is incurred as a period expense only. In fiscal 2019, we made the accounting policy election to recognize GILTI as a period expense.

The determination of the annual effective tax rate is based upon a number of significant estimates and judgments, including the estimated annual pretax income in each tax jurisdiction in which we operate, and the development of tax planning strategies during the year. In addition, as a global commercial enterprise, our tax expense can be impacted by changes in tax rates or laws, such as the Tax Act, the finalization of tax audits and reviews, and other factors that cannot be predicted with certainty. As such, there can be significant volatility in interim tax provisions.

Our effective tax rate for the three and nine months ended March 31, 2019 was 26.0% and 24.2%, respectively. Excluding certain discrete tax items, the adjusted effective tax rate for the three and nine months ended March 31, 2019 was 28.6% and 28.4%, respectively. During the three and nine month periods ended March 31, 2019, we recognized tax benefits for equity-based compensation of \$0.7 million and \$2.6 million, respectively, under ASU 2016-09. As a result of the enactment of the Tax Act in December 2017, we recognized a charge of \$56 million in the second quarter of fiscal 2018. Our reported tax rate was 18.1% for the third quarter of fiscal 2018, and 210.0% for the first nine months of fiscal 2018, which includes the Tax Act charge. The adjusted effective tax rate, excluding the Tax Act related charge and certain discrete tax items, was 28.2% for the three and nine months ended March 31, 2018.

## 11. Segment Information

We have determined that we operate in three identifiable industry segments: (a) security and inspection systems (Security division), (b) medical monitoring and diagnostic cardiology systems (Healthcare division) and (c) optoelectronic devices and manufacturing (Optoelectronics and Manufacturing division). We also have a corporate segment (Corporate) that includes executive compensation and certain other general and administrative expenses; expenses related to stock issuances and legal, audit and other professional service fees not allocated to industry segments. Both the Security and Healthcare divisions comprise primarily end-product businesses whereas the Optoelectronics and Manufacturing division primarily supplies components and subsystems to OEM customers, as well as the Security and Healthcare divisions. Sales between divisions are at transfer prices that approximate market values. All other accounting policies of the segments are the same as described in Note 1, Summary of Significant Accounting Policies of the Form 10-K for the fiscal year ended June 30, 2018.

The following tables set forth the results of operations and identifiable assets by industry segment (in thousands):

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2018	2019	2018	2019
<b>Revenues (1) — by Segment:</b>				
Security division	\$ 170,270	\$ 193,486	\$ 504,784	\$ 552,130
Healthcare division	43,758	48,865	141,793	138,697
Optoelectronics and Manufacturing division, including intersegment revenues	66,212	70,927	189,024	213,900
Intersegment revenues elimination	(12,941)	(8,994)	(33,641)	(30,989)
Total	<u>\$ 267,299</u>	<u>\$ 304,284</u>	<u>\$ 801,960</u>	<u>\$ 873,738</u>
	Three Months Ended March 31,		Nine Months Ended March 31,	
	2018	2019	2018	2019
<b>Income (loss) from operations — by Segment:</b>				
Security division	\$ 21,028	\$ 24,943	\$ 66,192	\$ 74,056
Healthcare division	(8,425)	5,418	(6,975)	5,752
Optoelectronics and Manufacturing division	6,547	7,320	16,224	22,212
Corporate	(10,730)	(5,354)	(28,601)	(21,265)
Eliminations (2)	(677)	(207)	(1,556)	(671)
Total	<u>\$ 7,743</u>	<u>\$ 32,120</u>	<u>\$ 45,284</u>	<u>\$ 80,084</u>

[Table of Contents](#)

	June 30, 2018	March 31, 2019
Assets — by Segment:		
Security division	\$ 804,527	\$ 798,215
Healthcare division	167,611	154,212
Optoelectronics and Manufacturing division	220,373	245,176
Corporate	66,453	90,258
Eliminations (2)	(3,273)	(3,746)
Total	<u>\$ 1,255,691</u>	<u>\$ 1,284,115</u>

- (1) For the nine months ended March 31, 2018, one customer, Servicio de Administración Tributaria (“SAT”) in Mexico, accounted for 11% of total net revenues. For the three months ended March 31, 2018 and the three and nine months ended March 31, 2019, no customer accounted for greater than 10% of total net revenues.
- (2) Eliminations within operating income primarily reflect the change in the elimination of intercompany profit in inventory not-yet-realized. Eliminations in assets reflect the amount of intercompany profits in inventory as of the balance sheet date. Such intercompany profit will be realized when inventory is shipped to the external customers of the Security and Healthcare divisions.

## ITEM 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

In this report, “OSI”, the “Company”, “we”, “us”, “our” and similar terms refer to OSI Systems, Inc. together with our wholly-owned subsidiaries.

