

OSI SYSTEMS INC
Form 10-Q
January 25, 2012
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark one)

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

For the quarterly period ended December 31, 2011

OR

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

For the transition period from _____ to _____

Commission File Number 0-23125

OSI SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

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

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 No

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

Large accelerated filer

Accelerated filer

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

Smaller reporting company

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

As of January 23, 2012, there were 19,773,542 shares of the registrant's common stock outstanding.

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OSI SYSTEMS, INC.

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Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. Condensed Consolidated Financial Statements****OSI SYSTEMS, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS****(in thousands, except share amounts)****(Unaudited)**

	June 30, 2011	December 31, 2011
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 55,619	\$ 52,868
Accounts receivable, net	136,716	145,314
Other receivables	5,012	5,045
Inventories	169,634	205,789
Deferred income taxes	17,156	17,233
Prepaid expenses and other current assets	21,149	14,151
Total current assets	405,286	440,400
Property and equipment, net	55,017	58,647
Goodwill	70,292	77,133
Intangible assets, net	33,707	33,087
Other assets	20,614	15,970
Total assets	\$ 584,916	\$ 625,237
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities:		
Accounts payable	\$ 66,462	\$ 88,807
Accrued payroll and employee benefits	24,417	18,399
Advances from customers	25,191	27,218
Accrued warranties	14,530	15,382
Deferred revenue	15,956	14,231
Other accrued expenses and current liabilities	14,425	13,814
Total current liabilities	160,981	177,851
Long-term debt	2,756	2,554
Other long-term liabilities	36,379	44,467
Total liabilities	200,116	224,872
Commitment and contingencies (Note 7)		
Stockholders Equity:		
Preferred stock, no par value authorized, 10,000,000 shares; no shares issued or outstanding		
Common stock, \$0.001 par value authorized, 100,000,000 shares; issued and outstanding, 19,507,065 at June 30, 2011 and 19,728,433 shares at December 31, 2011	272,552	276,438

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Retained earnings	110,103	127,165
Accumulated other comprehensive income (loss)	2,145	(3,238)
Total stockholders' equity	384,800	400,365
Total liabilities and stockholders' equity	\$ 584,916	\$ 625,237

See accompanying notes to condensed consolidated financial statements.

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

	For the Three Months Ended		For the Six Months Ended	
	December 31,		December 31,	
	2010	2011	2010	2011
Revenues	\$ 169,287	\$ 187,993	\$ 297,740	\$ 349,310
Cost of goods sold	109,264	122,169	190,819	230,629
Gross profit	60,023	65,824	106,921	118,681
Operating expenses:				
Selling, general and administrative expenses	33,958	35,979	65,934	70,346
Research and development	11,842	11,546	21,073	22,426
Restructuring and other charges	903		1,159	
Total operating expenses	46,703	47,525	88,166	92,772
Income from operations	13,320	18,299	18,755	25,909
Interest expense and other income, net	(506)	(721)	(1,096)	(1,520)
Income before provision for income taxes	12,814	17,578	17,659	24,389
Provision for income taxes	3,596	5,277	5,049	7,327
Net income	\$ 9,218	\$ 12,301	\$ 12,610	\$ 17,062
Earnings per share:				
Basic	\$ 0.49	\$ 0.62	\$ 0.68	\$ 0.87
Diluted	\$ 0.47	\$ 0.61	\$ 0.65	\$ 0.85
Shares used in per share calculation:				
Basic	18,752	19,685	18,592	19,630
Diluted	19,475	20,237	19,289	20,161

See accompanying notes to condensed consolidated financial statements.

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

(amounts in thousands)

(Unaudited)

	For the Three Months Ended December 31,		For the Six Months Ended December 31,	
	2010	2011	2010	2011
Net income	\$ 9,218	\$ 12,301	\$ 12,610	\$ 17,062
Other comprehensive income (loss):				
Foreign currency translation adjustment	(1,116)	(2,132)	3,795	(5,393)
Other	1,015	(261)	1,175	10
Other comprehensive income (loss)	(101)	(2,393)	4,970	(5,383)
Comprehensive income	\$ 9,117	\$ 9,908	\$ 17,580	\$ 11,679

