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

# FORM 10-Q

**(Mark one)**

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

**For the quarterly period ended December 31, 2009**

**OR**

o **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**

# OSI SYSTEMS, INC.
**(Exact name of registrant as specified in its charter)**

| | |
|---|---|
| **California**<br>(State or other jurisdiction of incorporation or organization) | **33-0238801**<br>(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)

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

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

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

| | |
|---|---|
| Large accelerated filer o | Accelerated filer x |
| Non-accelerated filer o<br>(Do not check if a smaller reporting company) | Smaller reporting company o |

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

As of January 26, 2010, there were 17,774,511 shares of the registrant's common stock outstanding.

**OSI SYSTEMS, INC.**
**INDEX**







## 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, 2009 | December 31, 2009 |
|---|---|---|
| **ASSETS** | | |
| Current Assets: | | |
| Cash and cash equivalents | $ 25,172 | $ 27,568 |
| Accounts receivable | 110,453 | 117,134 |
| Other receivables | 2,950 | 2,334 |
| Inventories | 150,763 | 128,884 |
| Deferred income taxes | 20,128 | 21,435 |
| Prepaid expenses and other current assets | 13,777 | 14,710 |
| Total current assets | 323,243 | 312,065 |
| Property and equipment, net | 42,232 | 47,344 |
| Goodwill | 60,195 | 64,779 |
| Intangible assets, net | 32,451 | 32,559 |
| Other assets | 16,707 | 16,365 |
| Total assets | $ 474,828 | $ 473,112 |
| **LIABILITIES AND SHAREHOLDERS' EQUITY** | | |
| Current Liabilities: | | |
| Bank lines of credit | $ 4,000 | $ — |
| Current portion of long-term debt | 8,557 | 7,572 |
| Accounts payable | 54,980 | 41,680 |
| Accrued payroll and employee benefits | 22,416 | 18,035 |
| Advances from customers | 12,863 | 22,220 |
| Accrued warranties | 10,106 | 10,170 |
| Deferred revenue | 8,880 | 7,719 |
| Other accrued expenses and current liabilities | 13,833 | 13,542 |
| Total current liabilities | 135,635 | 120,938 |
| Long-term debt | 39,803 | 30,938 |
| Other long-term liabilities | 23,390 | 29,463 |
| Total liabilities | 198,828 | 181,339 |
| 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, 17,411,569 at June 30, 2009 and 17,690,125 shares at December 31, 2009 | 225,297 | 231,306 |
| Retained earnings | 53,124 | 62,586 |

| | | |
|---|---|---|
| Accumulated other comprehensive loss | (2,421) | (2,119) |
| Total shareholders’ equity | 276,000 | 291,773 |
| Total liabilities and shareholders’ equity | $ 474,828 | $ 473,112 |

See accompanying notes to condensed consolidated financial statements.



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

| | For the Three Months Ended December 31, | | For the Six Months Ended December 31, | |
|---|---|---|---|---|
| | 2008 | 2009 | 2008 | 2009 |
| Revenues | $ 159,042 | $ 150,621 | $ 307,203 | $ 284,382 |
| Cost of goods sold | 104,623 | 94,256 | 203,149 | 183,550 |
| Gross profit | 54,419 | 56,365 | 104,054 | 100,832 |
| Operating expenses: | | | | |
| Selling, general and administrative expenses | 35,727 | 34,610 | 73,268 | 66,890 |
| Research and development | 8,669 | 10,353 | 18,882 | 18,342 |
| Restructuring and other charges | 2,798 | 607 | 3,599 | 607 |
| Total operating expenses | 47,194 | 45,570 | 95,749 | 85,839 |
| Income from operations | 7,225 | 10,795 | 8,305 | 14,993 |
| Interest and other expense, net | (863) | (784) | (1,758) | (1,389) |
| Income before provision for income taxes | 6,362 | 10,011 | 6,547 | 13,604 |
| Provision for income taxes | 2,200 | 3,059 | 2,253 | 4,142 |
| Net income | $ 4,162 | $ 6,952 | $ 4,294 | $ 9,462 |
| Earnings per share: | | | | |
| Basic | $ 0.24 | $ 0.39 | $ 0.24 | $ 0.54 |
| Diluted | $ 0.24 | $ 0.39 | $ 0.24 | $ 0.53 |
| Shares used in per share calculation: | | | | |
| Basic | 17,536 | 17,643 | 17,667 | 17,573 |
| Diluted | 17,558 | 18,014 | 17,765 | 17,906 |

See accompanying notes to condensed consolidated financial statements.



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

| | For the Six Months Ended December 31 | |
|---|---|---|
| | 2008 | 2009 |
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Net income | $ 4,294 | $ 9,462 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 8,628 | 8,490 |
| Stock based compensation expense | 2,392 | 2,398 |
| Provision (recovery) for losses on accounts receivable | 2,497 | (521) |
| Equity in earnings of unconsolidated affiliates | (1,255) | (323) |
| Deferred income taxes | (819) | (1,290) |
| Other | (12) | 80 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | 12,488 | (5,522) |
| Other receivables | (1,948) | 1,986 |
| Inventories | (13,983) | 19,887 |
| Prepaid expenses and other current assets | (8,435) | (987) |
| Accounts payable | 18,874 | (13,429) |
| Accrued payroll and related expenses | 463 | (2,146) |
| Advances from customers | 8,005 | 9,763 |
| Accrued warranties | (569) | 121 |
| Deferred revenue | 2,315 | (1,203) |
| Other accrued expenses and current liabilities | 192 | (3,378) |
| Net cash provided by operating activities | 33,127 | 23,388 |

| | | |
|---|---|---|
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Acquisition of property and equipment | (5,170) | (6,930) |
| Proceeds from the sale of property and equipment | 30 | 4 |
| Acquisition of businesses-net of cash acquired | — | (3,241) |
| Acquisition of intangible and other assets | (1,730) | (1,106) |
| Net cash used in investing activities | (6,870) | (11,273) |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Net repayments of bank lines of credit | (3,005) | (4,000) |
| Payments on long-term debt | (2,860) | (9,450) |
| Net payments of capital lease obligations | (496) | (334) |
| Repurchase of treasury shares | (7,170) | — |
| Proceeds from exercise of stock options and employee stock purchase plan | 1,664 | 3,423 |
| Net cash used in financing activities | (11,867) | (10,361) |
| EFFECT OF EXCHANGE RATE CHANGES ON CASH | 2,293 | 642 |
| NET INCREASE IN CASH AND CASH EQUIVALENTS | 16,683 | 2,396 |
| CASH AND CASH EQUIVALENTS - BEGINNING OF PERIOD | 18,232 | 25,172 |
| CASH AND CASH EQUIVALENTS - END OF PERIOD | $ 34,915 | $ 27,568 |
| Supplemental disclosure of cash flow information: | | |
| Interest paid | $ 1,875 | $ 1,309 |
| Income taxes paid | $ 2,271 | $ 4,549 |

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 and related services; (ii) Healthcare, providing patient monitoring, diagnostic cardiology and anesthesia systems, and related services; and (iii) Optoelectronics and Manufacturing, providing specialized electronic components 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, markets and services security and inspection systems worldwide, and provides turnkey security screening solutions. The Security division's products are used to inspect baggage, cargo, vehicles and other objects for weapons, explosives, drugs and other contraband and to screen people. These products and services are also used for the safe, accurate and efficient verification of cargo manifests for the purpose of assessing duties and monitoring the export and import of controlled materials.