This management’s discussion and analysis of financial condition as of March 31, 2019 and results of operations for the three and nine months ended March 31, 2019 should be read in conjunction with management’s discussion and analysis of financial condition and results of operations included in our Annual Report on Form 10-K for the fiscal year ended June 30, 2018.

### Forward-Looking Statements

*This report contains “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). Forward-looking statements relate to current expectations, beliefs, and projections concerning matters that are not historical facts. Words such as “project,” “believe,” “anticipate,” “plan,” “expect,” “intend,” “may,” “should,” “will,” “would,” and similar words and expressions are intended to identify forward-looking statements. The expectations, beliefs, and projections reflected in the forward-looking statements may prove to be inaccurate, and actual results may differ materially from those reflected in such forward-looking statements. Important factors that could cause our actual results to differ materially from those expectations are disclosed in this report, our Annual Report on Form 10-K for the fiscal year ended June 30, 2018 (including Part I, Item 1, “Business,” Part I, Item 1A, “Risk Factors” and Part II, Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations”), and other documents filed by us from time to time with the SEC. 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. For example, we could be exposed to a variety of negative consequences as a result of delays related to the award of domestic and international contracts; failure to secure the renewal of key customer contracts; delays in customer programs; delays in revenue recognition related to the timing of customer acceptance; unanticipated impacts of sequestration and other U.S. Government budget control provisions; changes in domestic and foreign government spending, budgetary, procurement and trade policies adverse to our businesses; global economic uncertainty; unfavorable currency exchange rate fluctuations; effect of changes in tax legislation, including the Tax Act; market acceptance of our new and existing technologies, products and services; our ability to win new business and convert any orders received to sales within the fiscal year; enforcement actions in respect of any noncompliance with laws and regulations including export control and environmental regulations and the matters that are the subject of some or all of our ongoing investigations and compliance reviews, contract and regulatory compliance matters, and actions, if brought, resulting in judgments, settlements, fines, injunctions, debarment or penalties, and other risks and uncertainties, including, but not limited to, those detailed herein and from time to time in our other SEC filings, which could have a material and adverse impact on our business, financial condition and results of operations. All forward-looking statements contained in this report are qualified in their entirety by this statement. Moreover, we operate in a very competitive and rapidly changing environment. New risks emerge from time to time. It is not possible for our management to predict all risks, nor can we assess the impact of all factors on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements we may make. In light of these risks, uncertainties, and assumptions, the future events and trends discussed in this report may not occur, and actual results could differ materially and adversely from those anticipated or implied in the forward-looking statements. Investors should not place undue reliance on forward-looking statements as a prediction of actual results. 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.*

## Executive Summary

We are a vertically integrated designer and manufacturer of specialized electronic systems and components for critical applications. We sell our products and provide related services in diversified markets, including homeland security, healthcare, defense and aerospace. We have three operating divisions: (a) Security, providing security and inspection systems and turnkey security screening solutions; (b) Healthcare, providing patient monitoring and diagnostic cardiology systems; and (c) Optoelectronics and Manufacturing, providing specialized electronic components for our Security and Healthcare divisions, as well as to third parties for applications in the defense and aerospace markets, among others.

*Security Division.* Through our Security division, we provide security screening products and services globally, as well as turnkey security screening solutions. These products and services are used to inspect baggage, parcels, cargo, people, vehicles and other objects for weapons, explosives, drugs, radioactive and nuclear materials and other contraband. Revenues from our Security division accounted for 63% of our total consolidated revenues for each of the nine months ended March 31, 2018 and 2019.

*Healthcare Division.* Through our Healthcare division, we design, manufacture, market and service patient monitoring and diagnostic cardiology systems globally for sale primarily to hospitals and medical centers. Our products monitor patients in critical, emergency and perioperative care areas of the hospital and provide 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 18% and 16% of our total consolidated revenues for the nine months ended March 31, 2018 and 2019, respectively.

*Optoelectronics and Manufacturing Division.* Through our Optoelectronics and Manufacturing division, we design, manufacture and market optoelectronic devices and flex circuits and provide electronics manufacturing services globally for use in a broad range of applications, including aerospace and defense electronics, security and inspection systems, medical imaging and diagnostics, telecommunications, office automation, computer peripherals, industrial automation, automotive diagnostic systems, and consumer products. We also provide our optoelectronic devices and electronics manufacturing services to OEM customers, and our own Security and Healthcare divisions. Revenues from external customers in our Optoelectronics and Manufacturing division accounted for 19% and 21% of our total consolidated revenues for the nine months ended March 31, 2018 and 2019, respectively.

