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

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**FORM 10-Q**

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(Mark one)

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

**For the quarterly period ended December 31, 2008**

**OR**

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

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

**Commission File Number 0-23125**

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**OSI SYSTEMS, INC.**

(Exact name of registrant as specified in its charter)

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

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

**12525 Chadron Avenue  
Hawthorne, California 90250**  
(Address of principal executive offices)

**(310) 978-0516**  
(Registrant's telephone number, including area code)

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

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

Large accelerated filer ☐

Accelerated filer ☒

Non-accelerated filer ☐

Smaller reporting company ☐

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

As of January 27, 2009, there were 17,276,879 shares of the registrant's common stock outstanding.

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# PART I. FINANCIAL INFORMATION

## Item 1. Condensed Consolidated Financial Statements

### OSI SYSTEMS, INC. AND SUBSIDIARIES CONDENSED CONSOLIDATED BALANCE SHEETS (in thousands, except share amounts)

|  | June 30,<br>2008 | December 31,<br>2008<br>(unaudited) |
|--|------------------|-------------------------------------|
| <b>ASSETS</b>  |                  |                                     |
| Current Assets:  |                  |                                     |
| Cash and cash equivalents  | \$ 18,232        | \$ 34,915                           |
| Accounts receivable, net   | 156,781          | 127,733                             |
| Other receivables  | 3,258            | 4,119                               |
| Inventories  | 144,807          | 143,726                             |
| Deferred income taxes  | 19,313           | 18,988                              |
| Prepaid expenses and other current assets  | 14,064           | 19,085                              |
| Total current assets   | 356,455          | 348,566                             |
| Property and equipment, net  | 47,191           | 43,524                              |
| Goodwill   | 60,408           | 59,315                              |
| Intangible assets, net   | 34,495           | 31,878                              |
| Other assets   | 9,092            | 11,141                              |
| Total assets   | <u>\$507,641</u> | <u>\$ 494,424</u>                   |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>  |                  |                                     |
| Current Liabilities:   |                  |                                     |
| Bank lines of credit   | \$ 18,657        | \$ 15,000                           |
| Current portion of long-term debt  | 6,593            | 7,515                               |
| Accounts payable   | 75,320           | 86,529                              |
| Accrued payroll and employee benefits  | 20,896           | 20,616                              |
| Advances from customers  | 6,746            | 12,501                              |
| Accrued warranties   | 11,597           | 9,708                               |
| Deferred revenue   | 7,414            | 7,158                               |
| Other accrued expenses and current liabilities   | 14,274           | 11,882                              |
| Total current liabilities  | 161,497          | 170,909                             |
| Long-term debt   | 49,091           | 43,567                              |
| Other long-term liabilities  | 17,804           | 18,360                              |
| Total liabilities  | 228,392          | 232,836                             |
| Minority interest  | 1,228            | 1,193                               |
| Commitment and contingencies (Note 7)  |                  |                                     |
| Shareholders' Equity:  |                  |                                     |
| Preferred stock, no par value—authorized, 10,000,000 shares; no shares issued or outstanding   | —                | —                                   |
| Common stock, no par value—authorized, 100,000,000 shares; issued and outstanding, 17,740,057 and 17,235,395 shares at June 30, 2008 and December 31, 2008, respectively | 224,581          | 221,442                             |
| Retained earnings  | 41,972           | 46,266                              |
| Accumulated other comprehensive income (loss)  | 11,468           | (7,313)                             |
| Total shareholders' equity   | 278,021          | 260,395                             |
| Total liabilities and shareholders' equity   | <u>\$507,641</u> | <u>\$ 494,424</u>                   |

See accompanying notes to condensed consolidated financial statements.

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

|   | For the Three Months Ended<br>December 31, |            | For the Six Months Ended<br>December 31, |            |
|---|--|------------|--|------------|
|   | 2007                                       | 2008       | 2007                                     | 2008       |
| Revenues  | \$ 164,194                                 | \$ 159,042 | \$ 295,207                               | \$ 307,203 |
| Cost of goods sold  | 105,193                                    | 104,623    | 192,096                                  | 203,149    |
| Gross profit  | 59,001                                     | 54,419     | 103,111                                  | 104,054    |
| Operating expenses:   |  |            |  |            |
| Selling, general and administrative expenses                            | 39,105                                     | 35,693     | 75,316                                   | 73,264     |
| Research and development  | 11,725                                     | 8,669      | 21,454                                   | 18,882     |
| Restructuring and other charges   | 2,114                                      | 2,798      | 2,199                                    | 3,599      |
| Total operating expenses  | 52,944                                     | 47,160     | 98,969                                   | 95,745     |
| Income from operations  | 6,057                                      | 7,259      | 4,142                                    | 8,309      |
| Interest expense, net   | (1,168)                                    | (863)      | (2,257)                                  | (1,758)    |
| Income before provision for income taxes and minority interest          | 4,889                                      | 6,396      | 1,885                                    | 6,551      |
| Provision for income taxes  | 1,721                                      | 2,200      | 666                                      | 2,253      |
| Minority interest of net earnings (losses) of consolidated subsidiaries | (312)                                      | 34         | (194)                                    | 4          |
| Net income  | \$ 3,480                                   | \$ 4,162   | \$ 1,413                                 | \$ 4,294   |
| Earnings per share:   |  |            |  |            |
| Basic   | \$ 0.20                                    | \$ 0.24    | \$ 0.08                                  | \$ 0.24    |
| Diluted   | \$ 0.20                                    | \$ 0.24    | \$ 0.08                                  | \$ 0.24    |
| Shares used in per share calculation:                                   |  |            |  |            |
| Basic   | 17,302                                     | 17,536     | 17,237                                   | 17,667     |
| Diluted   | 17,675                                     | 17,558     | 17,597                                   | 17,765     |

See accompanying notes to condensed consolidated financial statements.

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

|  | <b>For the Six Months Ended<br/>December 31</b> |                  |
|--|---|------------------|
|  | <b>2007</b>                                     | <b>2008</b>      |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>  |   |                  |
| Net income   | \$ 1,413  | \$ 4,294         |
| Adjustments to reconcile net income to net cash used in operating activities:      |   |                  |
| Depreciation and amortization  | 9,506   | 8,628            |
| Stock based compensation expense   | 2,301   | 2,392            |
| Provision for losses on accounts receivable  | 285   | 2,497            |
| Minority interest in net income of subsidiary                                      | (194)   | (36)             |
| Equity in earnings of unconsolidated affiliates                                    | (236)   | (1,255)          |
| Deferred income taxes  | (2,450)   | (819)            |
| Other  | (11)  | 24               |
| Changes in operating assets and liabilities:                                       |   |                  |
| Accounts receivable  | (9,763)   | 12,488           |
| Other receivables  | 1,249   | (1,948)          |
| Inventories  | (28,384)  | (13,983)         |
| Prepaid expenses and other current assets  | (5,286)   | (8,435)          |
| Accounts payable   | 24,017  | 18,874           |
| Accrued payroll and related expenses   | 2,640   | 463              |
| Advances from customers  | (10,378)  | 8,005            |
| Accrued warranties   | 1,691   | (569)            |
| Deferred revenue   | (8)   | 2,315            |
| Other accrued expenses and current liabilities                                     | (966)   | 192              |
| Net cash provided (used) in operating activities                                   | (14,574)  | 33,127           |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>  |   |                  |
| Acquisition of property and equipment  | (4,995)   | (5,170)          |
| Proceeds from the sale of property and equipment                                   | 95  | 30               |
| Buyback of subsidiary stock  | (659)   | —                |
| Acquisition of intangible and other assets   | (812)   | (1,730)          |
| Net cash used in investing activities  | (6,371)   | (6,870)          |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>  |   |                  |
| Net repayments of bank lines of credit   | (3,306)   | (3,005)          |
| Proceeds from long-term debt   | 44,891  | —                |
| Payments on long-term debt   | (23,197)  | (2,860)          |
| Net payments of capital lease obligations  | (578)   | (496)            |
| Repurchase of treasury shares  | —   | (7,170)          |
| Proceeds from exercise of stock options, warrants and employee stock purchase plan | 1,862   | 1,664            |
| Net cash provided (used) in financing activities                                   | 19,672  | (11,867)         |
| <b>EFFECT OF EXCHANGE RATE CHANGES ON CASH</b>                                     | (579)   | 2,293            |
| <b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>                        | (1,852)   | 16,683           |
| <b>CASH AND CASH EQUIVALENTS - BEGINNING OF PERIOD</b>                             | 15,980  | 18,232           |
| <b>CASH AND CASH EQUIVALENTS - END OF PERIOD</b>                                   | <u>\$ 14,128</u>                                | <u>\$ 34,915</u> |
| <b>Supplemental disclosure of cash flow information:</b>                           |   |                  |
| Interest   | \$ 2,342  | \$ 1,875         |
| Income taxes   | \$ 1,751  | \$ 2,271         |
| <b>Supplemental disclosure of non-cash investing activities:</b>                   |   |                  |
| Buyback of subsidiary stock with common stock                                      | \$ 5,898  | —                |
| Buyback of subsidiary stock in accounts payable                                    | \$ 15,146                                       | —                |

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

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

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

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

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

*Basis of Presentation*

The condensed consolidated financial statements include the accounts of OSI Systems, Inc. and its subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation. The condensed consolidated financial statements have been prepared by the Company, without audit, pursuant to Accounting Principles Board Opinion No. 28, “Interim Financial Reporting” and the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations. In the opinion of the Company’s management, all adjustments, consisting of only normal and recurring adjustments, necessary for a fair presentation of the financial position and the results of operations for the periods presented have been included. These condensed consolidated financial statements and the accompanying notes should be read in conjunction with the audited condensed consolidated financial statements and

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accompanying notes included in the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2008, filed with the Securities and Exchange Commission on August 28, 2008. The results of operations for the three months and six months ended December 31, 2008 are not necessarily indicative of the operating results to be expected for the full fiscal year or any future periods.