Through its Healthcare division, the Company designs, manufactures, markets and services patient monitoring, diagnostic cardiology and anesthesia delivery and ventilation systems worldwide primarily under the "Spacelabs" trade name. These products are used by care providers in critical care, emergency and perioperative areas within hospitals as well as physicians offices, medical clinics and ambulatory surgery centers.

Through its Optoelectronics and Manufacturing division, the Company designs, manufactures and markets optoelectronic devices and provides electronics 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), telecommunications, office automation, computer peripherals and industrial automation. This division provides products and services to original equipment manufacturers as well as to the Company's own Security and Healthcare divisions.

*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 interim financial reporting guidelines and the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations. In the opinion of the Company's management, 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 consolidated financial statements and accompanying notes included in the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2009, filed with the Securities and Exchange Commission on August 28, 2009. The results of operations for the three months and six months ended December 31, 2009, 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 1.1 million and 1.2 million shares of common stock for the three months and six months ended December 31, 2009, respectively, were not included in diluted earnings per share calculations because to do so would have been antidilutive. Stock options and warrants to purchase a total of 3.3 million and 2.5 million shares of common stock for the three months and six months ended December 31, 2008, 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 December 31, | | Six Months Ended December 31, | |
|---|---|---|---|---|
| | 2008 | 2009 | 2008 | 2009 |
| Net income available to common shareholders | $ 4,162 | $ 6,952 | $ 4,294 | $ 9,462 |
| Weighted average shares outstanding — basic | 17,536 | 17,643 | 17,667 | 17,573 |
| Dilutive effect of stock options and warrants | 22 | 371 | 98 | 333 |
| Weighted average of shares outstanding — diluted | 17,558 | 18,014 | 17,765 | 17,906 |
| Basic earnings per share | $ 0.24 | $ 0.39 | $ 0.24 | $ 0.54 |
| Diluted earnings per share | $ 0.24 | $ 0.39 | $ 0.24 | $ 0.53 |

*Comprehensive Income*

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

| | Three Months Ended December 31, | | Six Months Ended December 31, | |
|---|---|---|---|---|
| | 2008 | 2009 | 2008 | 2009 |
| Net income | $ 4,162 | $ 6,952 | $ 4,294 | $ 9,462 |
| Foreign currency translation adjustments | (13,112) | 1,371 | (19,519) | (205) |
| Unrealized net gain from derivative contracts | — | 88 | — | (111) |
| Reversal of (gains) losses on derivative contracts | 85 | 296 | 140 | 296 |
| Minimum pension liability adjustment | 399 | 87 | 598 | 106 |
| Changes in unrealized gains on investments | — | 72 | — | 216 |
| Comprehensive income (loss) | $ (8,466) | $ 8,866 | $ (14,487) | $ 9,764 |

*Fair Value of Financial Instruments*

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

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The Company has determined that all of its marketable securities fall into the "Level 1" category, which values assets at the quoted prices in active markets for identical assets; while the Company's derivative instruments fall into the "Level 2" category, which values assets and liabilities from observable inputs other than quoted market prices. As of December 31, 2009, the fair value of such assets was $3.7 million, while at June 30, 2009, the fair value was $2.9 million. There were no assets or liabilities for which "Level 3" valuation techniques were used and there were no assets and liabilities measured at fair value on a non-recurring basis.





*Derivative Instruments and Hedging Activity*

The Company's use of derivatives consists primarily of foreign exchange contracts and interest rate swap agreements. As of December 31, 2009, the Company had outstanding foreign currency forward contracts totaling $7.3 million. In addition, to reduce the unpredictability of cash flows for interest payments related to variable, LIBOR-based debt, the Company has outstanding an interest rate swap agreement, under which the Company incurs interest expense based upon a fixed 1.69% rate index for a portion of its term loan. The interest rate swap matures in March 2012. Each of these derivative contracts is considered an effective cash flow hedge in its entirety. As a result, the net gains or losses on such derivative contracts have been reported as a component of other comprehensive income in the Consolidated Financial Statements and are reclassified into net earnings when the hedged transactions settle.

*Business Combinations*

On July 28, 2009, the Company completed the acquisition of certain assets and the assumption of certain liabilities of RAD Electronics, Inc. The acquired operations design and manufacture cable assemblies and printed circuit boards for original equipment manufacturers in the commercial electronics industry. The Company acquired accounts receivable, inventory, and fixed assets, as well as all of the patents, intellectual property and intangible assets used in the acquired operations, all in exchange for (i) a $3.2 million cash payment at the closing of the transaction and (ii) additional consideration that may become payable over the next four years depending on the performance of the acquired operations. Under recently adopted guidelines for business combinations, the fair value of this contingent consideration was estimated to be $5.8 million and was recorded at the time of the acquisition as an other long-term liability in the condensed consolidated financial statements. The final purchase price allocation and fair value of the contingent consideration was compiled with the assistance of a third-party valuation firm. The resulting contingent liability shall be assessed and adjusted, if necessary, throughout the contingency period with changes in fair value being recognized in the consolidated statement of operations. During the three months ended December 31, 2009, no adjustment to the contingent liability was required to be recorded. The acquisition of RAD Electronics, Inc. was not considered material to the balance sheet as of December 31, 2009 and consolidated statement of operations for the three and six months ended December 31, 2009.

*Recent Accounting Updates Not Yet Adopted*

In October 2009, the Financial Accounting Standards Board issued an accounting standards update amending revenue recognition requirements for multiple-deliverable revenue arrangements. This update provides guidance on separating the deliverables and on the method to measure and allocate arrangement consideration, particularly when the arrangement includes both products and services provided to the customers. The update is effective for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. Early adoption is permitted. The Company has not yet adopted this update and is currently evaluating the impact it may have on its financial condition and results of operations.

## 2. Balance Sheet Details

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

| | June 30, 2009 | December 31, 2009 |
|---|---|---|
| **Accounts receivable** | | |
| Trade receivables | $ 116,140 | $ 122,845 |
| Receivables related to long term contracts — unbilled costs and accrued profit on progress completed | 1,209 | 835 |
| Total | 117,349 | 123,680 |
| Less: allowance for doubtful accounts | (6,896) | (6,546) |
| Accounts receivable, net | $ 110,453 | $ 117,134 |

The Company expects to bill and collect the receivables for unbilled costs and accrued profits at December 31, 2009, during the next twelve months.

| | June 30, 2009 | December 31, 2009 |
|---|---|---|
| **Inventories, net** | | |
| Raw materials | $ 77,488 | $ 68,866 |
| Work-in-process | 24,648 | 23,459 |
| Finished goods | 48,627 | 36,559 |
| Total | $ 150,763 | $ 128,884 |





| | June 30, 2009 | December 31, 2009 |
|---|---|---|
| **Property and equipment** | | |
| Land | $ 5,426 | $ 5,298 |
| Buildings | 8,927 | 8,809 |
| Leasehold improvements | 12,628 | 13,115 |
| Equipment and tooling | 48,659 | 56,782 |
| Furniture and fixtures | 4,802 | 4,933 |
| Computer equipment | 16,773 | 16,925 |
| Software | 11,032 | 12,513 |
| Total | 108,247 | 118,375 |
| Less: accumulated depreciation and amortization | (66,015) | (71,031) |
| Property and equipment, net | $ 42,232 | $ 47,344 |