*Acquisition Activity.* During the nine months ended March 31, 2019, we acquired an optoelectronics solutions business for \$17.5 million, plus up to \$1.0 million in potential earnout consideration, and also completed acquisitions of two small companies in our Security division. The acquisitions were financed with cash on hand and borrowings under our revolving bank line of credit.

## Trends and Uncertainties

The following is a discussion of certain trends and uncertainties that we believe have and may continue to influence our results of operations.

*Global Economic Considerations.* Global macroeconomic factors, coupled with the U.S. political climate, have created uncertainty and impacted demand for certain of our products and services primarily in our Security and Healthcare divisions. The current status and potential outcomes of Brexit negotiations has contributed to global economic uncertainty and could have an adverse impact on our UK business, including our orders and sales operations and personnel in the UK. We do not know how long this uncertainty will continue. Therefore, we expect that there may be a period of delayed or deferred purchasing by our customers. These factors could have a material negative effect on our business, results of operations and financial condition. Additionally, our international operations provide a significant portion of our total revenue and expenses. Many of these revenues and expenses are denominated in currencies other than the U.S. dollar, and, as a result, may be significantly affected by changes in foreign exchange rates.

*Global Trade.* The current domestic and international political environment, including existing and potential changes to U.S. and foreign policies related to global trade and tariffs, have resulted in uncertainty surrounding the future state of the global economy. Further, the U.S. government has announced that sanctions would be imposed against certain businesses and individuals in select countries. Additional changes may require us to modify our current business practices and could have a material adverse effect on our business, results of operations and financial condition in any particular reporting period.

[Table of Contents](#)

**Healthcare Considerations.** The results of our operations had been adversely impacted in prior periods by difficulties associated with product launches in our Healthcare division. These issues may continue to adversely impact our results of operations for additional periods. Additionally, there have been numerous efforts advanced by the Trump administration and Congress to repeal and replace or modify the Affordable Care Act, which has created uncertainty in the healthcare industry that has adversely impacted, and may continue to adversely impact, our results of operations.

**European Union Threat Detection Standards.** The European Union has implemented regulations for all airports within the EU to have hold baggage screening systems that are compliant with the European Civil Aviation Conference (ECAC) Standard 3 beginning in 2020. However, this deadline could potentially be delayed. Our Security division's real time tomography (RTT) product has passed the ECAC explosive detection system Standard 3 threat detection requirement.

**Government Policies.** Our net income could be affected by changes in U.S. or foreign government tax policies, such as the Tax Act, the implications and uncertainties of which are described elsewhere in this report. We attempt to manage our currency exposure in certain countries. Changes in government policies in these areas might impact our financial condition and results of operations.

**Results of Operations for the Three Months Ended March 31, 2018 (Q3 2018) Compared to Three Months Ended March 31, 2019 (Q3 2019) (amounts in millions)**

**Net Revenues**

The table below and the discussion that follows reflect the way in which we analyze our business. See Note 11 to the condensed consolidated financial statements for additional information about our business segments.

	Q3 2018	% of Net Revenues	Q3 2019	% of Net Revenues	\$ Change	% Change
Security	\$ 170.3	64%	\$ 193.5	64%	\$ 23.2	14%
Healthcare	43.7	16%	48.9	16%	5.2	12%
Optoelectronics / Manufacturing	53.3	20%	61.9	20%	8.6	16%
Total net revenues	<u>\$ 267.3</u>	<u>100%</u>	<u>\$ 304.3</u>	<u>100%</u>	<u>\$ 37.0</u>	<u>14%</u>

Revenues for the Security division during the three months ended March 31, 2019 increased primarily as a result of significant growth in sales of cargo and vehicle inspection equipment and explosive detection systems. These increases were partially offset by lower service revenue primarily as a result of the reduced revenues from the current contract with SAT in Mexico, as well as decreased sales of checkpoint equipment.

Revenues for the Healthcare division for the three months ended March 31, 2019 increased primarily driven by strong U.S. sales in our core patient monitoring business. In addition, the cardiology and supplies and accessories product lines reported modest year-over-year increases in revenue. These increases were partially offset by the de-emphasis of sales in, and exiting of, our anesthesia product line.

Revenues for the Optoelectronics and Manufacturing division for the three months ended March 31, 2019 increased primarily as a result of strong external sales growth in our commercial optoelectronics business along with modest growth in our contract manufacturing businesses as well as \$4.2 million in revenues from a business acquired in July 2018.

**Gross Profit**

	Q3 2018	% of Net Revenues	Q3 2019	% of Net Revenues
Gross profit	<u>\$ 97.6</u>	<u>36.5%</u>	<u>\$ 111.3</u>	<u>36.6%</u>

Gross profit during the three months ended March 31, 2019 increased as a result of the growth in net revenues. The gross margin for the quarter ended March 31, 2019 was relatively consistent with that of the same period in fiscal 2018.

