OSI SYSTEMS INC
Form 10-Q
April 27, 2010
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark one)

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

For the quarterly period ended March 31, 2010

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)

Delaware	**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 x No o

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

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

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

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

As of April 23, 2010, there were 18,246,719 shares of the registrant s common stock outstanding.

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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)

	June 30, 2009	March 31, 2010
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 25,172	$ 46,337
Accounts receivable, net	110,453	112,787
Other receivables	2,950	4,445
Inventories	150,763	122,804
Deferred income taxes	20,128	21,623
Prepaid expenses and other current assets	13,777	19,839
Total current assets	323,243	327,835
Property and equipment, net	42,232	51,307
Goodwill	60,195	64,257
Intangible assets, net	32,451	32,082
Other assets	16,707	18,506
Total assets	$ 474,828	$ 493,987
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities:		
Bank lines of credit	$ 4,000	$
Current portion of long-term debt	8,557	9,670
Accounts payable	54,980	40,347
Accrued payroll and employee benefits	22,416	19,993
Advances from customers	12,863	29,380
Accrued warranties	10,106	9,942
Deferred revenue	8,880	7,563
Other accrued expenses and current liabilities	13,833	14,605
Total current liabilities	135,635	131,500
Long-term debt	39,803	28,392
Other long-term liabilities	23,390	28,930
Total liabilities	198,828	188,822
Commitment and contingencies (Note 7)		
Stockholders Equity:		
Preferred stock, no par value authorized, 10,000,000 shares; no shares issued or outstanding		
Common stock, no par value authorized, 100,000,000 shares; issued and outstanding, 17,411,569 at June 30, 2009 and 18,246,719 shares at March 31, 2010	225,297	240,923

Retained earnings		53,124		68,696
Accumulated other comprehensive loss		(2,421)		(4,454)
Total stockholders equity		276,000		305,165
Total liabilities and stockholders equity	$	474,828	$	493,987

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 March 31, 2009	For the Three Months Ended March 31, 2010	For the Nine Months Ended March 31, 2009	For the Nine Months Ended March 31, 2010
Revenues	$ 144,095	$ 145,401	$ 451,298	$ 429,783
Cost of goods sold	94,264	92,184	297,413	275,734
Gross profit	49,831	53,217	153,885	154,049
Operating expenses:				
Selling, general and administrative expenses	34,406	34,789	107,674	101,679
Research and development	8,572	9,129	27,454	27,471
Restructuring and other charges	2,401	946	6,000	1,553
Total operating expenses	45,379	44,864	141,128	130,703
Income from operations	4,452	8,353	12,757	23,346
Interest expense and other income, net	(583)	175	(2,341)	(1,214)
Income before provision for income taxes	3,869	8,528	10,416	22,132
Provision for income taxes	1,296	2,416	3,549	6,558
Net income	$ 2,573	$ 6,112	$ 6,867	$ 15,574
Earnings per share:				
Basic	$ 0.15	$ 0.34	$ 0.39	$ 0.88
Diluted	$ 0.15	$ 0.33	$ 0.39	$ 0.85
Shares used in per share calculation:				
Basic	17,336	18,066	17,557	17,737
Diluted	17,396	18,772	17,624	18,219