## 3. Goodwill and Intangible Assets

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

| | Security | Healthcare | Optoelectronics and Manufacturing | Consolidated |
|---|---|---|---|---|
| Balance as of June 30, 2009 | $ 17,112 | $ 35,736 | $ 7,347 | $ 60,195 |
| Goodwill acquired during the period | — | — | 4,597 | 4,597 |
| Foreign currency translation adjustment | 89 | (122) | 20 | (13) |
| Balance as of December 31, 2009 | $ 17,201 | $ 35,614 | $ 11,964 | $ 64,779 |

Intangible assets consisted of the following (in thousands):

| | | June 30, 2009 | | | December 31, 2009 | | |
|---|---|---|---|---|---|---|---|
| | Weighted Average Lives | Gross Carrying Value | Accumulated Amortization | Intangibles Net | Gross Carrying Value | Accumulated Amortization | Intangibles Net |
| Amortizable assets: | | | | | | | |
| Software development costs | 5 years | $ 9,754 | $ 3,198 | $ 6,556 | $ 10,687 | $ 3,574 | $ 7,113 |
| Patents | 9 years | 921 | 334 | 587 | 1,159 | 360 | 799 |
| Core technology | 10 years | 2,224 | 977 | 1,247 | 2,152 | 1,053 | 1,099 |
| Developed technology | 13 years | 17,360 | 7,169 | 10,191 | 17,319 | 8,062 | 9,257 |
| Customer relationships/ backlog | 7 years | 9,456 | 4,876 | 4,580 | 10,474 | 5,508 | 4,966 |
| Total amortizable assets | | 39,715 | 16,554 | 23,161 | 41,791 | 18,557 | 23,234 |
| Non-amortizable assets: | | | | | | | |
| Trademarks | | 9,290 | — | 9,290 | 9,325 | — | 9,325 |
| Total intangible assets | | $ 49,005 | $ 16,554 | $ 32,451 | $ 51,116 | $ 18,557 | $ 32,559 |

Amortization expense related to intangibles assets was $2.0 million and $2.1 million for the six months ended December 31, 2008 and 2009, respectively; and $1.0 million and $1.1 million for the three months ended December 31, 2008 and 2009, respectively. At December 31, 2009, the estimated future amortization expense was as follows (in thousands):

| | |
|---|---|
| 2010 (remaining 6 months) | $ 2,063 |
| 2011 | 4,104 |
| 2012 | 4,065 |
| 2013 | 3,771 |
| 2014 | 2,589 |
| 2015 | 828 |
| 2016 and thereafter | 5,814 |
| Total | $ 23,234 |



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**4. Borrowings**

The Company maintains a credit agreement with certain lenders allowing for initial borrowings of up to $124.5 million. The credit agreement consists of a $74.5 million, five-year, revolving credit facility (including a $64.5 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, 2009, the effective, weighted-average interest rate under the credit agreement was 3.07%. 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, 2009, $34.0 million was outstanding under the term loan, while no debt was outstanding under the revolving credit facility, and $31.1 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, 2009, $17.7 million was outstanding under these letter-of-credit facilities, while no debt was outstanding. As of December 31, 2009, the total amount available under these credit facilities was $10.3 million, with a total cash borrowing sub-limit of $7.2 million

In fiscal 2005, the Company entered into a bank loan of $5.3 million to fund the acquisition of land and buildings in the U.K. The loan is payable over a 20-year period. The loan bears interest at British pound-based LIBOR plus 1.2%, payable on a quarterly basis. As of December 31, 2009, $3.3 million remained outstanding under this loan at an interest rate of 1.8% per annum.

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

| | June 30, 2009 | December 31, 2009 |
|---|---|---|
| Five-year term loan due in fiscal 2013 | $ 42,763 | $ 33,998 |
| Twenty-year term loan due in fiscal 2025 | 3,533 | 3,309 |
| Capital leases | 1,354 | 1,021 |
| Other | 710 | 182 |
| | 48,360 | 38,510 |
| Less current portion of long-term debt | (8,557) | (7,572) |
| Long-term portion of debt | $ 39,803 | $ 30,938 |

**5. Stock-based Compensation**

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

The Company recorded stock-based-compensation expense in the condensed consolidated statement of operations as follows (in thousands):

| | Three Months Ended December 31, | | Six Months Ended December 31, | |
|---|---|---|---|---|
| | 2008 | 2009 | 2008 | 2009 |
| Cost of goods sold | $ 48 | $ 68 | $ 108 | $ 140 |
| Selling, general and administrative | 1,091 | 1,147 | 2,157 | 2,149 |
| Research and development | 59 | 55 | 127 | 109 |
| Total stock-based compensation expense | $ 1,198 | $ 1,270 | $ 2,392 | $ 2,398 |

As of December 31, 2009, total unrecognized compensation cost related to non-vested share-based compensation arrangements granted was approximately $9.4 million. The Company expects to recognize these costs over a weighted-average period of 2.8 years.



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**6. Retirement Benefit Plans**

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

| | Three Months Ended December 31, | | Six Months Ended December 31, | |
|---|---|---|---|---|
| | 2008 | 2009 | 2008 | 2009 |
| Service cost | $ 8 | $ 27 | $ 324 | $ 34 |
| Interest cost | 58 | 45 | 138 | 86 |
| Amortization of prior service cost | — | 45 | — | 90 |
| Expected return on plan assets | (43) | — | (71) | — |
| Amortization of net loss | 21 | 35 | 47 | 62 |
| Net periodic pension expense | $ 44 | $ 152 | $ 438 | $ 272 |

For each of the three months ended December 31, 2008 and 2009, the Company made contributions of $0.1 million to these defined benefit plans. For the six months ended December 31, 2008 and 2009, the Company made contributions of $0.4 million and $0.2 million, respectively, to these defined benefit plans.

In addition, the Company maintains various defined contribution plans. For each of the three months ended December 31, 2008 and 2009, the Company made contributions of $0.7 million to these defined contribution plans. For each of the six months ended December 31, 2008 and 2009, the Company made contributions of $1.5 million to these defined contribution plans.

**7. Commitments and Contingencies**

*Legal Proceedings*

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

*Contingent Acquisition Obligations*

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

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

In fiscal 2004, the Company acquired Advanced Research & Applications Corp. During the seven years following the acquisition, contingent consideration is payable based on net revenues of products developed prior to the acquisition, provided certain requirements are met. The contingent consideration is capped at $30.0 million. As of December 31, no contingent consideration had been earned.

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

In fiscal 2009, the Company acquired S2 Global Inc., a company that offers turnkey security screening solutions in connection with the operation of security inspection products. Contingent consideration is payable based on net receipts generated from new business during the three years following the acquisition, provided certain requirements are met. The contingent consideration is capped at $10.0 million. As of December 31, 2009, no contingent consideration had been earned.

During the first quarter of fiscal 2010, the Company acquired RAD Electronics, Inc.  During the four years following the acquisition, contingent consideration is payable based on the performance of its operations.  The contingent obligation is capped at $14.4 million.





The fair market value of contingent consideration estimated to be paid was recorded as a liability at the time of the acquisition and shall be assessed and adjusted, if necessary, throughout the contingency period in accordance with generally accepted accounting standards.  As of December 31, 2009, the Company reported $5.8 million as other long-term liabilities in the condensed consolidated financial statements.