**Operating Expenses**

	Q3 2018	% of Net Revenues	Q3 2019	% of Net Revenues	\$ Change	% Change
Selling, general and administrative	\$ 59.8	22.4%	\$ 67.3	22.1%	\$ 7.5	13%
Research and development	15.9	5.9%	13.7	4.5%	(2.2)	(14)%
Impairment, restructuring and other charges	14.1	5.3%	(1.8)	(0.6)%	(15.9)	(113)%
Total operating expenses	<u>\$ 89.8</u>	<u>33.6%</u>	<u>\$ 79.2</u>	<u>26.0%</u>	<u>\$ (10.6)</u>	<u>(12)%</u>

**Selling, general and administrative.** Selling, general and administrative (SG&A) expenses consist primarily of compensation paid to sales, marketing and administrative personnel, professional service fees, third party commissions and marketing expenses. SG&A expenses increased to support the growth of the Company, including increased selling commissions, marketing programs and incentive based compensation.

**Research and development.** Research and development (R&D) expenses include research related to new product development and product enhancement expenditures. The decrease in R&D expenses reflected reduced costs in our Security division for ongoing engineering projects and decreased costs in our Healthcare division due to cost efficiencies realized with respect to ongoing project and development programs.

**Impairment, restructuring and other charges.** Impairment, restructuring and other charges generally consist of the write-down of assets that we believe are permanently impaired, charges related to reductions in our workforce, facility consolidations, costs related to acquisition activity, legal charges and other non-recurring charges. In the third quarter of fiscal 2019, we recovered certain legal costs through insurance reimbursement resulting in a net credit of \$1.8 million.

Such charges in the prior-year period included: (i) \$5.8 million of accrued charges for estimated settlements due to exiting the anesthesia product line; (ii) \$3.9 million of asset impairment associated with the anesthesia related assets; (iii) \$3.8 million of legal and settlement costs; (iv) \$0.4 million in facility closure and employee termination costs; and (v) \$0.2 million of other charges

**Other Income and Expenses**

**Interest expense, net.** For the three months ended March 31, 2019, interest and other expense, net was \$5.6 million as compared to \$4.6 million in the comparable prior-year period. This increase was driven primarily by a higher average debt balance and an increased average interest rate on our revolving credit facility. Interest expense in each period included \$2.0 million of non-cash interest expense related to the Notes (see Note 6 to the condensed consolidated financial statements for further discussion).

**Income taxes.** The effective tax rate for a particular period varies depending on a number of factors including (i) the mix of income earned in various tax jurisdictions, each of which applies a unique range of income tax rates and income tax credits, (ii) changes in previously established valuation allowances for deferred tax assets (changes are based upon our current analysis of the likelihood that these deferred tax assets will be realized), (iii) the level of non-deductible expenses, (iv) certain tax elections and (v) tax holidays granted to certain of our international subsidiaries. For the three months ended March 31, 2019, our income tax provision was \$6.9 million, compared to \$0.6 million for the comparable prior-year period. The effective tax rate for the three months ended March 31, 2019 was 26.0% compared to 18.1% in the prior year period. Excluding the net impact of a \$0.7 million discrete tax benefit, our effective tax rate for the three months ended March 31, 2019 was 28.6% compared to 28.2% in the same prior-year period.

**Results of Operations for the Nine Months Ended March 31, 2018 (YTD Q3 2018) Compared to Nine Months Ended March 31, 2019 (YTD Q3 2019) (amounts in millions)**

**Net Revenues**

The table below and the discussion that follows reflect the way in which we analyze our business. See Note 11 to the condensed consolidated financial statements for additional information about our business segments.

	YTD Q3 2018	% of Net Revenues	YTD Q3 2019	% of Net Revenues	\$ Change	% Change
Security	\$ 504.8	63%	\$ 552.1	63%	\$ 47.3	9%
Healthcare	141.8	18%	138.7	16%	(3.1)	(2)%
Optoelectronics / Manufacturing	155.4	19%	182.9	21%	27.5	18%
Total net revenues	<u>\$ 802.0</u>	<u>100%</u>	<u>\$ 873.7</u>	<u>100%</u>	<u>\$ 71.7</u>	<u>9%</u>

[Table of Contents](#)

Revenues for the Security division for the nine months ended March 31, 2019 increased as a result of significant growth in sales of cargo and vehicle inspection systems and explosive detection systems. These increases were partially offset by lower checkpoint and trace detection equipment revenues. In addition, service revenues decreased primarily due to a reduction in revenue from the contract with SAT in Mexico entered into in January 2018.