### *Per Share Computations*

The Company computes basic earnings per share by dividing net income available to common shareholders by the weighted average number of common shares outstanding during the period. The Company computes diluted earnings per share by dividing net income available to common shareholders by the sum of the weighted average number of common and dilutive potential common shares outstanding. Potential common shares consist of the shares issuable upon the exercise of stock options or warrants under the treasury stock method. Stock options and warrants to purchase a total of 3.3 million and 2.5 million shares of common stock for the three months and six months ended December 31, 2008, respectively, were not included in diluted earnings per share calculations because to do so would have been antidilutive. Stock options and warrants to purchase a total of 0.3 million shares of common stock for the three months and six months ended December 31, 2007, were not included in diluted earnings per share calculations because to do so would have been antidilutive. The following table sets forth the computation of basic and diluted earnings per share (in thousands, except per share amounts):

|  | Three Months Ended<br>December 31, |          | Six Months Ended<br>December 31, |          |
|--|------------------------------------|----------|----------------------------------|----------|
|  | 2007                               | 2008     | 2007                             | 2008     |
| Net income available to common shareholders      | \$ 3,480                           | \$ 4,162 | \$ 1,413                         | \$ 4,294 |
| Weighted average shares outstanding — basic      | 17,302                             | 17,536   | 17,237                           | 17,667   |
| Dilutive effect of stock options and warrants    | 373                                | 22       | 360                              | 98       |
| Weighted average of shares outstanding — diluted | 17,675                             | 17,558   | 17,597                           | 17,765   |
| Basic earnings per share                         | \$ 0.20                            | \$ 0.24  | \$ 0.08                          | \$ 0.24  |
| Diluted earnings per share                       | \$ 0.20                            | \$ 0.24  | \$ 0.08                          | \$ 0.24  |

### *Comprehensive Income*

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

|   | Three Months Ended<br>December 31, |            | Six Months Ended<br>December 31, |             |
|---|------------------------------------|------------|----------------------------------|-------------|
|   | 2007                               | 2008       | 2007                             | 2008        |
| Net income  | \$3,480                            | \$ 4,162   | \$1,413                          | \$ 4,294    |
| Reversal of gain on foreign currency forward contract | —                                  | 85         | —                                | 140         |
| Foreign currency translation adjustments              | 530                                | (13,047)   | 2,030                            | (19,519)    |
| Minimum pension liability adjustment                  | 1                                  | 399        | (85)                             | 598         |
| Other   | —                                  | —          | 57                               | —           |
| Comprehensive income (loss)                           | \$4,011                            | \$ (8,411) | \$3,415                          | \$ (14,487) |

### *Recent Accounting Pronouncements*

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

In February 2008, the FASB issued FASB Staff Position (FSP) FAS No. 157-2, "Effective Date of FASB Statement No. 157" (FSP 157-2). FSP 157-2 defers the effective date of SFAS 157 to fiscal years beginning after December 15, 2008, and interim periods

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within those fiscal years, for all nonfinancial assets and liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). Examples of items within the scope of FSP 157-2 are nonfinancial assets and nonfinancial liabilities initially measured at fair value in a business combination (but not measured at fair value in subsequent periods), and long-lived assets, such as property, plant and equipment and intangible assets measured at fair value for an impairment assessment under SFAS 144.

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

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

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133" (SFAS 161). The standard expands the disclosure requirements of SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," and requires qualitative disclosures about the objectives and strategies for using derivatives, quantitative disclosures about the fair value amounts of and gains and losses on derivative instruments, and disclosures about credit-risk-related contingent features in derivative agreements. SFAS 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. The Company is in the process of analyzing this new standard, which will be effective for the Company in the third quarter of fiscal 2009.

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

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

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### 2. Balance Sheet Details

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

|  | June 30,<br>2008  | December 31,<br>2008 |
|--|-------------------|----------------------|
| <b>Accounts receivable</b>   |                   |                      |
| Trade receivables  | \$ 158,326        | \$ 131,260           |
| Receivables related to long term contracts — unbilled costs and accrued profit on progress completed | 758               | 709                  |
| Total  | 159,084           | 131,969              |
| Less: allowance for doubtful accounts  | (2,303)           | (4,236)              |
| Accounts receivable, net   | <u>\$ 156,781</u> | <u>\$ 127,733</u>    |
| <b>Inventories, net</b>  |                   |                      |
| Raw materials  | \$ 70,339         | \$ 71,148            |
| Work-in-process  | 35,326            | 30,015               |
| Finished goods   | 39,142            | 42,563               |
| Total  | <u>\$ 144,807</u> | <u>\$ 143,726</u>    |
| <b>Property and equipment</b>  |                   |                      |
| Land   | \$ 6,246          | \$ 4,916             |
| Buildings  | 8,233             | 6,967                |
| Leasehold improvements   | 10,068            | 9,912                |
| Equipment and tooling  | 51,280            | 51,920               |
| Furniture and fixtures   | 5,243             | 4,559                |
| Computer equipment   | 15,856            | 16,387               |
| Software   | 11,500            | 11,399               |
| Total  | 108,426           | 106,060              |
| Less: accumulated depreciation and amortization  | (61,235)          | (62,536)             |
| Property and equipment, net  | <u>\$ 47,191</u>  | <u>\$ 43,524</u>     |

The Company expects to bill and collect the receivables for unbilled costs and accrued profits at December 31, 2008, during the next twelve months.

### 3. Goodwill and Intangible Assets

The changes in the carrying value of goodwill for the six month period ended December 31, 2008, are as follows (in thousands):

|   | Security         | Healthcare       | Optoelectronics<br>and<br>Manufacturing | Consolidated     |
|---|------------------|------------------|---|------------------|
| Balance as of June 30, 2008             | \$ 17,692        | \$ 35,569        | \$ 7,147                                | \$ 60,408        |
| Goodwill adjusted during the period     | —                | 929              | (118)                                   | 811              |
| Foreign currency translation adjustment | (616)            | (1,249)          | (39)                                    | (1,904)          |
| Balance as of December 31, 2008         | <u>\$ 17,076</u> | <u>\$ 35,249</u> | <u>\$ 6,990</u>                         | <u>\$ 59,315</u> |

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

|                             | Preliminary<br>Allocation | Adjustments | Final<br>Allocation |
|-----------------------------|---------------------------|-------------|---------------------|
| Goodwill                    | \$ 9,155                  | 929         | \$ 10,084           |
| Developed technology        | 2,219                     | 355         | 2,574               |
| Customer relationships      | 1,442                     | 11          | 1,453               |
| Trademarks                  | 3,994                     | (1,697)     | 2,297               |
| Deferred taxes              | (2,679)                   | 402         | (2,277)             |
| Total excess purchase price | <u>\$ 14,131</u>          | <u>—</u>    | <u>\$ 14,131</u>    |

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Intangible assets consisted of the following (in thousands):

|                                 |                              | June 30, 2008              |                             |                    | December 31, 2008          |                             |                    |
|---------------------------------|------------------------------|----------------------------|-----------------------------|--------------------|----------------------------|-----------------------------|--------------------|
|                                 | Weighted<br>Average<br>Lives | Gross<br>Carrying<br>Value | Accumulated<br>Amortization | Intangibles<br>Net | Gross<br>Carrying<br>Value | Accumulated<br>Amortization | Intangibles<br>Net |
| Amortizable assets:             |                              |                            |                             |                    |                            |                             |                    |
| Software development costs      | 5 years                      | \$ 6,265                   | \$ 2,634                    | \$ 3,631           | \$ 8,038                   | \$ 2,916                    | \$ 5,122           |
| Patents                         | 7 years                      | 451                        | 298                         | 153                | 600                        | 311                         | 289                |
| Core technology                 | 10 years                     | 2,684                      | 911                         | 1,773              | 1,938                      | 755                         | 1,183              |
| Developed technology            | 12 years                     | 17,276                     | 5,430                       | 11,846             | 17,193                     | 6,206                       | 10,987             |
| Customer relationships/ backlog | 7 years                      | 9,582                      | 3,697                       | 5,885              | 9,370                      | 4,225                       | 5,145              |
| Total amortizable assets        |                              | 36,258                     | 12,970                      | 23,288             | 37,139                     | 14,413                      | 22,726             |
| Non-amortizable assets:         |                              |                            |                             |                    |                            |                             |                    |
| Trademarks                      |                              | 11,207                     | —                           | 11,207             | 9,152                      | —                           | 9,152              |
| Total intangible assets         |                              | \$47,465                   | \$ 12,970                   | \$ 34,495          | \$46,291                   | \$ 14,413                   | \$ 31,878          |

Amortization expense related to intangibles assets was \$1.8 million and \$2.0 million for the six months ended December 31, 2007 and 2008, respectively; and \$0.9 million and \$1.0 million for the three months ended December 31, 2007 and 2008, respectively. At December 31, 2008, the estimated future amortization expense was as follows (in thousands):

|                           |                  |
|---------------------------|------------------|
| 2009 (remaining 6 months) | \$ 1,889         |
| 2010                      | 3,734            |
| 2011                      | 3,746            |
| 2012                      | 3,619            |
| 2013                      | 3,348            |
| 2014                      | 1,994            |
| 2015 and thereafter       | 4,396            |
| Total                     | <u>\$ 22,726</u> |

## 4. Borrowings

The Company maintains a credit agreement with certain lenders allowing for borrowings of up to \$124.5 million. The credit agreement consists of a \$74.5 million, five-year, revolving credit facility (including a \$45 million sub-limit for letters-of-credit) and a \$50 million five-year term loan. Borrowings under the agreement bear interest at either (i) the London Interbank Offered Rate (LIBOR) plus between 2.00% and 2.50% or (ii) the bank's prime rate plus between 1.00% and 1.50%. The rates are determined based on the Company's consolidated leverage ratio. As of December 31, 2008, the effective, weighted-average interest rate under the credit agreement was 2.59%. The Company's borrowings under the credit agreement are guaranteed by substantially all of the Company's direct and indirect wholly-owned subsidiaries and are secured by substantially all of the Company's and its subsidiary guarantors' assets. The agreement contains various representations, warranties, affirmative, negative and financial covenants, and conditions of default customary for financing agreements of this type. As of December 31, 2008, \$45.3 million was outstanding under the term loan, \$15.0 million was outstanding under the revolving credit facility, and \$12.7 million was outstanding under the letter-of-credit facility.

Several of the Company's foreign subsidiaries maintain bank lines-of-credit, denominated in local currencies, to meet short-term working capital requirements and for the issuance of letters-of-credit. As of December 31, 2008, \$21.3 million was outstanding under these letter-of-credit facilities, while no debt was outstanding. As of December 31, 2008, the total amount available under these credit facilities was \$28.4 million, with a total cash borrowing sub-limit of \$6.9 million.

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In December 2004, the Company entered into a bank loan of \$5.3 million to fund the acquisition of land and buildings in the U.K. The loan is payable over a 20-year period, with quarterly installments of £34,500 (approximately \$50,000 as of December 31, 2008). The loan bears interest at British pound-based LIBOR plus 1.2%, payable on a quarterly basis. As of December 31, 2008, \$3.2 million remained outstanding under this loan at an interest rate of 4.0% per annum.