*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 December 31, | | Six Months Ended December 31, | |
|---|---|---|---|---|
| | 2008 | 2009 | 2008 | 2009 |
| Balance at beginning of period | $ 10,705 | $ 9,507 | $ 11,597 | $ 10,106 |
| Additions | 1,189 | 1,726 | 2,204 | 1,997 |
| Reductions for warranty repair costs | (2,186) | (1,063) | (4,093) | (1,933) |
| Balance at end of period | $ 9,708 | $ 10,170 | $ 9,708 | $ 10,170 |

**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. The assumptions used to estimate the annual effective tax rate includes 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, increases or decreases in uncertain tax positions, utilization of research and development 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, and turnkey security screening solutions; (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 healthcare, 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 December 31, | | Six Months Ended December 31, | |
|---|---|---|---|---|
| | 2008 | 2009 | 2008 | 2009 |
| Revenues — by Segment: | | | | |
| Security division | $ 67,067 | $ 59,092 | $ 125,752 | $ 106,427 |
| Healthcare division | 59,695 | 57,048 | 114,522 | 104,010 |
| Optoelectronics and Manufacturing division, including intersegment revenues | 44,745 | 43,663 | 89,626 | 89,454 |
| Intersegment revenues elimination | (12,465) | (9,182) | (22,697) | (15,509) |
| Total | $ 159,042 | $ 150,621 | $ 307,203 | $ 284,382 |
| | | | | |
| Revenues — by Geography: | | | | |

| | | | | |
|---|---|---|---|---|
| North America | $ 110,714 | $ 110,841 | $ 216,903 | $ 206,916 |
| Europe | 37,171 | 35,545 | 72,261 | 66,080 |
| Asia | 23,622 | 13,417 | 40,736 | 26,895 |
| Intersegment revenues elimination | (12,465) | (9,182) | (22,697) | (15,509) |
| Total | $ 159,042 | $ 150,621 | $ 307,203 | $ 284,382 |
| | | | | |
| Operating income(loss) — by Segment: | | | | |
| Security division | $ 4,846 | $ 4,134 | $ 7,894 | $ 6,102 |
| Healthcare division | 2,285 | 5,808 | 460 | 7,303 |
| Optoelectronics and Manufacturing division | 3,195 | 3,257 | 7,057 | 6,718 |
| Corporate | (2,712) | (2,689) | (6,896) | (5,969) |
| Eliminations (1) | (389) | 285 | (210) | 839 |
| Total | $ 7,225 | $ 10,795 | $ 8,305 | $ 14,993 |

| | June 30, 2009 | December 31, 2009 |
|---|---|---|
| Assets — by Segment: | | |
| Security division | $ 191,164 | $ 201,227 |
| Healthcare division | 155,366 | 143,221 |
| Optoelectronics and Manufacturing division | 84,434 | 83,123 |
| Corporate | 47,633 | 48,471 |
| Eliminations (1) | (3,769) | (2,930) |
| Total | $ 474,828 | $ 473,112 |

(1) Eliminations within operating income primarily reflect the change in the elimination of intercompany profit in inventory not-yet-realized; while the eliminations in assets reflect the amount of intercompany profits in inventory as of the balance sheet date. Such intercompany profit will be realized when inventory is shipped to the external customers of the Security and Healthcare divisions.

**10. Subsequent Events**

The Company has evaluated its subsequent events through January 28, 2010, the filing date of the Company's Quarterly Report on Form 10-Q for the period ended December 31, 2009.





## 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, 2009.

### 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 and provide related services in diversified markets, including homeland security, healthcare, defense and aerospace. We have three operating divisions: (i) Security; (ii) Healthcare; and (iii) Optoelectronics and Manufacturing.

*Security Division.* Through our Security division, we design, manufacture, market and service security and inspection systems, and provide turnkey security screening solutions worldwide for sale primarily to U.S. federal, state and local government agencies as well as to foreign customers. These products and services 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 37% and 41% of our total consolidated revenues for the six months ended December 31, 2009 and 2008, respectively.

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

*Healthcare Division.* Through our Healthcare division, we design, manufacture, market and service 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% of our total consolidated revenues for the six months ended December 31, 2009 and 2008, respectively.

The healthcare markets in which we operate are highly competitive. We believe that our customers choose among competing products on the basis of product performance, functionality, value and service. We also believe that the worldwide economic slowdown has caused some hospitals and healthcare providers to delay purchases of our products and services. During this period of uncertainty, we anticipate lower sales of patient monitoring, diagnostic cardiology and anesthesia systems products than we have historically experienced, resulting in a negative impact on our sales. We cannot predict when the markets will recover and therefore when this





period of delayed and diminished purchasing will end. A prolonged delay could have a material adverse effect on our business, financial condition and results of operations.

*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 26% and 22% of our total consolidated revenues for the six months ended December 31, 2009 and 2008, respectively.

*Consolidated Results*. For the three months ended December 31, 2009, we reported an operating profit of $10.8 million, as compared to an operating profit of $7.2 million for the comparable prior-year period, which represents a 49% improvement over our prior-year performance, even though our revenue decreased by 5%. This improvement was driven by a $2.0 million improvement in gross profit as a result of a 3.2% improvement in gross margin due to changes in product mix and manufacturing cost reductions, and was also driven by a $1.1 million reduction in selling, general and administrative (SG&A) expenses. In addition to operational improvements, the reduced manufacturing costs and SG&A expenses resulted from the cost containment initiatives we have undertaken throughout the Company with particular emphasis in our Healthcare division. In addition, non-recurring restructuring charges decreased by $2.2 during the three months ended December 31, 2009. These improvements were partially offset by an increased investment in research and development (R&D) expenses of $1.7 million in support of new product introductions in both our Security and Healthcare divisions.

For the six months ended December 31, 2009, we reported an operating profit of $15.0 million, as compared to an operating profit of $8.3 million for the comparable prior-year period, which represents an 81% improvement over our prior-year performance. This $6.7 million improvement was primarily due to a $6.4 million reduction in SG&A expenses, as a result of our ongoing cost containment initiatives and due to reduced restructuring activities during the six months ended December 31, 2009, as compared to the comparable prior-year period. In addition, for the six months ended December 31, 2009, R&D expenses were $0.5 million lower than in the comparable prior-year period. The significant reduction in operating expenses and lower restructuring charges were partially offset by a $3.3 million, or 3%, decrease in gross profit, resulting primarily from a 7% revenue decrease during the six months ended December 31, 2009, as compared to the comparable prior-year period.

**Results of Operations**

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

**Net Revenues**

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

| (in millions) | Q2 2009 | % of Net Sales | Q2 2010 | % of Net Sales | $ Change | % Change |
|---|---|---|---|---|---|---|
| Security division | $ 67.1 | 42% | $ 59.1 | 39% | $ (8.0) | (12)% |
| Healthcare division | 59.7 | 38% | 57.0 | 38% | (2.7) | (5)% |
| Optoelectronics and Manufacturing division | 44.7 | 28% | 43.7 | 29% | (1.0) | (2)% |
| Intersegment revenues | (12.5) | (8)% | (9.2) | (6)% | 3.3 | 26% |
| Total revenues | $ 159.0 | 100% | $ 150.6 | 100% | $ (8.4) | (5)% |

Net revenues for the three months ended December 31, 2009, decreased $8.4 million, or 5%, to $150.6 million, from $159.0 million for the comparable prior-year period.