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	
	2010	2011
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 12,610	\$ 17,062
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	9,206	9,741
Stock based compensation expense	2,752	3,462
Provision for (recovery of) losses on accounts receivable	(425)	227
Equity in earnings of unconsolidated affiliates	(247)	(119)
Deferred income taxes	815	(168)
Other	126	28
Changes in operating assets and liabilities:		
Accounts receivable	6,632	(9,673)
Other receivables	(88)	(376)
Inventories	(26,703)	(38,112)
Prepaid expenses and other current assets	(809)	10,537
Accounts payable	23,102	22,415
Accrued payroll and related expenses	(7,162)	(5,745)
Advances from customers	(1,582)	4,175
Accrued warranties	1,005	1,050
Deferred revenue	(621)	(717)
Other accrued expenses and current liabilities	863	(1,303)
Net cash provided by operating activities	19,474	12,484
CASH FLOWS FROM INVESTING ACTIVITIES		
Acquisition of property and equipment	(4,590)	(9,083)
Acquisition of businesses-net of cash acquired	(5,248)	(3,189)
Acquisition of intangible and other assets	(1,764)	(1,794)
Net cash used in investing activities	(11,602)	(14,066)
CASH FLOWS FROM FINANCING ACTIVITIES		
Payments on long-term debt	(32,490)	(108)
Payments of capital lease obligations	(169)	
Proceeds from exercise of stock options and employee stock purchase plan	7,532	2,194
Repurchase of common shares		(1,770)
Net cash provided by (used in) financing activities	(25,127)	316
EFFECT OF EXCHANGE RATE CHANGES ON CASH	589	(1,485)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(16,666)	(2,751)
CASH AND CASH EQUIVALENTS - BEGINNING OF PERIOD	51,989	55,619
CASH AND CASH EQUIVALENTS - END OF PERIOD	\$ 35,323	\$ 52,868
Supplemental disclosure of cash flow information:		
Interest paid	\$ 796	\$ 1,559
Income taxes paid	\$ 3,707	\$ 1,125

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 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, primarily under the Rapiscan trade name, and provides turnkey security screening solutions under the S2 Global trade name. 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 physician 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, telecommunications, office automation, computer peripherals and industrial automation. This division provides products and services to original equipment manufacturers and end users as well as to the Company's own Security and Healthcare divisions.

Basis of Presentation

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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, 2011, filed with the Securities and Exchange Commission on August 26, 2011. The results of operations for the three and six months ended December 31, 2011, are not necessarily indicative of the operating results to be expected for the full fiscal year or any future periods.

Per Share Computations

The Company computes basic earnings per share by dividing net income available to common stockholders by the weighted average number of common shares outstanding during the period. The Company computes diluted earnings per share by dividing net income available to common stockholders by the sum of the weighted average number of common and dilutive potential common shares outstanding. Potential common shares consist of the shares issuable upon the exercise of stock options or warrants under the treasury stock method. Stock options to purchase a total of 0.2 million and 0.1 million shares, respectively, of common stock for the six months ended December 31, 2011 and 2010 were not included in diluted earnings per share calculations because to do so would have been antidilutive, while no such shares were excluded from the calculations for the three months ended December 31, 2011 and 2010.

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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,			
	2010		2011		2010		2011	
Net income available to common stockholders	\$	9,218	\$	12,301	\$	12,610	\$	17,062
Weighted average shares outstanding - basic		18,752		19,685		18,592		19,630
Dilutive effect of stock options and warrants		723		552		697		531
Weighted average of shares outstanding - diluted		19,475		20,237		19,289		20,161
Basic net income per share	\$	0.49	\$	0.62	\$	0.68	\$	0.87
Diluted net income per share	\$	0.47	\$	0.61	\$	0.65	\$	0.85

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. There were no assets or liabilities where Level 3 valuation techniques were used and there were no assets and liabilities measured at fair value on a non-recurring basis.

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

	June 30, 2011		December 31, 2011	
Level 1	\$	8,115	\$	8,233
Level 2		(187)		(417)
Total	\$	7,928	\$	7,816

Derivative Instruments and Hedging Activity

The Company's use of derivatives consists primarily of foreign exchange contracts. As of December 31, 2011, the Company had outstanding foreign currency forward contracts of approximately \$6.2 million. These contracts do not meet the criteria as an effective cash flow hedge. Therefore, the net gain (loss) is reported in Interest expense and other income, net in the condensed consolidated statement of operations.

Business Combinations

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

Recent Accounting Updates Not Yet Adopted

In December 2011, the Financial Accounting Standards Board issued accounting standards update ASU No 2011-11, *Disclosures about Offsetting Assets and Liabilities*, which is intended to facilitate comparison between entities reporting under U.S. GAAP and IFRS in disclosing derivatives, sale and repurchase agreements and reverse sale and repurchase agreements, and securities borrowing and securities lending arrangements. Both the gross information and net information about both instruments and transactions eligible for offset in the statement of financial position and instruments and transactions subject to an agreement similar to a master netting arrangement are required to be disclosed. The ASU is effective for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods. The Company has not yet adopted this update and is currently evaluating the impact it may have on its financial disclosures.

In December 2011, the Financial Accounting Standards Board issued accounting standards update ASU No 2011-12, *Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in*

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Accounting Standards Update No. 2011-05, which defer the effective date pertaining to reclassification adjustments out of accumulated other comprehensive income in Accounting Standards Update 2011-05, *Comprehensive Income* (Topic 220): Presentation of Comprehensive Income. The ASU is effective for at the same time as the amendments in Update 2011-05. The Company early adopted ASU 2011-05 and will await the outcome from the FASB's further evaluation of the reclassification presentation treatment.

