OSI SYSTEMS INC
Form 10-Q
October 30, 2008

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

FORM 10-Q

(Mark one)

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

For the quarterly period ended September 30, 2008

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	**33-0238801**
(State or other jurisdiction of incorporation or organization)	**(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 þ No o

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

Large accelerated filer o	Accelerated filer þ	Non-accelerated filer o	Smaller reporting company o

(Do not check if a smaller reporting company)

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

As of October 28, 2008, there were 17,839,522 shares of the registrant s common stock outstanding.

OSI SYSTEMS, INC.
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PART I. FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements

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

	June 30, 2008	September 30, 2008
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 18,232	$ 21,048
Accounts receivable, net	156,781	137,116
Other receivables	3,258	3,795
Inventories	144,807	148,599
Deferred income taxes	19,313	19,183
Prepaid expenses and other current assets	14,064	19,052
Total current assets	356,455	348,793
Property and equipment, net	47,191	45,480
Goodwill	60,408	60,624
Intangible assets, net	34,495	32,847
Other assets	9,092	10,504
Total assets	$ 507,641	$ 498,248
LIABILITIES AND SHAREHOLDERS EQUITY		
Current Liabilities:		
Bank lines of credit	$ 18,657	$ 9,000
Current portion of long-term debt	6,593	7,094
Accounts payable	75,320	71,328
Accrued payroll and employee benefits	20,896	19,505
Advances from customers	6,746	20,818
Accrued warranties	11,597	10,705
Deferred revenue	7,414	7,128
Other accrued expenses and current liabilities	14,274	11,045
Total current liabilities	161,497	156,623
Long-term debt	49,091	46,541
Other long-term liabilities	17,804	19,095
Total liabilities	228,392	222,259
Minority interest	1,228	1,198
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;, 17,740,057 and 17,837,846 shares, issued and outstanding, at June 30, 2008 and September 30, 2008, respectively	224,581	227,373
Retained earnings	41,972	42,104
Accumulated other comprehensive income	11,468	5,314
Total shareholders equity	278,021	274,791
Total liabilities and shareholders equity	$ 507,641	$ 498,248

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 September 30,	
	2007	**2008**
Revenues	$ 131,013	$ 148,161
Cost of goods sold	86,903	98,526
Gross profit	44,110	49,635
Operating expenses:		
Selling, general and administrative expenses	36,211	37,571
Research and development	9,729	10,213
Impairment, restructuring, and other charges	85	801
Total operating expenses	46,025	48,585
Income (loss) from operations	(1,915)	1,050
Interest expense, net	(1,089)	(895)
Income (loss) before benefit for income taxes and minority interest	(3,004)	155
Provision (benefit) for income taxes	(1,055)	53
Minority interest in net earnings (losses) of consolidated subsidiaries	118	(30)
Net income (loss)	$ (2,067)	$ 132
Income (loss) per share:		
Basic	$ (0.12)	$ 0.01
Diluted	$ (0.12)	$ 0.01
Shares used in per share calculation:		
Basic	17,171	17,797
Diluted	17,171	18,166

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 Three Months Ended September 30, 2007	For the Three Months Ended September 30, 2008
Cash flows from operating activities:		
Net income (loss)	$ (2,067)	$ 132
Adjustments to reconcile net income (loss) to net cash provided (used) by operating activities:		
Depreciation and amortization	4,547	4,359
Stock based compensation expense	1,095	1,193
Provision for losses on accounts receivable	145	1,144
Minority interest in net earnings (losses) of consolidated subsidiaries	118	(30)
Equity in (earnings) loss of unconsolidated affiliate	(81)	25
Deferred income taxes	(3,490)	(294)
Other	(24)	12
Changes in operating assets and liabilities:		
Accounts receivable	4,510	14,288
Other receivables	876	(1,497)
Inventories	(14,031)	(9,228)
Prepaid expenses and other current assets	(4,268)	(5,528)
Accounts payable	8,974	(1,643)
Accrued payroll and employee benefits	(369)	(1,054)
Advances from customers	1,661	14,825
Accrued warranties	498	(492)
Deferred revenue	(789)	1,337
Other accrued expenses and current liabilities	(949)	(2,863)
Net cash provided (used) by operating activities	(3,644)	14,686
Cash flows from investing activities:		
Acquisition of property and equipment	(2,600)	(2,186)
Proceeds from the sale of property and equipment	88	30
Buyback of subsidiary stock	(443)	
Acquisition of intangible and other assets	(853)	(727)
Net cash used in investing activities	(3,808)	(2,883)
Cash flows from financing activities:		
Net payments on bank lines of credit	(16,775)	(9,413)
Proceeds from long-term debt	44,883	
Payments on long-term debt	(22,488)	(1,794)
Payments on capital lease obligations	(341)	(263)
Proceeds from exercise of stock options and employee stock purchase plan	884	1,599

Net cash provided (used) by financing activities		6,163		(9,871)
Effect of exchange rate changes on cash		(47)		884
Net increase (decrease) in cash and cash equivalents		(1,336)		2,816
Cash and cash equivalents-beginning of period		15,980		18,232
Cash and cash equivalents-end of period	$	14,644	$	21,048
Supplemental disclosure of cash flow information:				
Cash paid during the year for:				
Interest	$	1,133	$	1,063
Income taxes	$	1,027	$	1,139

See accompanying notes to condensed consolidated financial statements.