Revenues for the Security division for the three months ended December 31, 2009, decreased $8.0 million, or 12%, to $59.1 million, from $67.1 million for the comparable prior-year period. The decrease was due to a 17% decrease in equipment sales, partially offset by a $1.5 million, or 13%, increase in revenue related to contracts to service such equipment. The decrease in equipment sales was due to timing of shipments as bookings during the quarter of $77.1 million exceeded sales during the quarter by 30% and bookings during the comparable prior-year period by 36%. Increased bookings during the quarter were driven by increased demand for checked baggage screening systems, people screening systems and our cargo inspection equipment. The increase in service revenue was due to the growing installed equipment base, from which we derive service revenues as warranty periods expire.

Revenues for the Healthcare division for the three months ended December 31, 2009, decreased $2.7 million, or 5%, to $57.0 million, from $59.7 million for the comparable prior-year period. We believe this decrease was primarily due to the general economic downturn and the uncertainty of healthcare reform legislation which resulted in curtailed spending by U.S. hospitals.





Revenues for the Optoelectronics and Manufacturing division for the three months ended December 31, 2009, decreased by $1.0 million, or 2%, to $43.7 million, from $44.7 million for the comparable prior-year period. Total revenues for the three months ended December 31, 2009, include external sales of $34.5 million, compared to $32.2 million in the comparable prior-year period. This $2.3 million increase was primarily due to sales orders from a defense-industry related customer in our contract manufacturing business. The $3.3 million decrease in intersegment sales resulted from lower sales to both our Security and Healthcare divisions, which is consistent with the decrease in revenues experienced by each of these divisions. Such intersegment sales are eliminated in consolidation.

**Gross Profit**

| (in millions) | Q2 2009 | % of Net Sales | Q2 2010 | % of Net Sales |
|---|---|---|---|---|
| Gross profit | $ 54.4 | 34.2% | $ 56.4 | 37.4% |

Gross profit increased $2.0 million, or 4%, to $56.4 million for the three months ended December 31, 2009, from $54.4 million for the comparable prior-year period, even though revenue decreased by 5%. The gross margin increased to 37.4%, from 34.2% over the comparable prior-year period. This increase was primarily attributable to manufacturing efficiencies gained through facility consolidation and operational improvement initiatives, and due to the favorable product mix of sales.

**Operating Expenses**

| (in millions) | Q2 2009 | % of Net Sales | Q2 2010 | % of Net Sales | $ Change | % Change |
|---|---|---|---|---|---|---|
| Selling, general and administrative | $ 35.7 | 22.4% | $ 34.6 | 23.0% | $ (1.1) | (3)% |
| Research and development | 8.7 | 5.4% | 10.4 | 6.9% | 1.8 | 21% |
| Restructuring and other charges | 2.8 | 1.8% | 0.6 | 0.4% | (2.2) | (79)% |
| Total operating expenses | $ 47.2 | 29.6% | $ 45.6 | 30.3% | $ (1.5) | (3)% |

**Selling, general and administrative expenses**. Selling, general and administrative 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, 2009, SG&A expenses decreased by $1.1 million, or 3%, to $34.6 million, from $35.7 million for the comparable prior-year period. This reduction in spending was a result of cost containment initiatives undertaken throughout the Company to better leverage our cost structure.

**Research and development**. Research and Development expenses include research related to new product development and product enhancement expenditures. For the three months ended December 31, 2009, such expenses increased $1.8 million, or 21%, to $10.4 million, from $8.6 million for the comparable prior-year period. As a percentage of revenues, R&D expenses were 6.9% for the three months ended December 31, 2009, compared to 5.4% for the comparable prior-year period. This increase in R&D expenses for the three month period ended December 31, 2009, resulted from an increase in R&D investment in our Security and Healthcare divisions in support of new product introductions.

**Restructuring and other charges.** In response to the challenging worldwide economic conditions, we continued to optimize our cost structure and consolidate facilities during the second quarter of fiscal 2010. In conjunction with these efforts, we incurred restructuring charges of $0.2 million in our Healthcare division and $0.4 million in our Optoelectronics and Manufacturing division for facility closure and employee severance during the three months ended December 31, 2009, as compared to incurring total restructuring charges of $2.8 million for the comparable prior-year period when more aggressive activity was initiated.

**Other Income and Expenses**

| (in millions) | Q2 2009 | % of Net Sales | Q2 2010 | % of Net Sales | $ Change | % Change |
|---|---|---|---|---|---|---|
| Interest and other expense, net | $ 0.9 | 0.6% | $ 0.8 | 0.5% | $ (0.1) | (11)% |

**Interest and other expense, net**. For the three months ended December 31, 2009, interest and other expense, net, decreased due to lower, market-driven interest rates on our outstanding borrowings as well as to lower levels of borrowing as a result of the generation of positive cash flow from operations.





**Income taxes**. For the three months ended December 31, 2009, our income tax provision was $3.1 million, compared to an income tax provision of $2.2 million for the comparable prior-year period. Our effective tax rate for the three months ended December 31, 2009 was 30.6%, compared to 34.4% 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, 2009 Compared to Six Months Ended December 31, 2008.*

**Net Revenues**

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

| (in millions) | YTD Q2 2009 | % of Net Sales | YTD Q2 2010 | % of Net Sales | $ Change | % Change |
|---|---|---|---|---|---|---|
| Security division | $ 125.8 | 41% | $ 106.4 | 37% | $ (19.4) | (15)% |
| Healthcare division | 114.5 | 37% | 104.0 | 37% | (10.5) | (9)% |
| Optoelectronics and Manufacturing division | 89.6 | 29% | 89.5 | 31% | (0.1) | 0% |
| Intersegment revenues | (22.7) | (7)% | (15.5) | (5)% | 7.2 | 32% |
| Total revenues | $ 307.2 | 100% | $ 284.4 | 100% | $ (22.8) | (7)% |

Net revenues for the six months ended December 31, 2009, decreased $22.8 million, or 7%, to $284.4 million from $307.2 million for the comparable prior-year period.

Revenues for the Security division for the six months ended December 31, 2009, decreased $19.4 million or 15%, to $106.4 million, from $125.8 million for the comparable prior-year period. The change was attributable to a 20% decrease in equipment sales, due in part to the timing of shipments, partially offset by a 4% increase in revenue related to contracts to service such equipment. The decrease in equipment sales was due to timing of shipments as bookings during the six months ended December 31, 2009 of $153.9 million exceeded sales during the period by 45% and bookings during the comparable prior-year period by 9%. Increased bookings during the period were driven by increased demand for checked baggage screening systems and people screening systems. The increase in service revenue was due to the growing installed equipment base, from which we derive service revenues as warranty periods expire.

Revenues for the Healthcare division for the six months ended December 31, 2009, decreased $10.5 million, or 9%, to $104.0 million, from $114.5 million for the comparable prior-year period. The decrease was primarily due to: (i) a $3.0 million decrease in patient monitoring revenues; (ii) a $3.7 million decreased in our anesthesia equipment sales revenue; and (iii) a $3.5 million decrease in the revenues of other product lines such as ambulatory blood pressure monitors and pulse oximeters. We believe these decreases were primarily due to the general economic downturn and the uncertainty of healthcare reform legislation which resulted in curtailed spending by U.S. hospitals.