2. Balance Sheet Details

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

	June 30, 2011	December 31, 2011
Accounts receivable		
Trade receivables	\$ 142,509	\$ 151,338
Less: allowance for doubtful accounts	(5,793)	(6,024)
Accounts receivable, net	\$ 136,716	\$ 145,314

	June 30, 2011	December 31, 2011
Inventories, net		
Raw materials	\$ 92,373	\$ 106,080
Work-in-process	37,202	40,478
Finished goods	40,059	59,231
Total	\$ 169,634	\$ 205,789

	June 30, 2011	December 31, 2011
Property and equipment		
Land	\$ 5,296	\$ 5,163
Buildings	9,638	9,609
Leasehold improvements	12,989	14,243
Equipment and tooling	72,104	77,251
Furniture and fixtures	4,431	4,444
Computer equipment	14,034	14,364
Software	14,618	14,998
Total	133,110	140,072
Less: accumulated depreciation and amortization	(78,093)	(81,425)
Property and equipment, net	\$ 55,017	\$ 58,647

3. Goodwill and Intangible Assets

The goodwill acquired during the period within the Security division related to an acquisition of a business that was considered immaterial to the Company. The changes in the carrying value of goodwill for the six month period ended December 31, 2011, are as follows (in thousands):

	Optoelectronics and							
	Security		Healthcare		Manufacturing	Consolidated		
Balance as of June 30, 2011	\$	21,040	\$	35,612	\$	13,640	\$	70,292
Goodwill acquired or adjusted during the period		8,502		344		(1,435)		7,411
Foreign currency translation adjustment		(428)		(128)		(14)		(570)
Balance as of December 31, 2011	\$	29,114	\$	35,828	\$	12,191	\$	77,133

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Intangible assets consisted of the following (in thousands):

	Weighted Average Lives	Gross Carrying Value	June 30, 2011		December 31, 2011		
			Accumulated Amortization	Intangibles Net	Gross Carrying Value	Accumulated Amortization	Intangibles Net
Amortizable assets:							
Software development costs	5 years	\$ 13,090	\$ 3,807	\$ 9,283	\$ 13,743	\$ 3,630	\$ 10,113
Patents	10 years	2,975	449	2,526	3,404	467	2,937
Core technology	10 years	2,151	1,376	775	2,076	1,431	645
Developed technology	13 years	18,823	10,718	8,105	18,601	11,485	7,116
Customer relationships/backlog	7 years	10,411	6,824	3,587	10,389	7,508	2,881
Total amortizable assets		47,450	23,174	24,276	48,213	24,521	23,692
Non-amortizable assets:							
Trademarks		9,431		9,431	9,395		9,395
Total intangible assets		\$ 56,881	\$ 23,174	\$ 33,707	\$ 57,608	\$ 24,521	\$ 33,087

Amortization expense related to intangibles assets totaled \$2.1 and \$2.3 million for the six months ended December 31, 2010 and 2011, respectively; and \$1.1 million for the three months ended December 31, 2010 and 2011. At December 31, 2011, the estimated future amortization expense was as follows (in thousands):

2012 (remaining 6 months)	\$	2,254
2013		4,303
2014		3,089
2015		1,696
2016		1,578
2017		1,229
2018 and thereafter		9,543
Total	\$	23,692

4. Borrowings

The Company has a credit agreement with a syndicate of banks for a \$250 million revolving credit facility. This credit agreement consists of a \$250 million, five-year revolving credit facility, including a \$200 million sub-limit for letters of credit. Borrowings under this facility bear interest, based on the Company's option, at either (i) London Interbank Offered Rate (LIBOR) plus margins that range from 1.50% to 2.00% or (ii) the sum of margins that range from 0.50% to 1.00% and the higher of (a) the bank's prime rate, (b) the Fed Funds rate plus 0.5% or (c) LIBOR plus 1.0%. The margins are determined by the Company's consolidated leverage ratio. The Company's borrowings under the credit agreement are guaranteed by the Company's U.S.-based subsidiaries and are secured by substantially all of the Company's and certain subsidiaries' assets. The agreement contains various representations, warranties, affirmative, negative and financial covenants, and conditions of default customary for financing agreements of this type, including restrictions on the Company's ability to pay cash dividends. As of December 31, 2011, there was no debt outstanding under the revolving credit facility and \$62.2 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, 2011, \$14.9 million was outstanding under these letter-of-credit

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facilities, while no debt was outstanding. As of December 31, 2011, the total amount available under these credit facilities was \$20.8 million, with a total cash borrowing sub-limit of \$4.1 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, 2011, \$2.8 million remained outstanding under this loan at an interest rate of 2.0% per annum.