Revenues for the Healthcare division for the nine months ended March 31, 2019 decreased primarily due to our de-emphasis of the anesthesia product line and the exit of an underperforming sales channel in the second quarter of fiscal 2019, which collectively resulted in approximately \$3.9 million of reduced revenues. This was partially offset by growth in supplies and accessories, cardiology and service sales.

Revenues for the Optoelectronics and Manufacturing division for the nine months ended March 31, 2019 increased primarily due to the contribution of \$21.4 million in revenues from two business acquired during calendar 2018 as well as strong general sales in our commercial optoelectronics business.

**Gross Profit**

	YTD Q3 2018	% of Net Revenues	YTD Q3 2019	% of Net Revenues
Gross profit	\$ 290.5	36.2%	\$ 317.6	36.3%

Gross profit during the nine months ended March 31, 2019 increased as a result of the growth in net revenues. The gross margin for the nine months ended March 31, 2019 was relatively consistent with that of the same period in fiscal 2018.

**Operating Expenses**

	YTD Q3 2018	% of Net Revenues	YTD Q3 2019	% of Net Revenues	\$ Change	% Change
Selling, general and administrative	\$ 175.6	21.9%	\$ 196.1	22.4%	\$ 20.5	12%
Research and development	46.1	5.8%	40.3	4.6%	(5.8)	(13)%
Impairment, restructuring and other charges	23.5	2.9%	1.1	0.1%	(22.4)	(95)%
Total operating expenses	\$ 245.2	30.6%	\$ 237.5	27.1%	\$ (7.7)	(3)%

**Selling, general and administrative.** SG&A expense increased to support our growth, including greater selling commissions expense and incentive based compensation programs.

**Research and development.** R&D expenses during the nine months ended March 31, 2019 decreased due to reduced costs in our Security division from consolidation following an acquisition completed in the prior year and reduced costs for ongoing engineering projects. Further, R&D expenses decreased in our Healthcare division due to reduced compensation and professional fees and the de-emphasis of the anesthesia product line and related development programs.

**Impairment, restructuring and other charges.** For the nine months ended March 31, 2019, we incurred restructuring and other charges of \$3.6 million related to employee termination and facility closure costs and \$0.3 million in acquisition costs, which were partially offset by a net \$2.8 million recovery of certain legal costs as a result of insurance reimbursements. Impairment, restructuring and other charges incurred in the prior year period include: (i) \$9.7 million of costs associated with the abandonment of a product line in our Healthcare division; (ii) \$3.1 million of impairment of intangibles, primarily trademarks, related to two acquired brands that have been merged into existing product lines as well as assets associated with abandoned product lines; (iii) \$8.1 million of accrued charges related to estimated legal settlements; (iv) \$1.3 million of acquisition costs; and (v) \$1.2 million of employee termination and facility closure costs for restructuring activities.

**Other Income and Expenses**

**Interest expense, net.** For the nine months ended March 31, 2019, interest expense, net, was \$16.5 million as compared to \$14.2 million for the same prior-year period. This increase was driven by higher fiscal 2019 average debt balances and the impact of increased interest rates under our revolving credit facility. Interest expense included \$5.8 million and \$5.6 million, respectively, of non-cash interest expense related to the Notes for the nine months ended March 31, 2019 and 2018 (see Note 6 to the condensed consolidated financial statements for further discussion).

**Income taxes.** For the nine months ended March 31, 2019, our income tax provision was \$15.4 million, compared to \$65.4 million for the comparable prior-year period. The prior year tax provision included \$56.2 million of discrete tax expense resulting from the enactment of the Tax Act and \$0.4 million related to other discrete tax items. The effective tax rate for the nine months ended March 31, 2019 was 24.2% compared to 210.0% in the prior period which includes the effect of the discrete tax item related to the enactment of the Tax Act. Excluding the net impact of discrete tax items, our effective tax rate for the nine months ended March 31, 2019 was 28.4%, compared to 28.2% in the prior-year period.

### **Liquidity and Capital Resources**

Our principal sources of liquidity are our cash and cash equivalents, cash generated from operations and our credit facility. Cash and cash equivalents totaled \$107.6 million as of March 31, 2019, an increase of 27% from \$84.8 million as of June 30, 2018. During the nine months ended March 31, 2019, we generated \$87.7 million of cash flow from operations. We utilized cash from operations and borrowings from our revolving line of credit as follows: (i) \$20.9 million invested in capital expenditures; (ii) \$19.9 million for the acquisition of businesses and intangible and other assets; and (iii) \$34.8 million for share repurchases and taxes paid related to the net share settlement of equity awards. If we continue to net settle equity awards, we will use additional cash to pay tax withholding obligations in connection with such settlements. We currently anticipate that our available funds, cash generated from operations, and credit facilities will be sufficient to meet our operational cash needs for the next 12 months and the foreseeable future beyond.