Revenues for the Optoelectronics and Manufacturing division for the six months ended December 31, 2009, were virtually unchanged at $89.5 million as compared to $89.6 million for the comparable prior-year period. Total revenues for the six months ended December 31, 2009, include external sales of $74.0 million, compared to $66.9 million in the comparable prior-year period. This $7.1 million increase was primarily due to sales orders from a defense-industry related customer in our contract manufacturing business. The $7.2 million decrease in intersegment sales from $22.7 million to $15.5 million resulted from lower sales to both our Healthcare and Security divisions, which is directionally consistent with the decrease in revenues experienced by our Security and Healthcare divisions. Such intersegment sales are eliminated in consolidation.

**Gross Profit**

| (in millions) | YTD Q2 2009 | % of Net Sales | YTD Q2 2010 | % of Net Sales |
|---|---|---|---|---|
| Gross profit | $ 104.1 | 33.9% | $ 100.8 | 35.4% |

Gross profit decreased $3.3 million, or 3%, to $100.8 million for the six months ended December 31, 2009, from $104.1 million for the comparable prior-year period. The change in gross profit is primarily the result of a 7% decrease in total revenues, which was partially offset by an improvement in our gross margin of 1.5%. The increase in gross margin was primarily attributable to manufacturing efficiencies gained through facility consolidation and cost-cutting activities and due to a favorable product mix of sales.



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**Operating Expenses**

| (in millions) | YTD Q2 2009 | % of Net Sales | YTD Q2 2010 | % of Net Sales | $ Change | % Change |
|---|---|---|---|---|---|---|
| Selling, general and administrative | $ 73.3 | 23.9% | $ 66.8 | 23.5% | $ (6.5) | (9)% |
| Research and development | 18.9 | 6.1% | 18.3 | 6.4% | (0.6) | (3)% |
| Restructuring and other charges | 3.6 | 1.2% | 0.6 | 0.2% | (3.0) | (83)% |
| Total operating expenses | $ 95.8 | 31.2% | $ 85.7 | 30.1% | $ (10.1) | (11)% |

**Selling, general and administrative expenses.** For the six months ended December 31, 2009, SG&A expenses decreased by $6.5 million, or 9%, to $66.8 million, from $73.3 million for the comparable prior-year period. This reduction in spending was a result of our ongoing company-wide cost containment initiatives and due to restructuring activities that were most heavily focused on our Healthcare division.

**Research and development**. R&D expenses include research related to new product development and product enhancement expenditures. For the six months ended December 31, 2009, such expenses decreased $0.6 million, or 3%, to $18.3 million, from $18.9 million for the comparable prior-year period. As a percentage of revenues, research and development expenses were 6.4% for the six months ended December 31, 2009, compared to 6.1% for the comparable prior-year period. The decrease in R&D expenses for the six month period ended December 31, 2009, was primarily attributable to increased government funded R&D programs.

**Restructuring and other charges**. In response to the worldwide economic downturn, we initiated an aggressive cost-cutting plan in the first half of fiscal 2009 to reduce our fixed cost structure. During the six months ended December 31, 2009, we continued this effort to further increase our operating efficiencies. In conjunction with these efforts, we incurred restructuring charges of $0.2 million in our Healthcare division and $0.4 million in our Optoelectronics and Manufacturing division for facility closure and employee severance during the six months ended December 31, 2009, as compared to incurring restructuring charges of $3.6 million for the comparable prior-year period when more aggressive activity was initiated.

**Other Income and Expenses**

| (in millions) | YTD Q2 2009 | % of Net Sales | YTD Q2 2010 | % of Net Sales | $ Change | % Change |
|---|---|---|---|---|---|---|
| Interest and other expense, net | $ 1.7 | 0.6% | $ 1.4 | 0.5% | $ (0.3) | (18)% |

**Interest and other expense, net.** For the six months ended December 31, 2009, interest and other expense, net decreased by $0.3 million, to $1.4 million from $1.7 million for the comparable prior-year period, primarily due to lower, market-driven interest rates on our outstanding borrowings as well as lower levels of borrowing as a result of the generation of positive cash flow from operations.

**Income taxes**. For the six months ended December 31, 2009, our income tax provision was $4.1 million, compared to $2.3 million for the comparable prior-year period. Our effective tax rate for the six months ended December 31, 2009, was 30.5%, compared to 34.4% 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 $27.6 million at December 31, 2009, an increase of $2.4 million from $25.2 million at June 30, 2009. The changes in our working capital and cash and cash equivalent balances during the six months ended are described below.

| (in millions) | June 30, 2009 | December 31, 2009 | % Change |
|---|---|---|---|
| Working capital | $ 187.6 | $ 191.1 | 2% |
| Cash and cash equivalents | 25.2 | 27.6 | 10% |



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*Working Capital.* Working capital increased primarily due to: (i) a $13.3 million decrease in accounts payable; (ii) a $6.7 million increase in accounts receivable; (iii) a $4.4 million decrease in accrued payroll and employee benefits; (iv) a $4.0 million reduction in our bank lines of credit; (v) a $2.4 million increase in cash and cash equivalents and (vi) a $1.5 million increase short term deferred tax assets. These increases to working capital were partially offset by: (i) a $21.9 million decrease in inventory, as a result of inventory reduction initiatives in all three divisions and (ii) a $9.4 million increase in advances by customers primarily in our Security division.

| (in millions) | YTD Q2 2009 | YTD Q2 2010 | $ Change |
|---|---|---|---|
| Cash provided by operating activities | $ 33.1 | $ 23.4 | $ (9.7) |
| Cash used in investing activities | (6.9) | (11.3) | (4.4) |
| Cash used in financing activities | (11.9) | (10.4) | 1.5 |

*Cash Provided by 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, 2009 was $23.4 million, a decrease of $9.7 million from the $33.1 million provided in the comparable prior-year period. This reduction in net cash provided was partially due to: (i) decreases in accounts payable of $32.3 million; (ii) an $18.0 million increase in accounts receivable and (iii) a $3.5 million reduction in deferred revenue. These reductions in net cash provided were partially offset by an increase in our net income of $2.6 million for the six months ended December 31, 2009, 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. Other sources of operating cash in the current year as compared to fiscal 2009 include: (i) a $33.9 million increase in net cash as a result of decreased inventory and (ii) an increase in net cash provided of $7.4 million from prepaid expenses and other current assets.

*Cash Used in Investing Activities.* Net cash used in investing activities was $11.3 million for the six months ended December 31, 2009, compared to $6.9 million for the six months ended December 31, 2008. During the six months ended December 31, 2009, we invested $6.9 million in capital expenditures as compared to $5.2 million during the comparable prior-year period. During the six months ended December 31, 2009, we also paid $3.2 million to acquire RAD Electronics, Inc. There were no acquisitions in the prior-year period.

*Cash Used in Financing Activities.* Net cash used in financing activities was $10.4 million for the six months ended December 31, 2009, compared to $11.9 million for the six months ended December 31, 2008. During the six months ended December 31, 2009, we paid down our revolving lines of credit by $4.0 million and our other debt and capital leases by $9.8 million. We received $3.4 million in proceeds from the exercise of stock options and the purchase of stock under our employee stock purchase plan which partially offset the debt payments. In the prior-year period, we used $7.2 million in cash to repurchase 600,000 shares of our common stock and we paid down our revolving lines of credit by $3.0 million and our other debt and capital leases by $3.4 million. We received $1.7 million in proceeds from the exercise of stock options and the purchase of stock under our employee stock purchase plan in the prior period.