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

| <u>(in thousands)</u>                    | <u>June 30,<br/>2008</u> | <u>December 31,<br/>2008</u> |
|--|--------------------------|------------------------------|
| Five-year term loan due in fiscal 2013   | \$47,763                 | \$ 45,263                    |
| Twenty-year term loan due in fiscal 2025 | 4,539                    | 3,178                        |
| Capital leases                           | 2,193                    | 1,705                        |
| Other                                    | 1,189                    | 936                          |
|  | <u>55,684</u>            | <u>51,082</u>                |
| Less current portion of long-term debt   | (6,593)                  | (7,515)                      |
| Long-term portion of debt                | <u>\$49,091</u>          | <u>\$ 43,567</u>             |

## 5. Stock-based Compensation

As of December 31, 2008, the Company maintained an equity participation plan and an employee stock purchase plan.

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

|  | <u>Three Months Ended<br/>December 31,</u> |                 | <u>Six Months Ended<br/>December 31,</u> |                |
|--|--|-----------------|--|----------------|
|  | <u>2007</u>                                | <u>2008</u>     | <u>2007</u>                              | <u>2008</u>    |
| Cost of goods sold                     | \$ 42                                      | \$ 48           | \$ 83                                    | \$ 108         |
| Selling, general and administrative    | 1,115                                      | 1,091           | 2,114                                    | 2,157          |
| Research and development               | 49   | 59              | 104                                      | 127            |
| Total stock-based-compensation expense | <u>\$ 1,206</u>                            | <u>\$ 1,198</u> | <u>\$2,301</u>                           | <u>\$2,392</u> |

As of December 31, 2008, total unrecognized compensation cost related to non-vested share-based compensation arrangements granted was approximately \$6.9 million. The Company expects to recognize these costs over a weighted-average period of 2.5 years.

## 6. Retirement Benefit Plans

The Company sponsors a number of qualified and nonqualified defined benefit pension plans for its employees. The benefits under these plans are based on years of service and an employee's highest twelve months' compensation during the last five years of employment. The components of net periodic pension expense are as follows (in thousands):

|                                | <u>Three Months Ended<br/>December 31,</u> |              | <u>Six Months Ended<br/>December 31,</u> |               |
|--------------------------------|--|--------------|--|---------------|
|                                | <u>2007</u>                                | <u>2008</u>  | <u>2007</u>                              | <u>2008</u>   |
| Service cost                   | \$ 76                                      | \$ 8         | \$ 147                                   | \$ 324        |
| Interest cost                  | 124  | 58           | 244                                      | 138           |
| Expected return on plan assets | (95)                                       | (43)         | (187)                                    | (71)          |
| Amortization of net loss       | 39   | 21           | 77                                       | 47            |
| Net periodic pension expense   | <u>\$ 144</u>                              | <u>\$ 44</u> | <u>\$ 281</u>                            | <u>\$ 438</u> |

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For the three months ended December 31, 2008 and 2007, the Company made contributions of \$0.1 million and \$0.3 million, respectively, to these defined benefit plans. For the six months ended December 31, 2008 and 2007, the Company made contributions of \$0.4 million and \$0.6 million, respectively, to these defined benefit plans.

In addition, the Company maintains various defined contribution plans. For the three months ended December 31, 2008 and 2007, the Company made contributions of \$0.7 million and \$0.2 million, respectively, to these defined contribution plans. For the six months ended December 31, 2008 and 2007, the Company made contributions of \$1.5 million and \$0.7 million, respectively, to these defined contribution plans.

## **7. Commitments and Contingencies**

### *Legal Proceedings*

In November 2002, L-3 Communications Corporation brought suit against the Company in the District Court for the Southern District of New York seeking a declaratory judgment that L-3 Communications Corporation had not breached its obligations to us concerning the acquisition of PerkinElmer's Security Detection Systems Business. The Company asserted counterclaims against L-3 Communications Corporation for, among other things, fraud and breach of fiduciary duty. In December 2006, judgment was entered in the Company's favor; however, on appeal, the judgment has been reversed in part and vacated in part. The Court of Appeals has remanded the case to the trial court, where it is currently pending, for retrial.

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

### *Contingent Acquisition Obligations*

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

In August 2002, the Company purchased a minority equity interest in CXR Limited. In June 2004, the Company increased its equity interest to approximately 75% and in December 2004, the Company acquired the remaining 25%. As compensation to the selling shareholders for this remaining interest, the Company agreed to make certain royalty payments during the 18 years following the acquisition of this remaining interest. Royalty payments are based on the license of, or sales of products containing, technology owned by CXR Limited. As of December 31, 2008, no royalty payments have been earned.

In January 2004, the Company acquired Advanced Research & Applications Corp.. During the seven years following the acquisition, contingent consideration is payable based on its net revenues, provided certain requirements are met. The contingent consideration is capped at \$30.0 million. As of December 31, 2008, no contingent consideration has been earned.

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In July 2005, the Company acquired certain assets of InnerStep, B.S.E., Inc. During the seven years following the acquisition, contingent consideration is payable based on its profits before interest and taxes, provided certain requirements are met. The contingent consideration is capped at \$6.0 million. As of December 31, 2008, no contingent consideration has been earned.

### *Environmental Contingencies*

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

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

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

The Company has not accrued for loss contingencies relating to the above environmental matters because it believes that, although unfavorable outcomes may be possible, they are not considered by the Company's management to be probable and reasonably estimable. If one or more of these matters are resolved in a manner adverse to the Company, the impact on the Company's results of operations, financial position and/or liquidity could be material.

### *Product Warranties*

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

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

|                                      | Three Months Ended<br>December 31, |                 | Six Months Ended<br>December 31, |                 |
|--------------------------------------|------------------------------------|-----------------|----------------------------------|-----------------|
|                                      | 2007                               | 2008            | 2007                             | 2008            |
| Balance at beginning of period       | \$ 7,998                           | \$10,705        | \$ 7,443                         | \$11,597        |
| Additions                            | 2,334                              | 1,189           | 3,666                            | 2,204           |
| Reductions for warranty repair costs | (1,174)                            | (2,186)         | (1,951)                          | (4,093)         |
| Balance at end of period             | <u>\$ 9,158</u>                    | <u>\$ 9,708</u> | <u>\$ 9,158</u>                  | <u>\$ 9,708</u> |

## 8. Income Taxes

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

## 9. Segment Information

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

The following table presents segment information (in thousands):

|   | Three Months Ended<br>December 31, |                  | Six Months Ended<br>December 31, |                  |
|---|------------------------------------|------------------|----------------------------------|------------------|
|   | 2007                               | 2008             | 2007                             | 2008             |
| <b>Revenues — by Segment:</b>   |                                    |                  |                                  |                  |
| Security division   | \$ 63,874                          | \$ 67,067        | \$ 112,680                       | \$ 125,752       |
| Healthcare division   | 67,862                             | 59,695           | 124,461                          | 114,522          |
| Optoelectronics and Manufacturing division, including intersegment revenues | 44,695                             | 44,745           | 81,065                           | 89,626           |
| Intersegment revenues elimination   | (12,237)                           | (12,465)         | (22,999)                         | (22,697)         |
| <b>Total</b>  | <b>\$164,194</b>                   | <b>\$159,042</b> | <b>\$295,207</b>                 | <b>\$307,203</b> |
| <b>Revenues — by Geography:</b>   |                                    |                  |                                  |                  |
| North America   | \$105,390                          | \$110,714        | \$196,476                        | \$216,903        |
| Europe  | 55,043                             | 37,171           | 93,642                           | 72,261           |
| Asia  | 16,008                             | 23,622           | 28,088                           | 40,736           |
| Intersegment revenues elimination   | (12,247)                           | (12,465)         | (22,999)                         | (22,697)         |
| <b>Total</b>  | <b>\$164,194</b>                   | <b>\$159,042</b> | <b>\$295,207</b>                 | <b>\$307,203</b> |
| <b>Operating income(loss) — by Segment:</b>                                 |                                    |                  |                                  |                  |
| Security division   | \$ 871                             | \$ 4,846         | \$ 174                           | \$ 7,894         |
| Healthcare division   | 6,242                              | 2,285            | 7,293                            | 460              |
| Optoelectronics and Manufacturing division                                  | 3,114                              | 3,195            | 4,453                            | 7,057            |
| Corporate   | (3,986)                            | (2,678)          | (7,465)                          | (6,892)          |
| Eliminations (1)  | (184)                              | (389)            | (313)                            | (210)            |
| <b>Total</b>  | <b>\$ 6,057</b>                    | <b>\$ 7,259</b>  | <b>\$ 4,142</b>                  | <b>\$ 8,309</b>  |

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|  | June 30,<br>2008        | December 31,<br>2008     |
|--|-------------------------|--------------------------|
| <b>Assets — by Segment:</b>                |                         |                          |
| Security division                          | \$ 199,884              | \$ 206,309               |
| Healthcare division                        | 172,038                 | 163,542                  |
| Optoelectronics and Manufacturing division | 95,615                  | 91,189                   |
| Corporate                                  | 43,313                  | 34,869                   |
| Eliminations (1)                           | (3,209)                 | (1,485)                  |
| <b>Total</b>                               | <b><u>\$507,641</u></b> | <b><u>\$ 494,424</u></b> |

- (1) Eliminations primarily reflect the elimination of intercompany profit in inventory not-yet-realized. This 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**

### **Cautionary Statement**

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

### **Critical Accounting Policies and Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires us to make estimates and assumptions and select accounting policies that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, as well as the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Our critical accounting policies are detailed in our Annual Report on Form 10-K for the year ended June 30, 2008.

### **Recent Accounting Pronouncements**

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

### **Executive Summary**

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

*Security Division.* Through our Security division, we design, manufacture and market security and inspection systems worldwide for sale primarily to U.S. federal, state and local government agencies as well as to foreign governments. These products are used to inspect baggage, cargo, vehicles and other objects for weapons, explosives, drugs and other contraband as well as to screen people. Revenues from our Security division accounted for 41% and 38% of our total consolidated revenues for the six months ended December 31, 2008 and 2007, respectively.

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

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*Healthcare Division.* Through our Healthcare division, we design, manufacture and market patient monitoring, diagnostic cardiology and anesthesia systems for sale primarily to hospitals and medical centers. Our products monitor patients in critical, emergency and perioperative care areas of the hospital and provide such information, through wired and wireless networks, to physicians and nurses who may be at the patient's bedside, in another area of the hospital or even outside the hospital. Revenues from our Healthcare division accounted for 37% and 42% of our total consolidated revenues for the six months ended December 31, 2008 and 2007, respectively.