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

	June 30,		December 31,
	2011		2011
Twenty-year term loan due in fiscal 2024	\$ 2,977	\$	2,767
Less current portion of long-term debt (in other accrued expenses and current liabilities)	221		213
Long-term portion of debt	\$ 2,756	\$	2,554

5. Stock-based Compensation

As of December 31, 2011, 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):

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	Three Months Ended December 31,				Six Months Ended December 31,			
	2010		2011		2010		2011	
Cost of goods sold	\$	82	\$	111	\$	170	\$	229
Selling, general and administrative		1,313		1,779		2,469		3,109
Research and development		59		60		113		124
Total stock-based compensation expense	\$	1,454	\$	1,950	\$	2,752	\$	3,462

As of December 31, 2011, total unrecognized compensation cost related to non-vested share-based compensation arrangements granted was approximately \$13.9 million. The Company expects to recognize these costs over a weighted-average period of 2.7 years.

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,			
	2010		2011		2010		2011	
Service cost	\$	153	\$	198	\$	278	\$	355
Amortization of net loss		189		112		223		224
Net periodic pension expense	\$	342	\$	310	\$	501	\$	579

For the three and six months ended December 31, 2010 and 2011, the Company made contributions of \$0.9 million and \$0.1 million, respectively to these defined benefit plans.

In addition, the Company maintains various defined contribution plans. For the three months ended December 31, 2010 and 2011, the Company made contributions of \$1.0 million and \$1.2 million, respectively, to these defined contribution plans. For the six months ended December 31, 2010 and 2011, the Company made contributions of \$2.4 million in each period 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 certain acquisitions, the Company may be obligated to make additional payments based on the achievement by the acquired operations of certain sales or profitability milestones. The maximum amount of such payments under arrangements with contingent consideration caps is \$62 million. In addition, one of the purchase agreements the Company entered into requires royalty payments through 2022 based on the license of, or sales of products containing the technology of CXR Limited, a company acquired in 2004.

For acquisitions that occurred prior to fiscal year 2010, the Statement of Financial Accounting Standards for Business Combinations, the then prevailing accounting standard, required the Company to account for such contingent payments as an addition to the purchase price of the acquired company. For subsequent acquisitions, the guidance under the Accounting Standards Codification for Purchase Price Allocations, required that the estimated fair value of these obligations be recorded as a liability in the condensed consolidated balance sheet with subsequent revisions reflected in the condensed consolidated statements of operations. As of December 31, 2011, \$16.0 million of contingent payment obligations are included in other long-term liabilities in the accompanying condensed consolidated balance sheets.

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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 the Company, 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):

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	Three Months Ended December 31,				Six Months Ended December 31,			
		2010		2011		2010		2011
Balance at beginning of period	\$	11,395	\$	14,438	\$	10,930	\$	14,530
Additions		1,832		1,816		2,969		2,650
Reductions for warranty repair costs and adjustments		(1,158)		(872)		(1,830)		(1,798)
Balance at end of period	\$	12,069	\$	15,382	\$	12,069	\$	15,382

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.

Table of Contents**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 and enterprise-wide information (in thousands):

	Three Months Ended December 31,		Six Months Ended December 31,	
	2010	2011	2010	2011
Revenues by Segment:				
Security division	\$ 76,703	\$ 88,977	\$ 127,800	\$ 161,574
Healthcare division	55,799	59,193	101,723	105,713
Optoelectronics and Manufacturing division, including intersegment revenues	47,682	51,359	89,593	104,450
Intersegment revenues elimination	(10,897)	(11,536)	(21,376)	(22,427)
Total	\$ 169,287	\$ 187,993	\$ 297,740	\$ 349,310
Revenues by Geography:				
North America	\$ 123,095	\$ 128,387	\$ 220,098	\$ 236,209
Europe	34,010	38,468	55,074	73,808
Asia	23,079	32,674	43,944	61,720
Intersegment revenues elimination	(10,897)	(11,536)	(21,376)	(22,427)
Total	\$ 169,287	\$ 187,993	\$ 297,740	\$ 349,310

	Three Months Ended December 31,		Six Months Ended December 31,	
	2010	2011	2010	2011
Operating income (loss) by Segment:				
Security division	\$ 7,004	\$ 8,001	\$ 9,115	\$ 11,846
Healthcare division	5,664	8,325	8,262	10,723
Optoelectronics and Manufacturing division	4,270	4,451	7,691	9,389
Corporate	(3,072)	(2,599)	(5,248)	(5,906)
Eliminations (1)	(546)	121	(1,065)	(143)
Total	\$ 13,320	\$ 18,299	\$ 18,755	\$ 25,909

	June 30,	December 31,
	2011	2011
Assets by Segment:		
Security division	\$ 245,068	\$ 306,270
Healthcare division	152,048	158,552

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Optoelectronics and Manufacturing division	109,961	112,318
Corporate	84,082	54,482
Eliminations (1)	(6,243)	(6,385)
Total	\$ 584,916	\$ 625,237

(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.