**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 $64.5 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, 2009, the effective, weighted-average interest rate under the credit agreement was 3.07%. Our borrowings under the credit agreement are guaranteed by substantially all of our direct and indirect wholly-owned subsidiaries and are secured by substantially all of our assets and the assets of our subsidiary guarantors. 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, 2009, $34.0 million was outstanding under the term loan, while no debt was outstanding under the revolving credit facility, and $31.1 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, 2009, $17.7 million was outstanding under these letter-of-credit facilities, while no debt was outstanding. As of December 31, 2009, the total amount available under these credit facilities was $10.3 million, with a total cash borrowing sub-limit of $7.2 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. The loan bears interest at British pound-based LIBOR plus 1.2%, payable on a quarterly basis. As of December 31, 2009, $3.3 million remained outstanding under this loan at an interest rate of 1.8% per annum.

Our long-term debt consisted of the following:

| | June 30, 2009 | December 31, 2009 |
|---|---|---|
| Five-year term loan due in fiscal 2013 | $ 42,763 | $ 33,998 |
| Twenty-year term loan due in fiscal 2025 | 3,533 | 3,309 |
| Capital leases | 1,354 | 1,021 |
| Other | 710 | 182 |
| | 48,360 | 38,510 |
| Less current portion of long-term debt | 8,557 | 7,572 |
| Long-term portion of debt | $ 39,803 | $ 30,938 |

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, 2009, we did not repurchase any shares under this program, and 711,205 shares were available for additional repurchase under the program as of December 31, 2009.

**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, 2009, no royalty payments had 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, 2009, no contingent consideration had 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 the profits of the business before interest and taxes, provided certain requirements are met. The contingent consideration is capped at $6.0 million. As of December 31, 2009, no contingent consideration had been earned.

In fiscal 2009, we acquired S2 Global, Inc., which offers turnkey security screening solutions in connection with the operation of security inspection products. Contingent consideration is payable based on net receipts generated from new business during the three years following the acquisition, provided certain requirements are met. The contingent consideration is capped at $10.0 million. As of December 31, 2009, no contingent consideration had been earned.

During the first quarter of fiscal 2010, we acquired RAD Electronics, Inc. During the four years following the acquisition, contingent consideration is payable based on the performance of its operations. The contingent obligation is capped at $14.4 million. Consistent with new accounting guidelines for acquisitions completed after January 1, 2009, the fair market value of contingent consideration deemed more-likely-than-not to be paid is recorded as a liability at the time of the acquisition. As a result, $5.8 million is recorded as other long-term liabilities in the condensed consolidated financial statements as of December 31, 2009.

**Off Balance Sheet Arrangements**

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

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

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

**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 losses of approximately $0.5 million and $0.2 million during the three months ended December 31, 2009 and 2008, respectively. For the six months ended December 31, 2009, we incurred losses of $0.6 million as compared to gains of $0.6 million for the comparable prior-year period. Furthermore, a 10% appreciation of the U.S. dollar relative to each of the local currencies would have resulted in a net increase in our operating income of approximately $2 million in the second quarter of fiscal 2010. Conversely, a 10% depreciation of the U.S. dollar relative to each of the local currencies would have resulted in a net decrease in our operating income of approximately $2 million in the second quarter of fiscal 2010.

**Use of Derivatives**

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

**Importance of International Markets**

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

**Inflation**

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





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

(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 2010 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, 2009, filed with the Securities and Exchange Commission, which describe various risks and uncertainties to which we are or may become subject.

**Item 6. Exhibits**

| | |
|---|---|
| 10.1 | Third Amendment to Credit Agreement and Consent, dated December 16, 2009, between Wachovia Bank, N.A. and OSI Systems, Inc. |
| 31.1 | Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 31.2 | Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 32.1 | Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 32.2 | Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |



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## Signatures

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized, in the City of Hawthorne, State of California on the 28th day of January 2010.

**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

# THIRD AMENDMENT TO CREDIT AGREEMENT AND CONSENT

**THIS THIRD AMENDMENT TO CREDIT AGREEMENT AND CONSENT** (this "Amendment"), dated as of December 16, 2009, 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.

**W I T N E S S E T H**

**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 (a) the Required Lenders amend certain provisions of the Credit Agreement and (b) the Administrative Agent consent to the change of the state of incorporation of the Borrower; and

**WHEREAS**, the Required Lenders are willing to make such amendments to the Credit Agreement and the Administrative Agent is willing to consent to the change of the state of incorporation of the Borrower, in each case, 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
## CONSENT

**1.1 Consent.** In accordance with Section 6.8 of the Credit Agreement, the Administrative Agent hereby consent to, on a one-time basis, the change of the state of incorporation of the Borrower from the State of California to the State of Delaware by merger of the Borrower into a newly created, wholly-owned subsidiary that is incorporated in Delaware (the "Reincorporation").

**1.2 Effectiveness of Consent.** This consent shall be effective only to the extent specifically set forth herein and shall not (a) be construed as a waiver of any breach or default nor as a waiver of any breach or default of which the Lenders have not been informed by the Borrower, (b) affect the right of the Lenders to demand compliance by the Borrower with all terms and conditions of the Credit Agreement, except as specifically modified or consented to by this Amendment, (c) be deemed a waiver of any transaction or future action on the part of the Borrower requiring the Lenders' or the Required Lenders' consent or approval under the Credit Agreement, or (d) except as consented to hereby, be deemed or construed to be a waiver or release of, or a limitation upon, the Administrative Agent's or the Lenders' exercise of any rights or remedies under the Credit Agreement or any other Credit Document, whether arising as a consequence of any Event of Default which may now exist or otherwise, all such rights and remedies hereby being expressly reserved.

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## ARTICLE II
## AMENDMENTS TO CREDIT AGREEMENT

**2.1 Definition of Business Day.** The definition of "Business Day" set forth in Section 1.1 of the Credit Agreement is hereby amended and restated in its entirety to read as follows:

*"Business Day" shall mean any day other than a Saturday, Sunday or other day on which commercial banks in Charlotte, North Carolina, New York, New York or Los Angeles, California are authorized or required by law to close; provided, however, that when used in connection with a rate determination, borrowing or payment in respect of a LIBOR Rate Loan, the term "Business Day" shall also exclude any day on which banks in London, England are not open for dealings in Dollar deposits in the London interbank market.*

**2.2 Definition of Dollar Equivalent.** The definition of "Dollar Equivalent" set forth in Section 1.1 of the Credit Agreement is hereby amended and restated in its entirety to read as follows:

*"Dollar Equivalent" shall mean, at any time, (a) with respect to Dollars or an amount denominated in Dollars, such amount and (b) with respect to an amount in Foreign Currency or an amount denominated in any Foreign Currency, the equivalent amount thereof in Dollars as determined by the Administrative Agent or the applicable Issuing Lender, as the case may be, at such time on the basis of the Spot Rate (determined by the Administrative Agent or such Issuing Lender as of the most recent Revaluation Date) for the purchase of Dollars with such Foreign Currency.*

**2.3 Definition of Permitted Lien.** The definition of "Permitted Lien" set forth in Section 1.1 of the Credit Agreement is hereby amended by (a) amending and restating clause (r) in its entirety and (b) adding a new clause (s) to the end of such definition, in each case, to read as follows:

*(r) cash collateral securing letters of credit permitted to the extent permitted under Section 6.1(j) in an aggregate amount not to exceed $50,000,000 at any time outstanding; and*