We had a five-year revolving credit facility maturing in December 2021 that allowed us to borrow up to \$525 million. As of March 31, 2019, there was \$124.0 million outstanding under the revolving credit facility and \$59.1 million outstanding under the letters of credit sub-facility. On April 23, 2019, we entered into an amendment to our revolving credit facility, which, among other things, increased the size of the credit facility from \$525 million to \$535 million and extended the maturity date to April 2024.

**Cash Provided by Operating Activities.** Cash flows from operating activities can fluctuate significantly from period to period, as net income, adjusted for non-cash items, and working capital fluctuations impact cash flows. During the nine months ended March 31, 2019, we generated cash from operations of \$87.7 million compared to \$115.8 million in the same prior-year period. Cash flow from operating activities during the first nine months of fiscal 2019 primarily consisted of net income of \$48.1 million, adjusted for certain non-cash items, including total depreciation and amortization of \$42.4 million, stock-based compensation expense of \$19.5 million, and amortization of debt discount and issuance costs of \$6.7 million, and was reduced by the net impact of changes in operating assets and liabilities, which decreased cash by \$27.4 million. Cash flow from operating activities during the first nine months of fiscal 2018 primarily consisted of net loss of \$34.2 million, adjusted for certain non-cash items, including total depreciation and amortization of \$55.4 million, stock-based compensation expense of \$17.8 million, amortization of debt discount and issuance costs of \$6.4 million, change in deferred taxes of \$50.8 as a result of the Tax Act and impairment charges of \$7.2 million, and was increased by the net impact of changes in operating assets and liabilities, which provided cash of \$10.4 million.

**Cash Used in Investing Activities.** Net cash used in investing activities was \$40.8 million for the nine months ended March 31, 2019 as compared to \$139.2 million for the nine months ended March 31, 2018. During the nine months ended March 31, 2019, we used cash of \$20.9 million for capital expenditures, \$17.5 million for the acquisition of an optoelectronics solutions business, and \$0.8 million for the acquisition of two businesses in our Security division. During the nine months ended March 31, 2018, we used cash of \$103.2 million for acquisitions, consisting primarily of the ETD business and a flex circuit business, and \$36.4 million in capital expenditures, including \$19.8 million to purchase the AS&E headquarters facility.

**Cash Provided by (Used in) Financing Activities.** Net cash used in financing activities was \$23.3 million for the nine months ended March 31, 2019, compared to net cash provided by financing activities of \$47.4 million for the nine months ended March 31, 2018. During the nine months ended March 31, 2019, our primary source of financing was \$11.0 million borrowed under our revolving credit facility. This source of funds was offset by \$34.8 million used for share repurchases and taxes paid related to the net share settlement of equity awards. During the nine months ended March 31, 2018, our primary source of financing was \$125 million borrowed under our revolving credit facility. This source of funds was partially offset by \$80.3 million used for share repurchases and taxes paid related to the net share settlement of equity awards.

### **Borrowings**

See Note 6 to the condensed consolidated financial statements for discussion regarding our revolving credit facility and our Notes.



### **Cash Held by Foreign Subsidiaries**

Our cash and cash equivalents totaled \$107.6 million at March 31, 2019. Of this amount, approximately 78% was held by our foreign subsidiaries and subject to repatriation tax considerations. These foreign funds were held primarily in the United Kingdom, Singapore, Malaysia, and Mexico, and to a lesser extent in India, Canada, and Germany among others. We intend to permanently reinvest certain earnings from foreign operations, and we currently do not anticipate that we will need this cash in foreign countries to fund our U.S. operations. In the event we repatriate cash from certain foreign operations and taxes have not previously been withheld on the related earnings, we would provide for withholding taxes at the time we change our intention with regard to the reinvestment of those earnings.

### **Issuer Purchases of Equity Securities**

We did not repurchase any shares during the quarter ended March 31, 2019.

### **Dividend Policy**

We have not paid any cash dividends since the consummation of our initial public offering in 1997 and we do not currently intend to pay any cash dividends in the foreseeable future. Our Board of Directors will determine the payment of future cash dividends, if any. Certain of our current bank credit facilities restrict the payment of cash dividends and future borrowings may contain similar restrictions.

### **Contractual Obligations**

During the nine months ended March 31, 2019, there were no material changes outside the ordinary course of business in the information regarding specified contractual obligations contained in our Annual Report on Form 10-K for the fiscal year ended June 30, 2018. See Notes 6 and 9 to the condensed consolidated financial statements for additional information regarding our current contractual obligations.