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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, 2011.

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 international 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 46% and 43% of our total consolidated revenues for the six months ended December 31, 2011 and 2010, respectively.

As a result of the terrorist attacks of September 11, 2001, and subsequent attacks in other locations worldwide, security and inspection products have increasingly been used at a wide range of facilities other than airports, such as border crossings, railway stations, seaports, cruise line terminals, freight forwarding operations, sporting venues, government and military installations and nuclear facilities. We believe that our wide-ranging product portfolio together with our ability to provide turnkey screening solutions position us to competitively pursue security and inspection opportunities as they arise throughout the world.

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 30% and 34% of our total consolidated revenues for the six months ended December 31, 2011 and 2010, respectively.

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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 anticipated lower sales of patient monitoring, diagnostic cardiology and anesthesia systems products than what we had historically experienced, which negatively impact on our sales. Although there are indications that a recovery is underway, we cannot predict when the markets will fully 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, 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 24% and 23% of our total consolidated revenues for the six months ended December 31, 2011 and 2010, respectively.

Results of Operations for the Three Months Ended December 31, 2011 Compared to Three Months Ended December 31, 2010 (amounts in millions)

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 2011	% of Net Sales	Q2 2012	% of Net Sales	\$ Change	% Change
Security division	\$ 76.7	45%	\$ 89.0	47%	\$ 12.3	16%
Healthcare division	55.8	33%	59.2	32%	3.4	6%
Optoelectronics and Manufacturing division	36.8	22%	39.8	21%	3.0	8%
Total revenues	\$ 169.3	100%	\$ 188.0	100%	\$ 18.7	11%

Total revenues for the three months ended December 31, 2011, increased \$18.7 million, or 11%, to \$188.0 million, from \$169.3 million for the comparable prior-year period.

Revenues for the Security division for the three months ended December 31, 2011, increased \$12.3 million, or 16%, to \$89.0 million, from \$76.7 million for the comparable prior-year period. The increase was primarily attributable to: (i) a \$2.7 million increase in sales of our conventional equipment, primarily in baggage and parcel inspection lines; (ii) \$5.9 million of revenue attributable to our performance as a prime contractor and hardware systems integrator on a large ongoing contract; and (iii) a \$3.3 million increase in service revenue.

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Revenues for the Healthcare division for the three months ended December 31, 2011, increased \$3.4 million, or 6%, to \$59.2 million, from \$55.8 million for the comparable prior-year period. The increase was primarily attributable to a 13% increase in sales in our North American region while sales in the rest of the world were unchanged. Among our product lines, the overall increase was a result of: (i) a \$3.1 million increase in patient monitoring product revenues, and (ii) a \$0.7 million increase in anesthesia product revenue; (iii) partially offset by a \$0.5 million decrease in cardiology product revenues.

Revenues for the Optoelectronics and Manufacturing division for the three months ended December 31, 2011, increased by \$3.0 million, or 8%, to \$39.8 million, from \$36.8 million for the comparable prior-year period. This increase was primarily attributable to: (i) a \$2.7 million increase in commercial optoelectronics sales and (ii) a \$0.3 million increase in contract manufacturing sales.

Gross Profit

(in millions)	Q2 2011	% of Net Sales	Q2 2012	% of Net Sales
Gross profit	\$ 60.0	35.4%	\$ 65.8	35.0%

Gross profit increased \$5.8 million, or 10%, to \$65.8 million for the three months ended December 31, 2011, from \$60.0 million for the comparable prior-year period, primarily as a result of an 11% increase in revenue. The gross margin decreased to 35.0% from 35.4% for the comparable prior-year period. The slight decrease was attributable to the faster growth within our Security division

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(which grew at 16%) and our Optoelectronics and Manufacturing division (which grew at 8%), which generate lower gross margins than our Healthcare division (which grew at 6%). In addition, product mix within our Security division negatively impacted gross margins.

Operating Expenses

(in millions)	Q2 2011	% of Net Sales	Q2 2012	% of Net Sales	\$ Change	% Change
Selling, general and administrative	\$ 34.0	20.1%	\$ 36.0	19.1%	\$ 2.0	6%
Research and development	11.8	7.0%	11.5	6.1%	(0.3)	(3)%
Restructuring and other charges	0.9	0.5%			(0.9)	na
Total operating expenses	\$ 46.7	27.6%	\$ 47.5	25.2%	\$ 0.8	2%

Selling, general and administrative expenses. Selling, general and administrative (SG&A) expenses consist primarily of compensation paid to sales, marketing and administrative personnel, professional service fees and marketing expenses. For the three months ended December 31, 2011, SG&A expenses increased by \$2.0 million, or 6%, to \$36.0 million, from \$34.0 million for the comparable prior-year period. This increase was mainly attributable to an increase in costs to support the 16% revenue growth in our Security division and to a lesser extent an increase in costs to support the 6% revenue growth in our Healthcare division. As a percentage of revenues, SG&A expenses were 19.1% for the three months ended December 31, 2011, compared to 20.1% for the comparable prior-year period. This decrease was a result of our ability to leverage our sales and administrative infrastructure.