*(s) additional Liens so long as the principal amount of Indebtedness and other obligations secured thereby does not exceed $1,000,000 in the aggregate.*

**2.4 Definition of Spot Rate.** The definition of "Spot Rate" set forth in Section 1.1 of the Credit Agreement is hereby amended and restated in its entirety to read as follows:

*"Spot Rate" for any Foreign Currency on any date means the rate determined by the Administrative Agent or the applicable Issuing Lender, as applicable, to be the rate quoted by the Person acting in such capacity as the spot rate for the purchase by such Person of such currency with*

*another currency through its principal foreign exchange trading office at approximately 11:00a.m. on the date two (2) Business Days prior to the date as of which the foreign exchange computation is made; provided that the Administrative Agent or the applicable Issuing Lender may obtain such spot rate from another financial institution designated by the Administrative Agent or the applicable Issuing Lender if the Person acting in such capacity does not have as of the date of determination a spot buying rate for any such currency; and provided further that the Issuing Lender may use such spot rate quoted on the date as of which the foreign exchange computation is made in the case of any Letter of Credit denominated in a Foreign Currency.*

**2.5** **Amendment to Section 2.3(a).** Section 2.3(a) of the Credit Agreement is hereby amended by deleting the reference to "**FORTY-FIVE MILLION DOLLARS ($45,000,000)**" and replacing it with **"SIXTY-FOUR MILLION FIVE HUNDRED THOUSAND DOLLARS ($64,500,000)**".

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

*(C) Foreign Subsidiaries may collectively incur Indebtedness under letters of credit in an aggregate amount not to exceed $40,000,000; and*



**2.7** **Amendment to Section 6.1.** Section 6.1 of the Credit Agreement is hereby amended by (a) amending and restating clause (j) in its entirety and (b) adding a new clause (k) to the end of such Section, in each case, to read as follows:

*(j) letters of credit (to the extent fully cash collateralized) in an aggregate amount not to exceed $50,000,000 at any time outstanding; and*

*(k) other unsecured Indebtedness of the Credit Parties which does not exceed $5,000,000 in the aggregate at any time outstanding.*

**2.8** **Amendment to Section 6.4(a)(iv).** Section 6.4(a)(iv) of the Credit Agreement is hereby amended and restated in its entirety to read as follows:

*(iv) (A) the sale, lease or transfer of property or assets from one Credit Party to another Credit Party, (B) the sale, lease or transfer of property or assets from a Subsidiary to a Credit Party, (C) the sale, lease or transfer of property or assets from a Subsidiary that is not a Credit Party to another Subsidiary that is not a Credit Party, (D) the dissolution of any Credit Party to the extent any and all assets of such Credit Party at the time of such dissolution are distributed to another Credit Party, (E) the dissolution of a Subsidiary that is not a Credit Party to the extent any and all assets of such Subsidiary at the time of such dissolution are distributed to another Subsidiary; (F) the sale or transfer by Spacelabs Medical, Inc. and Spacelabs Healthcare, Inc. of the Equity Interests in Spacelabs Healthcare Solutions Private Limited ultimately to Spacelabs Healthcare (Cyprus) Limited, (G) the sale or transfer by OSI Optoelectronics, Inc. and OSI Electronics, Inc. of the Equity Interests in OSI Optoelectronics Private Limited ultimately to OSI Optoelectronics Limited (Cyprus) or (H) the sale or transfer by OSI Systems, Inc. of the Equity Interests in Rapiscan Systems Private Limited ultimately to Rapiscan Systems (Cyprus) Limited;*

## ARTICLE III
## CONDITIONS TO EFFECTIVENESS

**3.1** **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 such fees and expenses that are payable in connection with the consummation of the transactions contemplated hereby and Moore & Van Allen PLLC shall have received from the Borrower payment of all outstanding fees and expenses previously incurred and all fees and expenses incurred in connection with this Amendment.

## ARTICLE IV
## COVENANT

**4.1** **Covenant.** The Credit Parties hereby covenant and agree to promptly, but in any event within two (2) Business Days, inform the Administrative Agent of the consummation of the Reincorporation (the "Merger



Date") and to provide the Administrative Agent with *certified* copies of all documents related to the Reincorporation.

## ARTICLE V
## MISCELLANEOUS

**5.1** **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. On and after the Merger Date, all references in the Credit Documents to "OSI

Systems, Inc., a California corporation" shall be deemed to mean and refer to "OSI Systems, Inc., a Delaware corporation". 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.

**5.2** **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.

**5.3** **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.

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

**5.5** **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.



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**5.6** **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.

**5.7** **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.

**5.8** **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.

**5.9** **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.

**5.10** 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.**

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

**5.12** **General Release.** In consideration of the Administrative Agent's, on behalf of the Lenders, willingness to enter into this Amendment, each Credit Party hereby releases and forever discharges the Administrative Agent, the Lenders and the Administrative Agent's and the Lender's respective predecessors, successors, assigns, officers, managers, directors, employees, agents, attorneys, representatives, and affiliates (hereinafter all of the above collectively referred to as "Bank Group"), from any and all claims, counterclaims, demands, damages, debts, suits, liabilities, actions and causes of action of any nature whatsoever, including, without limitation, all claims, demands, and causes of action for contribution and indemnity, whether arising at law or in equity, whether known or unknown, whether liability be direct or indirect, liquidated or unliquidated, whether absolute or contingent, foreseen or unforeseen, and whether or not heretofore asserted, which any Credit Party may have or claim to have against any of the Bank Group in any way related to or connected with the Credit Documents and the transactions contemplated thereby.

**5.13** **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]

IN WITNESS WHEREOF the parties hereto have caused this Amendment to be duly executed on the date first above written.

**BORROWER:**

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

By: /s/ Alan Edrick
Name: Alan Edrick
Title: Chief Financial Officer

**GUARANTORS:**

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

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

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

By: /s/ Alan Edrick
Name: Alan Edrick
Title: Chief Financial Officer

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

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

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

By: /s/ Alan Edrick
Name: Alan Edrick
Title: Chief Financial Officer

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

By: /s/ Alan Edrick
Name: Alan Edrick
Title: Chief Financial Officer

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

By: /s/ Alan Edrick
Name: Alan Edrick
Title: Chief Financial Officer

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

By: /s/ Alan Edrick
Name: Alan Edrick
Title: Chief Financial Officer

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

By: /s/ Shiva Kumar
Name: Shiva Kumar

Title: President

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

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

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

By: /s/ Alan Edrick
Name: Alan Edrick
Title: Chief Financial Officer

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

By: /s/ Alan Edrick
Name: Alan Edrick
Title: Chief Financial Officer

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

By: /s/ Alan Edrick
Name: Alan Edrick
Title: Chief Financial Officer

**ADMINISTRATIVE AGENT:**

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

By: /s/ Richard I. Polver
Name: Richard I. Polver
Title: Senior Vice President

**EXHIBIT 31.1**

# 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 28, 2010

/s/ Deepak Chopra
Deepak Chopra
Chief Executive Officer

**EXHIBIT 31.2**

**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 28, 2010

/s/ Alan Edrick
Alan Edrick
Chief Financial Officer

**EXHIBIT 32.1**

**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, 2009 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 28, 2010

/s/ Deepak Chopra

Deepak Chopra

Chief Executive Officer

**EXHIBIT 32.2**

**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, 2009 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 28, 2010

/s/ Alan Edrick
Alan Edrick
Chief Financial Officer