### **Off Balance Sheet Arrangements**

As of March 31, 2019, we did not have any significant off-balance sheet arrangements, as defined in Item 303(a)(4) of Regulation S-K.

### **New Accounting Pronouncements**

For information with respect to recent accounting pronouncements and the potential impact of those pronouncements on our condensed consolidated financial statements, see Note 1 to the condensed consolidated financial statements.

## **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

There have been no material changes to our market risk during the nine months ended March 31, 2019. For a discussion of our exposure to market risk, refer to our market risk disclosures set forth in Part II, Item 7A “Quantitative and Qualitative Disclosures About Market Risk” in our Annual Report on Form 10-K for the fiscal year ended June 30, 2018.

## **ITEM 4. CONTROLS AND PROCEDURES**

### **Evaluation of Disclosure Controls and Procedures**

As of March 31, 2019, 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) or 15d-15(e) of the Exchange Act). Based upon management’s review and evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of the period covered by this Quarterly Report on Form 10-Q, our disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified by the SEC and is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

### **Changes in Internal Control over Financial Reporting**

There were no changes in our internal control over financial reporting during the third quarter of fiscal 2019 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**Limitations on Effectiveness of Controls and Procedures**

In designing and evaluating our controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud within the Company have been detected.

## PART II — OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

The material legal proceedings in which we are involved are discussed in Note 9, “Commitments and Contingencies,” to our Condensed Consolidated Financial Statements in this Quarterly Report on Form 10-Q, and are hereby incorporated by reference.

### ITEM 1A. RISK FACTORS

The discussion of our business, operations, and financial results 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, 2018, filed with the SEC on August 28, 2018, which describe various risks and uncertainties which could materially affect our business, financial condition or results of operations in the future. There have been no material changes to the risk factors included in our Annual Report on Form 10-K. The risks described in our Annual Report on Form 10-K are not the only risks we face. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially and adversely affect our business, financial condition and results of operations.

### ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None

### ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None

### ITEM 4. MINE SAFETY DISCLOSURES

Not applicable

### ITEM 5. OTHER INFORMATION

On April 29, 2019, we entered into amendments to employment agreements with Ajay Mehra, our Executive Vice President and Director, and Victor Sze, our Executive Vice President and General Counsel. The amendments provide these executives with certain additional death and disability benefits. The foregoing description of the amendments is qualified in its entirety by reference to the provisions of the amendments, each of which is filed as an exhibit to this Quarterly Report on Form 10-Q.

### ITEM 6. EXHIBITS

2.1	<a href="#">Equity Purchase Agreement, dated as of May 31, 2017, by and among OSI Systems, Inc., OSI (Holdings) Company Limited, Smiths Detection, LLC, Smiths Detection United Kingdom Limited, Smiths Detection (Australia) Pty Ltd, and Smiths Detection Group Limited (1)</a>
10.1	<a href="#">Sixth Amendment to Credit Agreement dated April 23, 2019 between Wells Fargo Bank, N.A. and OSI Systems, Inc. (2)</a>
10.2*†	<a href="#">Second Amendment to Employment Agreement effective as of April 29, 2019 by and between OSI Systems, Inc. and Ajay Mehra</a>
10.3*†	<a href="#">Second Amendment to Employment Agreement effective as of April 29, 2019 by and between OSI Systems, Inc. and Victor Sze</a>
31.1	<a href="#">Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</a>
31.2	<a href="#">Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</a>
32.1	<a href="#">Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</a>
32.2	<a href="#">Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</a>
101.INS	XBRL Instance Document.
101.SCH	XBRL Taxonomy Extension Schema Document.
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document.
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document.
101.LAB	XBRL Taxonomy Extension Label Linkbase Document.
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document.

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\* Filed herewith

† Denotes a management contract or compensatory plan or arrangement.

(1) Previously filed with our Current Report on Form 8-K filed on June 1, 2017.

(2) Previously filed with our Current Report on Form 8-K filed on April 23, 2019.



**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 2019.

**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

Ajay Mehra  
VIA HAND DELIVERY

**Re: Employment Agreement**

Dear Ajay:

You and OSI Systems, Inc. (the "Company") have entered into that certain Employment Agreement dated January 1, 2012, as thereafter amended (collectively, the "Agreement"). We hereby amend that Agreement to add the following:

"3.8 **International Travel Special Service Payment.** If while travelling on Company business outside the United States, Executive dies or suffers an injury that results in a physical or mental incapacity or disability which prevents (or will prevent) Executive from performing the essential functions of the position required of him under the Employment Agreement for an aggregate period of 180 days within any 12 month period, the Company shall pay to Executive (or, in the case of death, Executive's estate) a lump sum bonus payment of Five Million Dollars (\$5,000,000), less customary taxes and other withholdings, as soon as practicable following such occurrence, but in no event later than March 15 of the calendar year following the calendar year in which Executive's death or disability occurs, as determined to compliance with all applicable laws. Such payment shall be in addition to any and all amounts payable under this Agreement and any employee benefit plans, programs or insurance coverages sponsored by the Company and shall be subject to execution by the Executive (or the executor of the Executive's estate, if applicable) of a customary and reasonable release of liabilities in favor of the Company and its Affiliates."