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

1. Basis of Presentation

Description of Business

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

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

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

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

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

Basis of Presentation

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

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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 restricted shares and shares issuable upon the exercise of stock options or warrants under the treasury stock method. Stock options and warrants to purchase a total of 2.7 million and 1.1 million shares of common stock for the three months ended September 30, 2007 and 2008, respectively, were not included in diluted earnings per share calculations because to do so would have been antidilutive. The following table sets forth the computation of basic and diluted earnings per share (in thousands, except per share amounts):

	Three months Ended September 30,	
	2007	**2008**
Net income (loss)	$ (2,067)	$ 132
Effect of dilutive interest in subsidiary stock	(1)	
Net income (loss) available to common shareholders	$ (2,068)	$ 132
Weighted average shares outstanding basic	17,171	17,797
Dilutive effect of stock options and warrants		369
Weighted average shares outstanding diluted	17,171	18,166
Basic earnings (loss) per share	$ (0.12)	$ 0.01
Diluted earnings (loss) per share	$ (0.12)	$ 0.01

Comprehensive Income

Comprehensive loss is computed as follows (in thousands):

	Three months Ended September 30,	
	2007	**2008**
Net income (loss)	$ (2,067)	$ 132
Gain on foreign currency forward contract		55
Foreign currency translation adjustments	1,645	(6,408)
Minimum pension liability adjustment	(174)	199
Comprehensive loss	$ (596)	$ (6,022)

As of September 30, 2008, the Company had an $8.3 million foreign currency forward contract to sell Polish zloty in anticipation of the sale and settlement in the second quarter of fiscal 2009 of products denominated in Polish zloty. Pursuant to SFAS No. 133 Accounting for Derivative Instruments and Hedging Activities (as amended) (SFAS 133), the entire amount of this forward contract is considered a cash flow hedge. As a result, the gain on this foreign currency forward contract for the three months ended September 30, 2008 of $0.1 million has been reported as a component of other comprehensive income in the condensed consolidated financial statements.

Recent Accounting Pronouncements

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

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

The partial adoption of SFAS 157 on July 1, 2008 with respect to financial assets and financial liabilities recognized or disclosed at fair value in the financial statements on a recurring basis did not have a material impact on the Company s condensed consolidated financial statements. The Company is in the process of analyzing the potential impact of SFAS No. 157 relating to its planned July 1, 2009 adoption of the remainder of the standard.

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

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

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

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

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2. Balance Sheet Details

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

	June 30, 2008	September 30, 2008
Accounts receivable		
Trade receivables	$ 158,326	$ 139,372
Receivables related to long term contracts unbilled costs and accrued profit on progress completed	758	880
Total	159,084	140,252
Less: allowance for doubtful accounts	(2,303)	(3,136)
Accounts receivable, net	$ 156,781	$ 137,116

The Company expects to bill and collect the receivables for unbilled costs and accrued profits at September 30, 2008, during the next twelve months.

	June 30, 2008	September 30, 2008
Inventories, net		
Raw materials	$ 70,339	$ 71,059
Work-in-process	35,326	34,729
Finished goods	39,142	42,811
Total	$ 144,807	$ 148,599

	June 30, 2008	September 30, 2008
Property and equipment, net		
Land	$ 6,246	$ 5,877
Buildings	8,233	7,921
Leasehold improvements	10,068	10,158
Equipment and tooling	51,280	50,980
Furniture and fixtures	5,243	5,115
Computer equipment	15,856	16,807
ERP software	11,500	11,260
Total	108,426	108,118
Less: accumulated depreciation and amortization	(61,235)	(62,638)
Property and equipment, net	$ 47,191	$ 45,480

3. Goodwill and Intangible Assets

The changes in the carrying value of goodwill for the three month period ended September 30, 2008, are as follows (in thousands):

	Security	Healthcare	Optoelectronics and Manufacturing	Consolidated
Balance as of June 30, 2008	$ 17,692	$ 35,569	$ 7,147	$ 60,408
Goodwill acquired or adjusted during the period		949		949
Foreign currency translation adjustment	(378)	(352)	(3)	(733)
Balance as of September 30, 2008	$ 17,314	$ 36,166	$ 7,144	$ 60,624

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

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

Intangible assets consisted of the following (in thousands):

		June 30, 2008			September 30, 2008		
	Weighted Average Lives	Gross Carrying Value	Accumulated Amortization	Intangibles Net	Gross Carrying Value	Accumulated Amortization	Intangibles Net
Amortizable assets:							
Software development costs	5 years	$ 6,265	$ 2,634	$ 3,631	$ 7,181	$ 2,775	$ 4,406
Patents	8 years	451	298	153	573	306	267
Core technology	10 years	2,684	911	1,773	2,477	903	1,574
Developed technology	13 years	17,276	5,430	11,846	17,509	5,851	11,658
Customer relationships/ backlog	7 years	9,582	3,697	5,885	9,532	4,001	5,531
Total amortizable assets							