The healthcare markets in which we operate are highly competitive. We believe that our customers choose among competing products on the basis of product performance, functionality, value and service. During the current fiscal year, the challenging US macroeconomic environment including the tighter credit markets have negatively impacted our sales as certain hospitals have delayed capital spending. In response to the decreased revenue level during our second quarter of fiscal 2009, we extended restructuring activities initiated in fiscal 2007 including headcount reductions, which are expected to result in approximately \$10 million of annualized savings.

*Optoelectronics and Manufacturing Division.* Through our Optoelectronics and Manufacturing division, we design, manufacture and market optoelectronic devices and value-added manufacturing services worldwide for use in a broad range of applications, including aerospace and defense electronics, security and inspection systems, medical imaging and diagnostics, computed tomography, fiber optics, telecommunications, gaming, office automation, computer peripherals and industrial automation. We also provide our optoelectronic devices and value-added manufacturing services to our own Security and Healthcare divisions. External revenues from our Optoelectronics and Manufacturing division accounted for 22% and 20% of our total consolidated revenues for the six months ended December 31, 2008 and 2007, respectively.

*Consolidated Results.* For the three months ended December 31, 2008, we reported an operating profit of \$7.3 million, as compared to an operating profit of \$6.1 million for the comparable prior year period, which represents a 20% improvement over our prior year performance. This improvement was driven primarily by a \$6.5 million reduction in selling, general and administrative (SG&A) and research and development (R&D) expenses following restructuring initiatives we have undertaken in the last year, as well as various other efficiencies. This reduction in operating expenses more than offset a \$4.6 million decrease in gross profit resulting primarily from a 3% revenue decrease during the three months ended December 31, 2008 and a 1.7% decrease in gross margin, primarily due to product mix. In addition, we incurred non-recurring restructuring charges of \$2.8 million in the three months ended December 31, 2008, as compared to \$2.1 million in the prior year.

For the six months ended December 31, 2008, we reported an operating profit of \$8.3 million, as compared to an operating profit of \$4.1 million for the comparable prior year period, which represents a 102% improvement over prior year performance. This \$4.2 million improvement was primarily a result of a \$4.6 million reduction in SG&A and R&D expenses, following restructuring initiatives we have undertaken in the last year, various other efficiencies that we achieved, and a \$0.9 million increase in gross profit that was driven by the 4% revenue growth during the six months ended December 31, 2008. These favorable impacts on operating income were partially offset by a 1.0% decrease in gross margin, primarily due to product mix and non-recurring restructuring charges of \$3.6 million in the six months ended December 31, 2008, as compared to \$2.2 million in the prior year.

## **Results of Operations**

*Three Months Ended December 31, 2008 Compared to Three Months Ended December 31, 2007.*

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### Net Revenues

The table below and the discussion that follows are based upon the way in which we analyze our business. See Note 10 to the condensed consolidated financial statements for additional information about our business segments.

| <u>(in millions)</u>                       | <u>Q2<br/>2008</u> | <u>% of<br/>Net Sales</u> | <u>Q2<br/>2009</u> | <u>% of<br/>Net Sales</u> | <u>\$ Change</u> | <u>% Change</u> |
|--|--------------------|---------------------------|--------------------|---------------------------|------------------|-----------------|
| Security division                          | \$ 63.9            | 39%                       | \$ 67.1            | 42%                       | \$ 3.2           | 5%              |
| Healthcare division                        | 67.9               | 41%                       | 59.7               | 38%                       | (8.2)            | (12)%           |
| Optoelectronics and Manufacturing division | 44.7               | 27%                       | 44.7               | 28%                       | —                | —               |
| Intersegment revenues                      | (12.3)             | (7)%                      | (12.5)             | (8)%                      | (0.2)            | (2)%            |
| Total revenues                             | <u>\$164.2</u>     | <u>100%</u>               | <u>\$159.0</u>     | <u>100%</u>               | <u>\$ (5.2)</u>  | <u>(3)%</u>     |

Net revenues for the three months ended December 31, 2008, decreased \$5.2 million, or 3%, to \$159.0 million, from \$164.2 million for the comparable prior-year period.

Revenues for the Security division for the three months ended December 31, 2008, increased \$3.2 million, or 5%, to \$67.1 million, from \$63.9 million for the comparable prior-year period. The increase was primarily due to a \$6.5 million, or 23%, increase in sales of baggage and parcel inspection, people screening and hold baggage screening equipment and to a \$1.8 million, or 18%, increase in service revenue, partially offset by a decrease in sales of cargo and vehicle inspection systems equipment of \$5.1 million or 20% due to the timing of shipments.

Revenues for the Healthcare division for the three months ended December 31, 2008, decreased \$8.2 million, or 12%, to \$59.7 million, from \$67.9 million for the comparable prior-year period. The decrease was primarily due to a decrease in patient monitoring equipment sales, primarily in North America, of \$7.1 million, generally attributable to the weak U.S. economy, and lower clinical trial services revenue of \$1.6 million.

Revenues for the Optoelectronics and Manufacturing division for the three months ended December 31, 2008, were \$44.7 million, unchanged from the comparable prior-year period. Included in this total revenue amount for the three months ended December 31, 2008, the Optoelectronics and Manufacturing division recorded intersegment sales of \$12.5 million, compared to \$12.3 million in the comparable prior-year period. Such intersegment sales are eliminated in consolidation.

### Gross Profit

| <u>(in millions)</u> | <u>Q2<br/>2008</u> | <u>% of<br/>Net Sales</u> | <u>Q2<br/>2009</u> | <u>% of<br/>Net Sales</u> |
|----------------------|--------------------|---------------------------|--------------------|---------------------------|
| Gross profit         | <u>\$59.0</u>      | <u>35.9%</u>              | <u>\$54.4</u>      | <u>34.2%</u>              |

Gross profit decreased \$4.6 million, or 8%, to \$54.4 million for the three months ended December 31, 2008, from \$59.0 million for the comparable prior-year period, primarily as a result of a 12% decrease in revenue in our Healthcare division. The gross margin decreased to 34.2%, from 35.9% over the comparable prior-year period. This decrease was primarily attributable to a decrease in revenues of our Healthcare division, primarily in patient monitoring sales, which generally carry higher gross margins than many of our other products.

### Operating Expenses

| <u>(in millions)</u>                | <u>Q2<br/>2008</u> | <u>% of<br/>Net Sales</u> | <u>Q2<br/>2009</u> | <u>% of<br/>Net Sales</u> | <u>\$ Change</u> | <u>% Change</u> |
|-------------------------------------|--------------------|---------------------------|--------------------|---------------------------|------------------|-----------------|
| Selling, general and administrative | \$39.1             | 23.8%                     | \$35.7             | 22.4%                     | \$ (3.4)         | (9)%            |
| Research and development            | 11.7               | 7.1%                      | 8.6                | 5.4%                      | (3.1)            | (26)%           |
| Restructuring and other charges     | 2.1                | 1.3%                      | 2.8                | 1.8%                      | 0.7              | 33%             |
| Total operating expenses            | <u>\$52.9</u>      | <u>32.2%</u>              | <u>\$47.1</u>      | <u>29.6%</u>              | <u>\$ (5.8)</u>  | <u>(11)%</u>    |

**Selling, general and administrative expenses.** SG&A expenses consist primarily of compensation paid to sales, marketing and administrative personnel, professional service fees and marketing expenses. For the three months ended December 31, 2008, SG&A expenses decreased by \$3.4 million, or 9%, to \$35.7 million, from \$39.1 million for the comparable prior-year period. As a percentage of revenues, SG&A expenses for the three months ended December 31, 2008 decreased to 22.4%, from 23.8% for the comparable prior-year period. This reduction in spending was a direct result of cost containment initiatives throughout the Company including the restructuring activities, which were heavily focused in our Healthcare division.

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**Research and development.** R&D expenses include research related to new product development and product enhancement expenditures. For the three months ended December 31, 2008, such expenses decreased \$3.1 million, or 26%, to \$8.6 million, from \$11.7 million for the comparable prior-year period. As a percentage of revenues, R&D expenses were 5.4% for the three months ended December 31, 2008, compared to 7.1% for the comparable prior-year period. This decrease in R&D expenses for the three month period ended December 31, 2008, resulted from a reduction in R&D spending by our Healthcare division, primarily following restructuring activities and a decrease in R&D spending by our Security division due to receipt of offsetting third-party grants.

**Restructuring and other charges.** In fiscal 2007, we initiated a series of restructuring activities, which were intended to align our global capacity and infrastructure with demand by our customers and thereby improve our operating efficiencies. During the second quarter ended December 31, 2008, we continued this initiative and realigned our operations to further increase our operating efficiency. As a result, we recorded restructuring charges of \$2.8 million. These charges included \$2.5 million in our Healthcare division, \$0.2 million in our Security division and \$0.1 million in our Optoelectronics and Manufacturing division, primarily relating to facility closure and employee severance costs. During the second quarter ended December 31, 2007, we recorded total restructuring and other charges of \$2.1 million. These charges included \$1.8 million in our Security division, \$0.2 million charges in our Healthcare division and \$0.1 million in our Optoelectronics and Manufacturing division, primarily relating to severance and manufacturing relocation costs.

### Other Income and Expenses

| <u>(in millions)</u>           | <u>Q2</u><br><u>2008</u> | <u>% of</u><br><u>Net Sales</u> | <u>Q2</u><br><u>2009</u> | <u>% of</u><br><u>Net Sales</u> | <u>\$ Change</u> | <u>% Change</u> |
|--------------------------------|--------------------------|---------------------------------|--------------------------|---------------------------------|------------------|-----------------|
| Interest expense               | \$ 1.3                   | 0.7%                            | \$ 1.0                   | 0.6%                            | \$ (0.3)         | (23)%           |
| Interest income                | (0.1)                    | —                               | (0.1)                    | —                               | —                | —               |
| Total other income and expense | <u>\$ 1.2</u>            | <u>0.7%</u>                     | <u>\$ 0.9</u>            | <u>0.6%</u>                     | <u>\$ (0.3)</u>  | <u>(25)%</u>    |

**Interest expense.** For the three months ended December 31, 2008, we incurred interest expense of \$1.0 million, compared to \$1.3 million for the comparable prior year period. The decrease in interest expense was due to a lower cost of borrowing, which was partially offset by higher levels of debt. We incurred higher levels of debt in connection with a \$15.8 million repurchase, during fiscal 2008, of all outstanding shares of Spacelabs Healthcare and as well as a \$7.2 million repurchase, during the three months ended December 31, 2008, of 600,000 shares of our common stock.