When fully executed, this letter will become a part of the Agreement. Except as amended by this letter, the Agreement will continue in full force and effect. Please indicate your agreement by counter-signing this letter where indicated below.

Very truly yours,

/s/ Deepak Chopra  
DEEPAK CHOPRA  
Chief Executive Officer

AGREED:

/s/ Ajay Mehra  
Ajay Mehra

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Victor Sze  
VIA HAND DELIVERY

**Re: Employment Agreement**

Dear Victor:

You and OSI Systems, Inc. (the "Company") have entered into that certain Employment Agreement dated January 1, 2012, as thereafter amended (collectively, the "Agreement"). We hereby amend that Agreement to add the following:

"3.8 **International Travel Special Service Payment.** If while travelling on Company business outside the United States, Executive dies or suffers an injury that results in a physical or mental incapacity or disability which prevents (or will prevent) Executive from performing the essential functions of the position required of him under the Employment Agreement for an aggregate period of 180 days within any 12 month period, the Company shall pay to Executive (or, in the case of death, Executive's estate) a lump sum bonus payment of Five Million Dollars (\$5,000,000), less customary taxes and other withholdings, as soon as practicable following such occurrence, but in no event later than March 15 of the calendar year following the calendar year in which Executive's death or disability occurs, as determined to compliance with all applicable laws. Such payment shall be in addition to any and all amounts payable under this Agreement and any employee benefit plans, programs or insurance coverages sponsored by the Company and shall be subject to execution by the Executive (or the executor of the Executive's estate, if applicable) of a customary and reasonable release of liabilities in favor of the Company and its Affiliates."

When fully executed, this letter will become a part of the Agreement. Except as amended by this letter, the Agreement will continue in full force and effect. Please indicate your agreement by counter-signing this letter where indicated below.

Very truly yours,

/s/ Deepak Chopra  
DEEPAK CHOPRA  
Chief Executive Officer

AGREED:

/s/ Victor Sze  
Victor Sze

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**CERTIFICATION**

Certification required by Rule 13a-14(a) or Rule 15d-14(a)  
and under Section 302 of the Sarbanes-Oxley Act of 2002

I, Deepak Chopra, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of OSI Systems, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 1, 2019

/s/ Deepak Chopra  
Deepak Chopra  
Chief Executive Officer

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**CERTIFICATION**

Certification required by Rule 13a-14(a) or Rule 15d-14(a)  
and under Section 302 of the Sarbanes-Oxley Act of 2002

I, Alan Edrick, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of OSI Systems, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 1, 2019

/s/ Alan Edrick  
Alan Edrick  
Chief Financial Officer

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**CERTIFICATION OF CHIEF EXECUTIVE OFFICER PURSUANT TO 18 U.S.C. SECTION 1350  
AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of OSI Systems, Inc. (the "Company") on Form 10-Q for the quarter ended March 31, 2019, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Deepak Chopra, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934, as amended; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company at the dates and for the periods presented in the Report.

Date: May 1, 2019

/s/ Deepak Chopra  
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Deepak Chopra  
Chief Executive Officer

The foregoing certification is being furnished solely pursuant to 18 U.S.C. Section 1350, is not being filed as part of the Report or as a separate disclosure document, and is not being incorporated by reference into any filing of the Company under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended (whether made before or after the date of the Report), irrespective of any general incorporation language contained in such filing. The signed original of this certification required by Section 906 of the Sarbanes-Oxley Act of 2002 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

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**CERTIFICATION OF CHIEF FINANCIAL OFFICER PURSUANT TO 18 U.S.C. SECTION 1350  
AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of OSI Systems, Inc. (the "Company") on Form 10-Q for the quarter ended March 31, 2019, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Alan Edrick, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934, as amended; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company at the dates and for the periods presented in the Report.

Date: May 1, 2019

/s/ Alan Edrick  
\_\_\_\_\_  
Alan Edrick  
Chief Financial Officer

The foregoing certification is being furnished solely pursuant to 18 U.S.C. Section 1350, is not being filed as part of the Report or as a separate disclosure document, and is not being incorporated by reference into any filing of the Company under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended (whether made before or after the date of the Report), irrespective of any general incorporation language contained in any such filing. The signed original of this certification required by Section 906 of the Sarbanes-Oxley Act of 2002 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

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