Research and development. Research and development (R&D) expenses include research related to new product development and product enhancement expenditures. For the three months ended December 31, 2011, such expenses decreased \$0.3 million, or 3%, to \$11.5 million, from \$11.8 million for the comparable prior-year period. As a percentage of revenues, R&D expenses were 6.1% for the three months ended December 31, 2011, compared to 7.0% for the comparable prior-year period.

Other Income and Expenses

	Q2 2011	% of Net Sales	Q2 2012	% of Net Sales	\$ Change	% Change
Interest expense and other income, net	\$ 0.5	0.3%	\$ 0.7	0.4%	\$ 0.2	40%

Interest expense and other income, net. For the three months ended December 31, 2011, interest expense and other income, net, amounted to \$0.7 million, as compared to \$0.5 million for the same prior-year period. The increase was due to higher utilization of the letters-of-credit facility and a loss related to the performance of a foreign currency forward contract, which was not treated as a cash flow hedge, partially offset by lower interest expense as a result of lower levels of outstanding debt during the current year.

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Income taxes. For the three months ended December 31, 2011, our income tax provision was \$5.3 million, compared to \$3.6 million for the comparable prior-year period. Our effective tax rate for the three months ended December 31, 2011, was 30.0%, compared to 28.1% 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.

Results of Operations for the Six Months Ended December 31, 2011 Compared to Six Months Ended December 31, 2010 (amounts in millions)

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 2011	% of Net Sales	YTD Q2 2012	% of Net Sales	\$ Change	% Change
Security division	\$ 127.8	43%	\$ 161.6	46%	\$ 33.8	26%
Healthcare division	101.7	34%	105.7	30%	4.0	4%
Optoelectronics and Manufacturing division	68.2	23%	82.0	24%	13.8	20%
Total revenues	\$ 297.7	100%	\$ 349.3	100%	\$ 51.6	17%

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Net revenues for the six months ended December 31, 2011, increased \$51.6 million, or 17%, to \$349.3 million, from \$297.7 million for the comparable prior-year period.

Revenues for the Security division for the six months ended December 31, 2011, increased \$33.8 million, or 26%, to \$161.6 million, from \$127.8 million for the comparable prior-year period. The increase was primarily attributable to: (i) a \$17.1 million, or 17%, increase in equipment sales, mainly driven by a \$10.1 million increase in our baggage and parcel inspection, hold baggage screening and people screening equipment and a \$7.4 million increase in sales of cargo and vehicle inspection equipment; (ii) \$5.9 million of revenue attributable to our performance as a prime contractor and hardware systems integrator on a large ongoing contract; and (iii) a \$9.2 million, or 33%, increase in revenue related to contracts to service such 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 six months ended December 31, 2011, increased \$4.0 million, or 4%, to \$105.7 million, from \$101.7 million for the comparable prior-year period. The increase was primarily attributable to 8% and 9% increases in sales in our North American and Asian/Latin American regions partially offset by a 5% decrease in our European/Middle East/Africa region. Among our product lines, the overall increase was a result of: a \$5.2 million increase in patient monitoring product revenues, which was partially offset by a \$1.2 million decrease in cardiology product revenues.

Revenues for the Optoelectronics and Manufacturing division for the six months ended December 31, 2011, increased \$13.8 million, or 20%, to \$82.0 million, from \$68.2 million for the comparable prior-year period. This increase was primarily attributable to: (i) a \$10.1 million increase in commercial optoelectronic sales and (ii) a \$3.7 million increase in contract manufacturing sales.

Gross Profit

(in millions)	YTD Q2 2011	% of Net Sales	YTD Q2 2012	% of Net Sales
Gross profit	\$ 106.9	35.9%	\$ 118.7	34.0%

Gross profit increased \$11.8 million, or 10%, to \$118.7 million for the six months ended December 31, 2011, from \$106.9 million for the comparable prior-year period. The gross margin during the period declined to 34.0% from 35.9% for the comparable prior-year period. The decrease was mainly due to relatively faster growth within our Security division (which grew at 26%) and our Optoelectronics and Manufacturing division (which grew at 17%), which generate lower gross margins than our Healthcare division (which grew by 4%). In addition, product mix within our Security division negatively impacted gross margin.