**Income taxes.** For the three months ended December 31, 2008, our income tax provision was \$2.2 million, compared to an income tax provision of \$1.7 million for the comparable prior-year period. Our effective tax rate for the three months ended December 31, 2008 was 34.4%, compared to 35.2% in the comparable prior-year period. Our provision for income taxes is dependent on the mix of income from U.S. and foreign locations due to tax rate differences among such countries as well as due to the impact of permanent taxable differences.

*Six Months Ended December 31, 2008 Compared to Six Months Ended December 31, 2007.*

### Net Revenues

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

| <u>(in millions)</u>                       | <u>YTD Q2</u><br><u>2008</u> | <u>% of</u><br><u>Net Sales</u> | <u>YTD Q2</u><br><u>2009</u> | <u>% of</u><br><u>Net Sales</u> | <u>\$ Change</u> | <u>% Change</u> |
|--|------------------------------|---------------------------------|------------------------------|---------------------------------|------------------|-----------------|
| Security division                          | \$ 112.7                     | 38%                             | \$ 125.8                     | 41%                             | \$ 13.1          | 12%             |
| Healthcare division                        | 124.5                        | 42%                             | 114.5                        | 37%                             | (10.0)           | (8)%            |
| Optoelectronics and Manufacturing division | 81.0                         | 27%                             | 89.6                         | 29%                             | 8.6              | 11%             |
| Intersegment revenues                      | (23.0)                       | (7)%                            | (22.7)                       | (7)%                            | 0.3              | 1%              |
| Total revenues                             | <u>\$ 295.2</u>              | <u>100%</u>                     | <u>\$ 307.2</u>              | <u>100%</u>                     | <u>\$ 12.0</u>   | <u>4%</u>       |

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Net revenues for the six months ended December 31, 2008, increased \$12.0 million, or 4%, to \$307.2 million from \$295.2 million for the comparable prior-year period.

Revenues for the Security division for the six months ended December 31, 2008, increased \$13.1 million or 12%, to \$125.8 million, from \$112.7 million for the comparable prior-year period. The increase was attributable to a \$12.5 million, or 25%, increase in sales of baggage and parcel inspection, people screening and hold baggage screening equipment, and to a \$5.5 million, or 30%, increase in service revenue, partially offset by a decrease in sales of cargo and vehicle inspection systems of \$4.9 million or 11% due to the timing of shipments.

Revenues for the Healthcare division for the six months ended December 31, 2008, decreased \$10.0 million, or 8%, to \$114.5 million, from \$124.5 million for the comparable prior-year period. The decrease was primarily due to a decrease in patient monitoring equipment sales, primarily in North America, of \$9.6 million, generally attributable to the weak U.S. economy, and lower clinical trial services revenue of \$2.8 million.

Revenues for the Optoelectronics and Manufacturing division for the six months ended December 31, 2008, increased \$8.6 million, or 11%, to \$89.6 million, from \$81.0 million for the comparable prior-year period. The change in revenues was attributable to increased contract manufacturing sales of \$10.1 million and increased commercial optoelectronics sales of \$2.4 million. These increases were partially offset by decreases in weapons simulation sales of \$3.6 million. The increase in contract manufacturing revenues is primarily due to the fulfillment of a significant defense-industry related contract that is expected to continue through the end of fiscal 2009 and into the first quarter of fiscal 2010. Included in this total revenue amount for the six months ended December 31, 2008, the Optoelectronics and Manufacturing division recorded intersegment sales of \$22.7 million, compared to \$23.0 million in the comparable prior-year period. Such intersegment sales are eliminated in consolidation.

### Gross Profit

| <u>(in millions)</u> | <u>YTD Q2<br/>2008</u> | <u>% of<br/>Net Sales</u> | <u>YTD Q2<br/>2009</u> | <u>% of<br/>Net Sales</u> |
|----------------------|------------------------|---------------------------|------------------------|---------------------------|
| Gross profit         | <u>\$ 103.1</u>        | <u>34.9%</u>              | <u>\$ 104.1</u>        | <u>33.9%</u>              |

Gross profit increased \$1.0 million, or 1%, to \$104.1 million for the six months ended December 31, 2008, from \$103.1 million for the comparable prior-year period. The increase in gross profit is primarily the result of a 4% increase in total revenues. The gross profit margin decreased to 33.9%, from 34.9% for the comparable prior-year period. This decrease was primarily attributable to a decrease in sales of patient monitors by our Healthcare division, which generally carry higher gross margins than many of our other products and an increase in contract manufacturing sales by our Optoelectronics and Manufacturing division, which sales generally carry lower gross margins than many of our other offerings.

### Operating Expenses

| <u>(in millions)</u>                | <u>YTD Q2<br/>2008</u> | <u>% of<br/>Net Sales</u> | <u>YTD Q2<br/>2009</u> | <u>% of<br/>Net Sales</u> | <u>\$ Change</u> | <u>% Change</u> |
|-------------------------------------|------------------------|---------------------------|------------------------|---------------------------|------------------|-----------------|
| Selling, general and administrative | \$ 75.3                | 25.5%                     | \$ 73.3                | 23.9%                     | \$ (2.0)         | (3)%            |
| Research and development            | 21.5                   | 7.3%                      | 18.9                   | 6.1%                      | (2.6)            | (12)%           |
| Restructuring and other charges     | 2.2                    | 0.7%                      | 3.6                    | 1.2%                      | 1.4              | 64%             |
| Total operating expenses            | <u>\$ 99.0</u>         | <u>33.5%</u>              | <u>\$ 95.8</u>         | <u>31.2%</u>              | <u>\$ (3.2)</u>  | <u>(3)%</u>     |

**Selling, general and administrative expenses.** For the six months ended December 31, 2008, SG&A expenses decreased by \$2.0 million, or 3%, to \$73.3 million, from \$75.3 million for the comparable prior-year period. As a percentage of revenues, SG&A expenses for the six months ended December 31, 2008 decreased to 23.9%, from 25.5% for the comparable prior-year period. This reduction was primarily due to a decrease of \$3.1 million in spending following restructuring activities, which were heavily focused in our Healthcare division.

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**Research and development.** R&D expenses include research related to new product development and product enhancement expenditures. For the six months ended December 31, 2008, such expenses decreased \$2.6 million, or 12%, to \$18.9 million, from \$21.5 million for the comparable prior-year period. As a percentage of revenues, research and development expenses were 6.1% for the six months ended December 31, 2008, compared to 7.3% for the comparable prior-year period. The decrease in R&D expenses for the six month period ended December 31, 2008, was primarily attributable to: (i) a decrease in R&D spending within our Security division of \$0.9 million due to receipt of offsetting third-party grants and (ii) and a decrease of \$1.7 million in the six months ended December 31, 2008 in our Healthcare division, primarily attributable to cost cutting activities associated with restructuring.

**Restructuring and other charges.** In fiscal 2007, we initiated a series of restructuring activities that were intended to align our global capacity and infrastructure with demand by our customers and thereby improve our operating efficiencies. During the six months ended December 31, 2008, we continued this initiative to further increase our operating efficiencies. As a result, we recorded restructuring charges of \$3.6 million. These charges included \$3.0 million in our Healthcare division, \$0.2 million in our Security division, \$0.1 million in our Optoelectronics and Manufacturing division, and \$0.3 million in our Corporate segment, primarily relating to facility closure and employee severance costs. During the six months ended December 31, 2007, we recorded restructuring charges of \$2.2 million. These charges included \$1.9 million in our Security division, \$0.2 million in our Healthcare division, and \$0.1 million in our Optoelectronics and Manufacturing division, primarily relating to employee severance and manufacturing relocation costs.

### Other Income and Expenses

| (in millions)                  | YTD Q2<br>2008 | % of<br>Net Sales | YTD Q2<br>2009 | % of<br>Net Sales | \$ Change | % Change |
|--------------------------------|----------------|-------------------|----------------|-------------------|-----------|----------|
| Interest expense               | \$ 2.4         | 0.9%              | \$ 2.0         | 0.7%              | \$ (0.4)  | (17)%    |
| Interest income                | (0.2)          | (0.1)%            | (0.3)          | (0.1)%            | (0.1)     | (50)%    |
| Total other income and expense | \$ 2.2         | 0.8%              | \$ 1.7         | 0.6%              | \$ (0.5)  | (23)%    |

**Interest expense.** For the six months ended December 31, 2008, we incurred interest expense of \$2.0 million, compared to \$2.4 million for the comparable prior-year period. The decrease in interest expense was primarily attributable to a lower cost of borrowing, which was partially offset by higher levels of debt. We incurred higher levels of debt in connection with a \$15.8 million repurchase, during fiscal 2008, of all outstanding shares of Spacelabs Healthcare and as well as a \$7.2 million repurchase, during the three months ended December 31, 2008 of 600,000 shares of our common stock.

**Income taxes.** For the six months ended December 31, 2008, our income tax provision was \$2.3 million, compared to a benefit of \$0.7 million for the comparable prior-year period. Our effective tax rate for the six months ended December 31, 2008 was 34.4%, compared to 35.3% in the comparable prior-year period. Our provision for income taxes is dependent on the mix of income from U.S. and foreign locations due to tax rate differences among such countries as well as due to the impact of permanent taxable differences.

### Liquidity and Capital Resources

To date, we have financed our operations primarily through cash flow from operations, proceeds from equity issuances and our credit facilities. Cash and cash equivalents totaled \$34.9 million at December 31, 2008, an increase of \$16.7 million from \$18.2 million at June 30, 2008. The changes in our working capital and cash and cash equivalent balances during the six months ended are described below.

| (in millions)             | June 30,<br>2008 | December 31,<br>2008 | % Change |
|---------------------------|------------------|----------------------|----------|
| Working capital           | \$ 195.0         | \$ 177.7             | (9)%     |
| Cash and cash equivalents | 18.2             | 34.9                 | 92%      |

**Working Capital.** The decrease in working capital is primarily due to decreases in accounts receivable of \$29.1 million, due to an ongoing focus on collections, an increase in accounts payable of \$11.2 million and an increase in advances from customers of \$5.8 million, due primarily to a small number of large sales by our Security division. These decreases to working capital were partially offset by: (i) a \$16.7 million increase in cash; (ii) a \$5.0 million increase in prepaid assets, partially due to the renewal of our worldwide insurance policies and prepayments to vendors following advances by customers; (iii) a \$3.7 million decrease in our bank lines of credit; and (iv) a \$2.4 million reduction in other accrued expenses and current liabilities.

| (in millions)                                | YTD Q2<br>2008 | YTD Q2<br>2009 | \$ Change |
|--|----------------|----------------|-----------|
| Cash provided (used) in operating activities | \$ (14.6)      | \$ 33.1        | \$ 47.7   |
| Cash used in investing activities            | (6.4)          | (6.9)          | (0.5)     |
| Cash provided (used) in financing activities | 19.7           | (11.9)         | (31.6)    |

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*Cash Provided (Used) in Operating Activities.* Cash flows from operating activities can fluctuate significantly from period to period, as net income, tax timing differences, and other items can significantly impact cash flows. Net cash provided by operations for the six months ended December 31, 2008 was \$33.1 million, an increase of \$47.7 million from the \$14.6 million used in the comparable prior-year period. This improvement was partially due to an increase in our net income of \$5.1 million for the six months ended December 31, 2008, after giving consideration to non-cash operating items including depreciation and amortization, stock-based compensation, deferred taxes and provision for losses on accounts receivable, among others, for both periods. The improvement was also due to better working capital management in the current year period versus the prior year period, resulting in: (i) a \$22.2 million reduction in accounts receivable due to an ongoing focus on collections; (ii) an \$18.4 million increase in advances from customers; and (iii) a \$14.4 million decrease in inventory. These cash generating improvements were partially offset by: (i) decreases in accounts payable of \$5.1 million; (ii) increases in other receivables of \$3.2 million as well as (iii) increases in prepaid expenses and other current assets of \$3.1 million.

*Cash Used in Investing Activities.* Net cash used in investing activities was \$6.9 million for the six months ended December 31, 2008, compared to \$6.4 million for the six months ended December 31, 2007. During the six months ended December 31, 2008, the primary investing activity involved \$5.2 million of capital expenditures as compared to \$5.0 million for capital expenditures during the comparable prior year period. During the six months ended December 31, 2008, we also acquired intangible and other assets of \$1.7 million as compared to \$0.8 million during the comparable prior-year period. In addition, during the comparable prior year period, we repurchased shares of Spacelabs Healthcare stock for \$0.7 million.

*Cash Provided (Used) in Financing Activities.* Net cash used in financing activities was \$11.9 million for the six months ended December 31, 2008, compared to net cash provided by financing activities of \$19.7 million for the six months ended December 31, 2007. During the six months ended December 31, 2008, we used \$7.2 million in cash to repurchased 600,000 shares of our common stock. We paid down our ongoing scheduled debt and capital leases by an additional \$3.4 million and we paid down our revolving lines of credit by \$3.0 million. In the prior year period, we had received net proceeds of \$21.7 million when we entered into a new credit agreement while simultaneously paying down the preceding credit facility, less the ongoing repayment of our new credit agreement as well as all other scheduled debt and capital lease payments. In the prior year period, we also paid down our revolving lines of credit by \$3.3 million.

### **Borrowings**

We maintain a credit agreement with certain lenders allowing for borrowings of up to \$124.5 million. The credit agreement consists of a \$74.5 million, five-year, revolving credit facility (including a \$45 million sub-limit for letters-of-credit) and a \$50 million five-year term loan. Borrowings under the agreement bear interest at either (i) the London Interbank Offered Rate (LIBOR) plus between 2.00% and 2.50% or (ii) the bank's prime rate plus between 1.00% and 1.50%. The rates are determined based on our consolidated leverage ratio. As of December 31, 2008, the effective, weighted-average interest rate under the credit agreement was 2.59%. Our borrowings under the credit agreement are guaranteed by substantially all of the Company's direct and indirect wholly-owned subsidiaries and are secured by substantially all of the Company's and its subsidiary guarantors' assets. The agreement contains various representations, warranties, affirmative, negative and financial covenants, and conditions of default customary for financing agreements of this type. As of December 31, 2008, \$45.3 million was outstanding under the term loan, \$15.0 million was outstanding under the revolving credit facility, and \$12.7 million was outstanding under the letter-of-credit facility.

Several of our foreign subsidiaries maintain bank lines-of-credit, denominated in local currencies, to meet short-term working capital requirements and for the issuance of letters-of-credit. As of December 31, 2008, \$21.3 million was outstanding under these letter-of-credit facilities, while no debt was outstanding. As of December 31, 2008, the total amount available under these credit facilities was \$28.4 million, with a total cash borrowing sub-limit of \$6.9 million.

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In December 2004, we entered into a bank loan of \$5.3 million to fund the acquisition of land and buildings in the U.K. The loan is payable over a 20-year period, with quarterly installments of £34,500 (approximately \$50,000 as of December 31, 2008). The loan bears interest at British pound-based LIBOR plus 1.2%, payable on a quarterly basis. As of December 31, 2008, \$3.2 million remained outstanding under this loan at an interest rate of 4% per annum.

Our long-term debt consisted of the following:

| <u>(in thousands)</u>                    | <u>June 30,</u><br><u>2008</u> | <u>December 31,</u><br><u>2008</u> |
|--|--------------------------------|------------------------------------|
| Five-year term loan due in fiscal 2013   | \$47,763                       | \$ 45,263                          |
| Twenty-year term loan due in fiscal 2025 | 4,539                          | 3,178                              |
| Capital leases                           | 2,193                          | 1,705                              |
| Other                                    | 1,189                          | 936                                |
|  | <u>55,684</u>                  | <u>51,082</u>                      |
| Less current portion of long-term debt   | 6,593                          | 7,515                              |
| Long-term portion of debt                | <u>\$49,091</u>                | <u>\$ 43,567</u>                   |

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

### **Stock Repurchase Program**

Our Board of Directors has authorized a stock repurchase program under which we can repurchase up to 3,000,000 shares of our common stock. During the three months ended December 31, 2008, we repurchased 604,128 shares under this program and 726,845 shares were available for additional repurchase under the program as of December 31, 2008. Upon repurchase, the shares are restored to the status of authorized but unissued shares and we record them as a reduction in the number of shares of common stock issued and outstanding in our condensed consolidated financial statements.

### **Dividend Policy**

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

### **Contractual Obligations**

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

In August 2002, we purchased a minority equity interest in CXR Limited. In June 2004, we increased our equity interest to approximately 75% and in December 2004, we acquired the remaining 25%. As compensation to the selling shareholders for this remaining interest, we agreed to make certain royalty payments during the 18 years following the acquisition of its remaining interest. Royalty payments are based on the license of, or sales of products containing technology owned by CXR Limited. As of December 31, 2008, no royalty payments have been earned.

In January 2004, we acquired Advanced Research & Applications Corp.. During the seven years following the acquisition, contingent consideration is payable based on its net revenues, provided certain requirements are met. The contingent consideration is capped at \$30.0 million. As of December 31, 2008, no contingent consideration has been earned.

In July 2005, we acquired certain assets of InnerStep, B.S.E., Inc. During the seven years following the acquisition, contingent consideration is payable based on its profits before interest and taxes, provided certain requirements are met. The contingent consideration is capped at \$6.0 million. As of December 31, 2008, no contingent consideration has been earned.

## **Off Balance Sheet Arrangements**

As of December 31, 2008, we did not have any significant off balance sheet arrangements as defined in Item 303(a)(4) of Regulation S-K.

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

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

### **Market Risk**

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

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

### **Foreign Currency**

We maintain the accounts of our operations in each of the following countries in the following currencies: Finland, France, Germany, Italy and Greece (Euros), Singapore (Singapore dollars and U.S. dollars), Malaysia (Malaysian ringgits), United Kingdom (U.K. pounds), Norway (Norwegian kroners), India (Indian rupees), Indonesia (Indonesian rupiah), Hong Kong (Hong Kong dollars), China (Chinese renminbi), Canada (Canadian dollars), Australia (Australian dollars) and Cyprus (Cypriot pounds). Foreign currency financial statements are translated into U.S. dollars at period-end rates, with the exception of revenues, costs and expenses, which are translated at average rates during the reporting period. We include gains and losses resulting from foreign currency transactions in income, while we exclude those resulting from translation of financial statements from income and include them as a component of accumulated other comprehensive income (AOCI). Transaction gains and losses, which were included in our condensed consolidated statement of operations, amounted to a loss of approximately \$0.2 million during the three months ended December 31, 2008, as compared to a gain of \$0.1 million for the comparable prior year period; and gains of \$0.6 million and \$0.2million for the six months ended December 31, 2008 and 2007, respectively. Furthermore, a 10% appreciation of the U.S. dollar relative to the local currency exchange rates would have resulted in a net increase in our operating income of approximately \$2 million in second quarter of fiscal 2008. Conversely, a 10% depreciation of the U.S. dollar relative to the local currency exchange rates would have resulted in a net decrease in our operating income of approximately \$2 million in second quarter of fiscal 2008.

### **Use of Derivatives**

From time to time, our use of derivatives consists primarily of foreign exchange contracts and interest rate swaps. There were no foreign exchange contracts or interest rate swaps outstanding as of June 30, 2008 and December 31, 2008.

### **Importance of International Markets**

International markets provide us with significant growth opportunities. However, the following events, among others, could adversely affect our financial results in subsequent periods: periodic economic downturns in different regions of the world, changes in trade policies or tariffs, wars and other forms of political instability. We continue to perform ongoing credit evaluations of our customers' financial condition and, if deemed necessary, we require advance payments for sales. We monitor economic and currency conditions

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around the world to evaluate whether there may be any significant effect on our international sales in the future. Due to our overseas investments and the necessity of dealing in local currencies in many foreign business transactions, we are at risk with respect to foreign currency fluctuations.

### **Inflation**

We do not believe that inflation had a material impact on our results of operations during the three and six months ended December 31, 2008.

### **Interest Rate Risk**

We classify all highly liquid investments with maturity of three months or less as cash equivalents and record them in the balance sheet at fair value.

## **Item 4. Controls and Procedures**

### *(a) Evaluation of Disclosure Controls and Procedures*

As of December 31, 2008, the end of the period covered by this report, our management, including our Chief Executive Officer and our Chief Financial Officer, reviewed and evaluated the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended). Such disclosure controls and procedures are designed to ensure that material information we must disclose in this report is recorded, processed, summarized and filed or submitted on a timely basis. Based upon that evaluation our management, Chief Executive Officer and Chief Financial Officer, concluded that our disclosure controls and procedures were effective as of December 31, 2008.