Operating Expenses

(in millions)	YTD Q2 2011	% of Net Sales	YTD Q2 2012	% of Net Sales	\$ Change	% Change
Selling, general and administrative	\$ 65.9	22.1%	\$ 70.3	20.1%	\$ 4.4	7%

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Research and development		21.1	7.1%	22.5	6.5%	1.4	7%
Restructuring and other charges		1.1	0.4%		%	(1.1)	na
Total operating expenses	\$	88.1	29.6%	\$ 92.8	26.6%	\$ 4.7	5%

Selling, general and administrative expenses. For the six months ended December 31, 2011, SG&A expenses increased by \$4.4 million, or 7%, to \$70.3 million, from \$65.9 million for the comparable prior-year period. This \$4.4 million increase was primarily attributable to an increase in SG&A costs to support the company-wide 17% revenue growth, especially the 26% revenue growth in the Security division. As a percentage of revenues, SG&A expenses were 20.1% for the six months ended December 31, 2011, compared to 22.1% for the comparable prior-year period. This decrease was a result of our ability to leverage our sales and administrative infrastructure.

Research and development. R&D expenses include research related to new product development and product enhancement expenditures. For the six months ended December 31, 2011, such expenses increased \$1.4 million, or 7%, to \$22.5 million, from \$21.1 million for the comparable prior-year period. As a percentage of revenues, research and development expenses were 6.5% for the six months ended December 31, 2011, compared to 7.1% for the comparable prior-year period. The increase in R&D expenses for the six month period ended December 31, 2011, primarily resulted from an increase in R&D investment in our Security and Healthcare divisions, in support of multiple new product introductions.

Table of Contents**Other Income and Expenses**

(in millions)	YTD Q2 2011	% of Net Sales	YTD Q2 2012	% of Net Sales	\$ Change	% Change
Interest expense and other income, net	\$ 1.1	0.4%	\$ 1.5	0.4%	\$ 0.4	36%

Interest expense and other income, net. For the six months ended December 31, 2011, interest expense and other income, net, amounted to \$1.5 million as compared to \$1.1 million for the same prior-year period. The increase was due to higher utilization of the letters-of-credit facility and a loss related to the performance of a foreign currency forward contract, which was not treated as a cash flow hedger, partially offset by lower interest expense as a result of lower levels of outstanding debt during the current year.

Income taxes. For the six months ended December 31, 2011, our income tax provision was \$7.3 million, compared to \$5.1 million for the comparable prior-year period. Our effective tax rate for the six months ended December 31, 2011, was 30.0%, compared to 28.6% 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 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 \$52.9 million at December 31, 2011, a decrease of \$2.7 million from \$55.6 million at June 30, 2011. The changes in our working capital and cash and cash equivalent balances during the six months ended are described below.

(in millions)	June 30, 2011	December 31, 2011	% Change
Working capital	\$ 244.3	\$ 262.5	7%
Cash and cash equivalents	55.6	52.9	(5)%

Working Capital. Working capital increased primarily due to: (i) a \$36.2 million increase in inventory primarily in our Security division, to support future order fulfillment; (ii) an \$8.6 million increase in accounts receivable primarily in our Security division driven by our 16% second quarter revenue growth; and (iii) a \$6.0 million decrease in accrued payroll and employee benefits. These increases to working capital were partially offset by: (i) a \$22.3 million increase in accounts payable, driven in part by the increase in inventory as previously noted; and (ii) a \$9.3 million decrease in prepaid expenses and other current assets.

(in millions)	YTD Q2 2011	YTD Q2 2012	\$ Change
Cash provided by operating activities	\$ 19.5	\$ 12.5	\$ (7.0)
Cash used in investing activities	(11.6)	(14.1)	2.5
Cash provided by (used in) financing activities	(25.1)	0.3	25.4

Cash Provided by Operating Activities. Cash flows from operating activities can fluctuate significantly from period to period, as net income, tax timing differences, customer collections, vendor payments and other items can significantly impact cash flows. Net cash provided by operations for the six months ended December 31, 2011, was \$12.5 million, a decrease of \$7.0 million from the \$19.5 million provided in the comparable prior-year period. This reduction in net cash provided was primarily due to the changes in working capital in the current-year period versus the prior-year period resulting in: (i) a \$16.3 million increase in the change in accounts receivables primarily in our Security division driven mainly by the 26% or \$34 million year over year increase in Security division revenues; (ii) an \$11.4 million increase in the change in inventory, reflecting build-up of inventory mainly in our Security division to support growth and (iii) a \$2.2 million decrease in other accrued expenses and other current liabilities. These unfavorable changes in cash flow were partially offset by the following favorable changes in working capital: (i) an \$11.3 million increase in cash from prepaid expenses and other current assets; (ii) a \$5.8 million increase in cash received as advances from customers; and (iii) a \$5.4 million increase in net income for the six months ended December 31, 2011, after giving consideration to non-cash operating items including depreciation and amortization, stock-based compensation and deferred taxes, among others, for both periods.