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

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

## **PART II OTHER INFORMATION**

## **Item 1. Legal Proceedings**

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

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

## **Item 1A. Risk Factors**

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

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

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

During the three months ended December 31, 2008, pursuant to this program, we repurchased a total of 604,128 shares of our common stock in open market transactions. The following table provides a monthly summary of such stock repurchase activity:

|               | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plan | Maximum Number of Shares that May Yet Be Purchased Under the Plan (1) |
|---------------|----------------------------------|------------------------------|---|---|
| October 2008  | —                                | —                            | 0   | 1,330,973   |
| November 2008 | 306,103                          | \$ 11.09                     | 306,103   | 1,024,870   |
| December 2008 | 298,025                          | \$ 12.63                     | 298,025   | 726,845   |
| <b>Total</b>  | <b>604,128</b>                   | <b>\$ 11.85</b>              | <b>604,128</b>  |   |

### Item 4. Submission of Matters to a Vote of Security Holders

We held our Annual Meeting on December 8, 2008. At the meeting, shareholders voted on the following actions:

#### 1. Election of Directors.

| <u>Name</u>          | <u>For</u> | <u>Withheld</u> |
|----------------------|------------|-----------------|
| Deepak Chopra        | 14,554,446 | 385,138         |
| Ajay Mehra           | 14,497,511 | 442,073         |
| Steven C. Good       | 13,309,310 | 1,630,274       |
| Meyer Luskin         | 14,066,465 | 873,119         |
| Chand R. Viswanathan | 14,861,290 | 78,294          |
| Leslie E. Bider      | 14,021,422 | 918,162         |

The six nominees who received the highest number of votes (all of the above individuals) were elected to the Board of Directors and will serve as directors until our next annual meeting and until their successor is elected and qualified.

#### 2. Ratification of the appointment of Moss Adams LLP as our independent registered public accounting firm for the fiscal year ending June 30, 2009.

|                |            |
|----------------|------------|
| <b>For</b>     | 14,910,335 |
| <b>Against</b> | 19,960     |
| <b>Abstain</b> | 9,289      |

The proposal was approved.

#### 3. Ratification of the adoption of the OSI System, Inc. 2008 Employee Stock Purchase Plan, including the reservation of 1,500,000 shares of our Common Stock for issuance thereunder.

|                  |            |
|------------------|------------|
| <b>For</b>       | 10,902,621 |
| <b>Against</b>   | 961,147    |
| <b>Abstain</b>   | 661,063    |
| <b>Non-Votes</b> | 2,414,753  |

The proposal was approved.

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**Item 6. Exhibits**

- 10.1 Second Amendment to Credit Agreement
- 31.1 Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 32.2 Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

**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 29th day of January 2009.

**OSI SYSTEMS, INC.**

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

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

## SECOND AMENDMENT TO CREDIT AGREEMENT

**THIS SECOND AMENDMENT TO CREDIT AGREEMENT** (this "Amendment"), dated as of November 13, 2008, is by and among **OSI SYSTEMS, INC.**, a California corporation (the "Borrower"), the Domestic Subsidiaries of the Borrower as may from time to time become a party hereto (collectively, the "Guarantors"), and **WACHOVIA BANK, NATIONAL ASSOCIATION**, as administrative agent on behalf of the Lenders under the Credit Agreement (as hereinafter defined) (in such capacity, the "Administrative Agent"). Capitalized terms used herein and not otherwise defined herein shall have the meanings ascribed thereto in the Credit Agreement.

## WITNESSETH

**WHEREAS**, the Borrower, the Guarantors, certain banks and financial institutions from time to time party thereto (the "Lenders") and the Administrative Agent are parties to that certain Credit Agreement dated as of July 27, 2007 (as amended, modified, extended, restated, replaced, or supplemented from time to time, the "Credit Agreement");

**WHEREAS**, the Credit Parties have requested that the Lenders amend certain provisions of the Credit Agreement; and

**WHEREAS**, the Required Lenders are willing to make such amendments to the Credit Agreement, subject to the terms and conditions set forth herein.

**NOW, THEREFORE**, in consideration of the agreements hereinafter set forth, and for other good and valuable consideration, the receipt and adequacy of which are hereby acknowledged, the parties hereto agree as follows:

**ARTICLE I**  
**AMENDMENTS TO CREDIT AGREEMENT**

**1.1 Amendment to Definition of Excess Cash Flow.** The definition of Excess Cash Flow is hereby amended and restated in its entirety to read as follows:

*"Excess Cash Flow" shall mean, with respect to any fiscal year of the Borrower, for the Borrower and its Subsidiaries on a Consolidated basis, an amount equal to, without duplication, (a) cash flow from operations for the Borrower and its Subsidiaries on a Consolidated basis for such period minus (b) Consolidated Capital Expenditures for such period minus (c) optional prepayments of the Term Loan and of the Revolving Loans (to the extent accompanied by a corresponding reduction of the Revolving Commitments) made during such period minus (d) License Fees for such period minus (e) Scheduled Funded Debt Payments minus (f) cash consideration paid in connection with Permitted Acquisitions, including any earnout payments made during such period minus (g) fees paid in relation to this Agreement minus (h) Restricted Payments made during such period to the extent permitted by Section 6.10(d).*

**1.2 Amendment to Definition of Foreign Currency.** The definition of Foreign Currency is hereby amended and restated in its entirety to read as follows:

*"Foreign Currency" shall mean any of the following: (a) Euro, Sterling and Canadian Dollars and (b) any other currency that is freely tradable and convertible into Dollars that is approved by the applicable Issuing Lender and the Administrative Agent.*

**1.3 Amendment to Definition of LOC Obligations.** The definition of LOC Obligations is hereby amended and restated in its entirety to read as follows:

*“LOC Obligations” shall mean, at any date of determination, the sum of (a) with respect to all Letters of Credit issued in Dollars, the Dollar Equivalent of the maximum amount which is, or at any time thereafter may become, available to be drawn under such Letters of Credit then outstanding, assuming compliance with all requirements for drawings referred to in such Letters of Credit, (b) with respect to all Letters of Credit issued in a Foreign Currency, the Dollar Equivalent of the maximum amount which is, or at any time thereafter may become, available to be drawn under such Letter of Credit then outstanding, assuming compliance with all requirements for drawings referred to in such Letters of Credit and (c) the aggregate amount of all drawings under Letters of Credit honored by the Issuing Lender but not theretofore reimbursed.*

**1.4 Amendment to Definition of Permitted Acquisition.** Clause (v) of the definition of Permitted Acquisition is hereby amended and restated in its entirety to read as follows:

*(v)(A) for any Permitted Acquisition with total consideration greater than \$10,000,000, the Target shall have earnings before interest, taxes, depreciation and amortization (using the methodology applied in the calculation of Consolidated EBITDA) for the four fiscal quarter period ending prior to the acquisition date in an amount greater than \$0 and (B) for any Permitted Acquisition with total consideration less than or equal to \$10,000,000, the Target shall have earnings before interest, taxes, depreciation and amortization (using the methodology applied in the calculation of Consolidated EBITDA) for the four fiscal quarter period ending prior to the acquisition date in an amount greater than negative \$3,000,000.*

**1.5 Amendment to Section 1.6(b).** Section 1.6(b) of the Credit Agreement is hereby amended and restated in its entirety to read as follows:

*(b) Any request for a Letter of Credit in a currency other than Dollars shall be made to the Administrative Agent and the applicable Issuing Lender, not later than 11:00 A.M., five (5) Business Days prior to the date of the desired L/C Credit Extension (or such other time or date as may be agreed by the Administrative Agent and the applicable Issuing Lender, in their sole discretion). The Administrative Agent and the applicable Issuing Lender shall promptly notify the Borrower of the response to any request pursuant to this Section.*

**1.6 Amendment to Section 2.3(j).** Section 2.3(j) of the Credit Agreement is hereby amended and restated in its entirety to read as follows:

*(j) The Borrower may request, and any Issuing Lender may issue, Letters of Credit denominated in any Foreign Currency (any such Letter of Credit, a “Foreign Currency Letter of Credit”), subject to the following provisions:*

**1.7 Amendment to Section 2.3(j)(iii).** Section 2.3(j)(iii) of the Credit Agreement is hereby amended and restated in its entirety to read as follows:

*(iii) Reserved.*

**1.8 Amendment to Section 2.3(j)(v).** Section 2.3(j)(v) of the Credit Agreement is hereby amended and restated in its entirety to read as follows:

*(v) within five days of demand therefor by the applicable Issuing Lender, the Borrower shall reimburse such Issuing Lender for any Foreign Currency Letter of Credit, for any costs, expenses, losses or liabilities (including foreign currency exchange costs and losses) incurred by such Issuing Lender in connection with any drawing under such Foreign Currency Letter of Credit and the reimbursement of such drawing in Dollars rather than the applicable Foreign Currency, including, without limitation, any costs, expenses, losses or liabilities resulting from the determination of the Spot Rate two Business Days prior to the date a drawing under such Foreign Currency Letter of Credit is reimbursed.*

**1.9 Amendment to Section 2.3.** A new clause (k) shall be added to the end of Section 2.3 of the Credit Agreement to read as follows:

*(k) Issuing Lenders. Each Issuing Lender shall (i) prior to the issuance, renewal or extension of any Letter of Credit, receive written confirmation from the Administrative Agent that such issuance, renewal or extension meets the requirements set forth in Section 2.3, (ii) provide to the Administrative Agent, upon the issuance, renewal or extension of any Letter of Credit and on a monthly basis, a report that details the activity with respect to each Letter of Credit issued by such Issuing Lender (including an indication of the maximum amount then in effect with respect to each such Letter of Credit) and (iii) upon the Administrative Agent's request, any other documentation relating to any such Letter of Credit (including, without limitation, copies of such Letters of Credit).*

**1.10 Amendment to Section 6.1(i).** Section 6.1(i)(A) of the Credit Agreement is hereby amended and restated in its entirety to read as follows:

*(i) (A) Foreign Subsidiaries organized under the laws of the United Kingdom may incur cash borrowings (excluding Foreign Mortgage Indebtedness) in an aggregate amount not to exceed \$15,000,000,*

**1.11 Amendment to Section 6.10.** Section 6.10 of the Credit Agreement is hereby amended and restated in its entirety to read as follows:

**Section 6.10 Restricted Payments.**

*The Credit Parties will not, nor will they permit any Subsidiary to, directly or indirectly, declare, order, make or set apart any sum for or pay any Restricted Payment, except (a) to make dividends payable solely in the same class of Equity Interest of such Person, (b) to make dividends or other distributions payable to the Credit Parties (directly or indirectly through its Subsidiaries), (c) so long as (i) no Default or Event of Default shall have occurred and be continuing or would result therefrom and (ii) the Borrower shall be in pro forma compliance with the financial covenants set forth in Sections 5.9 after giving effect to any such payment, the Credit Parties may (A) effectuate the Specified Investment, (B) purchase shares (or the equivalent, or rights to acquire shares or the equivalent) held by directors, officers and employees of such Credit Party and (C) make interest payments with respect to Subordinated Debt and (d) so long as (i) no Default or Event of Default shall have occurred and be continuing or would result therefrom, (ii) the Borrower shall be in pro forma compliance with the financial covenants set forth in Sections 5.9 after giving effect to any such repurchase, (iii) after giving effect to such repurchase, there shall be at least \$25,000,000 of Revolver Availability and (iv) after giving effect to any such repurchase on a Pro Forma Basis, the Borrower shall have a Consolidated Leverage Ratio of less than or equal to 2.00 to 1.0, the Borrower may repurchase shares of its Equity Interests in an aggregate amount not to exceed \$25,000,000 during the term of this Agreement as measured by the purchase price paid by the Borrower for such Equity Interests.*

**ARTICLE II  
CONDITIONS TO EFFECTIVENESS**

**2.1 Closing Conditions.** This Amendment shall become effective as of the day and year set forth above (the "Amendment Effective Date") upon satisfaction of the following conditions (in form and substance reasonably acceptable to the Administrative Agent):

(a) Executed Amendment. Receipt by the Administrative Agent of counterparts of this Amendment executed by a duly authorized officer of each party hereto.

(b) Executed Lender Consents. Receipt by the Administrative Agent of executed lender consents, in substantially the form of Exhibit A attached hereto (each a "Lender Consent"), from the Required Lenders authorizing the Administrative Agent to enter into this Amendment on their behalf. The delivery by the Administrative Agent of its signature page to this Amendment shall constitute conclusive evidence that the consents from the Required Lenders have been obtained.

(c) **Fees and Expenses.** The Administrative Agent shall have received from the Borrower, on behalf of each Lender that executes and delivers a Lender Consent to the Administrative Agent by 5:00 p.m. (Charlotte, NC time) on November 14, an amendment fee in an amount equal to five (5) basis points on (i) the aggregate Revolving Commitments of such approving Revolving Lenders and (ii) the outstanding principal amount of the Term Loan held by such approving Term Loan Lenders. In addition, the Administrative Agent shall have received from the Borrower such other fees and expenses that are payable in connection with the consummation of the transactions contemplated hereby, including, without limitation, the reasonable fees and expenses of Moore & Van Allen PLLC.

### **ARTICLE III MISCELLANEOUS**

**3.1 Amended Terms.** On and after the Amendment Effective Date, all references to the Credit Agreement in each of the Credit Documents shall hereafter mean the Credit Agreement as amended by this Amendment. Except as specifically amended hereby or otherwise agreed, the Credit Agreement is hereby ratified and confirmed and shall remain in full force and effect according to its terms.

**3.2 Representations and Warranties of Credit Parties.** Each of the Credit Parties represents and warrants as follows:

(a) It has taken all necessary action to authorize the execution, delivery and performance of this Amendment.

(b) This Amendment has been duly executed and delivered by such Person and constitutes such Person's legal, valid and binding obligations, enforceable in accordance with its terms, except as such enforceability may be subject to (i) bankruptcy, insolvency, reorganization, fraudulent conveyance or transfer, moratorium or similar laws affecting creditors' rights generally and (ii) general principles of equity (regardless of whether such enforceability is considered in a proceeding at law or in equity).

(c) No consent, approval, authorization or order of, or filing, registration or qualification with, any court or governmental authority or third party is required in connection with the execution, delivery or performance by such Person of this Amendment.

(d) The representations and warranties set forth in Article III of the Credit Agreement are true and correct as of the date hereof (except for those which expressly relate to an earlier date).

(e) After giving effect to this Amendment, no event has occurred and is continuing which constitutes a Default or an Event of Default.

(f) The Security Documents continue to create a valid security interest in, and Lien upon, the Collateral, in favor of the Administrative Agent, for the benefit of the Lenders, which security interests and Liens are perfected in accordance with the terms of the Security Documents and prior to all Liens other than Permitted Liens.

(g) Except as specifically provided in this Amendment, the Credit Party Obligations are not reduced or modified by this Amendment and are not subject to any offsets, defenses or counterclaims.

**3.3 Reaffirmation of Credit Party Obligations.** Each Credit Party hereby ratifies the Credit Agreement and acknowledges and reaffirms (a) that it is bound by all terms of the Credit Agreement applicable to it and (b) that it is responsible for the observance and full performance of its respective Credit Party Obligations.

**3.4 Credit Document.** This Amendment shall constitute a Credit Document under the terms of the Credit Agreement.

**3.5 Expenses.** The Borrower agrees to pay all reasonable costs and expenses of the Administrative Agent in connection with the preparation, execution and delivery of this Amendment, including without limitation the reasonable fees and expenses of the Administrative Agent's legal counsel.

**3.6 Further Assurances.** The Credit Parties agree to promptly take such reasonable action, upon the request of the Administrative Agent, as is necessary to carry out the intent of this Amendment.

**3.7 Entirety.** This Amendment and the other Credit Documents embody the entire agreement among the parties hereto and supersede all prior agreements and understandings, oral or written, if any, relating to the subject matter hereof.

**3.8 Counterparts; Telecopy.** This Amendment may be executed in any number of counterparts, each of which when so executed and delivered shall be an original, but all of which shall constitute one and the same instrument. Delivery of an executed counterpart to this Amendment by telecopy or other electronic means shall be effective as an original and shall constitute a representation that an original will be delivered.

**3.9 No Actions, Claims, Etc.** As of the date hereof, each of the Credit Parties hereby acknowledges and confirms that it has no knowledge of any actions, causes of action, claims, demands, damages and liabilities of whatever kind or nature, in law or in equity, against the Administrative Agent, the Lenders, or the Administrative Agent's or the Lenders' respective officers, employees, representatives, agents, counsel or directors arising from any action by such Persons, or failure of such Persons to act under this Credit Agreement on or prior to the date hereof.

**3.10 GOVERNING LAW. THIS AMENDMENT SHALL BE GOVERNED BY, AND SHALL BE CONSTRUED AND ENFORCED IN ACCORDANCE WITH THE LAWS OF THE STATE OF NEW YORK.**

**3.11 Successors and Assigns.** This Amendment shall be binding upon and inure to the benefit of the parties hereto and their respective successors and assigns.

**3.12 General Release.** In consideration of the Administrative Agent, on behalf of the Lenders, entering into this Amendment, each Credit Party hereby releases the Administrative Agent, the Lenders, and the Administrative Agent's and the Lenders' respective officers, employees, representatives, agents, counsel and directors from any and all actions, causes of action, claims, demands, damages and liabilities of whatever kind or nature, in law or in equity, now known or unknown, suspected or unsuspected to the extent that any of the foregoing arises from any action or failure to act under the Credit Agreement on or prior to the date hereof.

**3.13 Consent to Jurisdiction; Service of Process; Waiver of Jury Trial.** The jurisdiction, services of process and waiver of jury trial provisions set forth in Sections 9.13 and 9.16 of the Credit Agreement are hereby incorporated by reference, *mutatis mutandis*.

[REMAINDER OF PAGE INTENTIONALLY LEFT BLANK]

**BORROWER:**

**OSI SYSTEMS, INC.,**  
a California corporation

By: /s/ Deepak Chopra  
Name: Deepak Chopra  
Title: Chief Executive Officer

**GUARANTORS:**

**DOLPHIN MEDICAL, INC.,**  
a California corporation

By: /s/ Deepak Chopra  
Name: Deepak Chopra  
Title: Chief Executive Officer

**FERSON TECHNOLOGIES, INC.,**  
a California corporation

By: /s/ Deepak Chopra  
Name: Deepak Chopra  
Title: Chief Executive Officer

**METOREX SECURITY PRODUCTS, INC.,**  
a California corporation

By: /s/ Deepak Chopra  
Name: Deepak Chopra  
Title: Chief Executive Officer

**OSI DEFENSE SYSTEMS, LLC,**  
a Florida limited liability company

By: /s/ Deepak Chopra  
Name: Deepak Chopra  
Title: Chief Executive Officer

**OSI ELECTRONICS, INC.,**  
a California corporation

By: /s/ Deepak Chopra  
Name: Deepak Chopra  
Title: Chief Executive Officer

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**OSI OPTOELECTRONICS, INC.,**  
a California corporation

By: /s/ Deepak Chopra  
Name: Deepak Chopra  
Title: Chief Executive Officer

**OSTEOMETER MEDITECH, INC.,**  
a California corporation

By: /s/ Deepak Chopra  
Name: Deepak Chopra  
Title: Chief Executive Officer

**RAPISCAN SECURITY PRODUCTS, INC.,**  
a California corporation

By: /s/ Deepak Chopra  
Name: Deepak Chopra  
Title: Chief Executive Officer

**RAPISCAN LABORATORIES, INC.,**  
a Delaware corporation

By: /s/ Shiva Kumar  
Name: Shiva Kumar  
Title: President

**RAPISCAN SYSTEMS, INC.,**  
a California corporation

By: /s/ Deepak Chopra  
Name: Deepak Chopra  
Title: Chief Executive Officer

**SPACELABS HEALTHCARE, INC.,**  
a Delaware corporation

By: /s/ Deepak Chopra  
Name: Deepak Chopra  
Title: Chief Executive Officer

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**SPACELABS HEALTHCARE, L.L.C.,**  
a Washington limited liability company

By: /s/ Deepak Chopra  
Name: Deepak Chopra  
Title: Chief Executive Officer

**SPACELABS MEDICAL, INC.,**  
a Delaware corporation

By: /s/ Deepak Chopra  
Name: Deepak Chopra  
Title: Chief Executive Officer

**ADMINISTRATIVE AGENT:**

**WACHOVIA BANK, NATIONAL ASSOCIATION,**  
as a Lender and as Administrative Agent on behalf of the Required Lenders

By: /s/ James Travagline  
Name: James Travagline  
Title: Vice President

**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 15(d)-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: January 29, 2009

/s/ Deepak Chopra

Deepak Chopra

Chief Executive Officer

**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 15(d)-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: January 29, 2009

/s/ Alan Edrick

Alan Edrick

Chief Financial Officer

**CERTIFICATION**

Certification of Chief Executive Officer

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350

In connection with the Quarterly Report of OSI Systems, Inc. (the “Company”) on Form 10-Q for the quarter ended December 31, 2008 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) 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 this Report.

Date: January 29, 2009

/s/ Deepak Chopra

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Deepak Chopra

Chief Executive Officer

**CERTIFICATION**

Certification of Chief Financial Officer

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350

In connection with the Quarterly Report of OSI Systems, Inc. (the "Company") on Form 10-Q for the quarter ended December 31, 2008 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) 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 this Report.

Date: January 29, 2009

/s/ Alan Edrick

Alan Edrick

Chief Financial Officer