Cash Used in Investing Activities. Net cash used in investing activities was \$14.1 million for the six months ended December 31, 2011, compared to \$11.6 million for the six months ended December 31, 2010. During the six months ended December 31, 2011, we invested \$9.1 million in capital expenditures, as compared to \$4.6 million during the comparable prior-year period. During the six months ended December 31, 2011, we also paid \$3.2 million for the acquisition of businesses, as compared to the \$5.2 million during the comparable prior-year period. During the six months ended December 31, 2011, we paid \$2.1 million for the acquisition of intangible assets as compared to the \$1.8 million during the comparable prior-year period.

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Cash Used in Financing Activities. Net cash provided by financing activities was \$0.3 million for the six months ended December 31, 2011, compared to net cash used in financing activities of \$25.1 million for the six months ended December 31, 2010. During the six months ended December 31, 2011, we paid down our debt by \$0.1 million. During the six months ended December 31, 2010, we entered into a \$250 million revolving credit facility with a syndicate of banks. In connection with our entry into the new credit facility, we repaid \$32.5 million in term loans to terminate our former credit facility. We also paid down our then-outstanding capital lease obligations by \$0.2 million. During the six months ended December 31, 2011 we received \$0.4 million in net proceeds from the exercise of stock options and the purchase of stock under our employee stock purchase plan, net of any repurchase of shares. In the prior-year period, we received \$7.5 million in proceeds from the exercise of stock options and the purchase of stock under our employee stock purchase plan.

Borrowings

Outstanding lines of credit and current and long-term debt totaled \$2.8 million at December 31, 2011, a decrease of \$0.2 million from \$3.0 million at June 30, 2011. See Note 4 to the condensed consolidated financial statements for further discussion.

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, 2011, we did not repurchase any shares under this program and 711,205 shares were available for repurchase under the program as of December 31, 2011.

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

We presented our contractual obligations in our Annual Report on Form 10-K for the fiscal year ended June 30, 2011. There have been no significant changes in those obligations during the first six months of fiscal 2012. See Note 7 to the condensed consolidated financial statements for further discussion.

Off Balance Sheet Arrangements

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As of December 31, 2011, 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, 2011, 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, 2011.

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 (U.S. dollars), Malaysia (U.S. dollars), United Kingdom (U.K. pounds), Norway (Norwegian kroners), India (Indian rupees), Indonesia (Indonesian rupiah), Hong Kong (Hong Kong dollars), China (Chinese yuan), Canada (Canadian dollars), Mexico (Mexican pesos), 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

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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 statements of operations, amounted to a loss of \$0.1 million and a gain of \$0.3 million during the three months ended December 31, 2010 and 2011, respectively. For the six months ended December 31, 2010 and 2011, we incurred loss of \$1.0 million and gain of \$0.3 million, respectively. 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 2012. 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 2012.

Use of Derivatives

Our use of derivatives consists primarily of foreign exchange contracts. As discussed in Note 1 to the condensed consolidated financial statements, we had foreign currency forward contracts of approximately \$6.2 million outstanding as of December 31, 2011.

Importance of International Markets

International markets provide us with significant growth opportunities. However, as a result of our worldwide business operations, we are subject to various risks, including: international regulatory requirements and policy changes; difficulties in accounts receivable collection and the management of distributors; geopolitical and economic instability; currency exchange rate fluctuations; and tariff regulations. In response to these risks and others, we continue to perform ongoing credit evaluations of our customers' financial condition and, if deemed necessary, we require advance payments for sales. Also, we monitor geopolitical, economic and currency conditions around the world to evaluate whether there may be any significant effect on our international sales in the future.

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, 2011.

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, 2011, 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, 2011.

(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 2012 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 arising out of the ordinary course of business. 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.

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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, 2011, filed with the Securities and Exchange Commission on August 26, 2011, which describe various risks and uncertainties to which we are or may become subject. There have been no material changes to the risk factors included in our Annual Report.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds None

Item 3. Default Upon Senior Securities None

Item 4. (Removed and Reserved)

Item 5. Other Information

On December 15, 2011, we entered into a second amendment to our credit agreement with a syndicate of banks for our \$250 million revolving credit facility. The amendment increased the aggregate committed amount available to us under our letter of credit subfacility from \$175 million to \$200 million. A copy of the amendment is filed as Exhibit 10.1 to this Quarterly Report on Form 10-Q.

Item 6. Exhibits

10.1	Second Amendment to Credit Agreement
31.1	Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document

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101.DEF XBRL Extension Definition

101.LAB XBRL Taxonomy Extension Label Linkbase Document

101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

XBRL information is furnished and not filed for purpose of Sections 11 and 12 of the Securities Act of 1933 and Section 18 of the Securities Exchange Act of 1934, and is not subject to liability under those sections, is not part of any registration statement or prospectus to which it relates and is not incorporated or deemed to be incorporated by reference into any registration statement, prospectus or other document.

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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 25th day of January 2012.

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