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 Nine Months Ended March 31, 2009	2010
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 6,867	$ 15,574
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	12,820	13,208
Stock based compensation expense	3,895	3,685
Provision (recoveries) for losses on accounts receivable	5,153	(417)
Equity in earnings of unconsolidated affiliates	(549)	(402)
Deferred income taxes	(880)	(1,703)
Other	133	120
Changes in operating assets and liabilities net of business acquisitions:		
Accounts receivable	16,892	(2,493)
Other receivables	(1,152)	249
Inventories	(19,347)	22,079
Prepaid expenses and other current assets	(2,420)	(6,231)
Accounts payable	9,116	(14,501)
Accrued payroll and related expenses	1,032	429
Advances from customers	6,524	17,870
Accrued warranties	(213)	70
Deferred revenue	2,694	(1,334)
Other accrued expenses and current liabilities	(451)	(6,344)
Net cash provided by operating activities	40,114	39,859
CASH FLOWS FROM INVESTING ACTIVITIES		
Acquisition of property and equipment	(9,354)	(12,402)
Proceeds from the sale of property and equipment	56	35
Acquisition of business-net of cash acquired		(3,241)
Acquisition of intangible and other assets	(3,105)	(2,225)
Net cash used in investing activities	(12,403)	(17,833)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net repayments of bank lines of credit	(9,353)	(4,000)
Payments on long-term debt	(4,274)	(9,527)
Net payments of capital lease obligations	(731)	(495)
Proceeds from exercise of stock options and employee stock purchase plan	3,255	11,751
Repurchase of common shares	(7,388)	
Net cash used in financing activities	(18,491)	(2,271)
EFFECT OF EXCHANGE RATE CHANGES ON CASH	1,199	1,410
NET INCREASE IN CASH AND CASH EQUIVALENTS	10,419	21,165
CASH AND CASH EQUIVALENTS - BEGINNING OF PERIOD	18,232	25,172
CASH AND CASH EQUIVALENTS - END OF PERIOD	$ 28,651	$ 46,337
Supplemental disclosure of cash flow information:		
Interest paid	$ 2,504	$ 1,885
Income taxes paid	$ 3,769	$ 5,756

See accompanying notes to condensed consolidated financial statements.

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OSI SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(amounts in thousands, unless specified)

(Unaudited)

1. Basis of Presentation

Description of Business

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

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

Through its Security division, the Company designs, manufactures, markets and services security and inspection systems worldwide, and provides turnkey security screening solutions. The Security division s products are used to inspect baggage, cargo, vehicles and other objects for weapons, explosives, drugs and other contraband and to screen people. These products and services are also used for the safe, accurate and efficient verification of cargo manifests for the purpose of assessing duties and monitoring the export and import of controlled materials.

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

Through its Optoelectronics and Manufacturing division, the Company designs, manufactures and markets optoelectronic devices and provides electronics manufacturing services worldwide for use in a broad range of applications, including aerospace and defense electronics, security and inspection systems, medical imaging and diagnostics, computed tomography (CT), telecommunications, office automation, computer peripherals and industrial automation. This division provides products and services to original equipment manufacturers as well as to the Company s own Security and Healthcare divisions.

Basis of Presentation

The condensed consolidated financial statements include the accounts of OSI Systems, Inc. and its subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation. The condensed consolidated financial statements have been prepared by the Company, without audit, pursuant to interim financial reporting guidelines and the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations. In the opinion of the Company s management, all adjustments, consisting of only normal and recurring adjustments, necessary for a fair presentation of the financial position and the results of operations for the periods presented have been included. These condensed consolidated financial statements and the accompanying notes should be read in conjunction with the audited consolidated financial statements and accompanying notes included in the Company s Annual Report on Form 10-K for the fiscal year ended June 30, 2009, filed with the Securities and Exchange Commission on August 28, 2009. The results of operations for the three months and nine months ended March 31, 2010, 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, restricted stock and warrants to purchase a total of 0.7 million shares of common stock for the nine months ended March 31, 2010, were not included in diluted earnings per share calculations because to do so would have been anti-

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dilutive. Stock options and warrants to purchase a total of 2.1 million shares of common stock for the three months and nine months ended March 31, 2009, were not included in diluted earnings per share calculations because to do so would have been anti-dilutive. The following table sets forth the computation of basic and diluted earnings per share (in thousands, except per share amounts):

	Three Months Ended March 31, 2009	Three Months Ended March 31, 2010	Nine Months Ended March 31, 2009	Nine Months Ended March 31, 2010
Net income available to common stockholders	$ 2,573	$ 6,112	$ 6,867	$ 15,574
Weighted average shares outstanding basic	17,336	18,066	17,557	17,737
Dilutive effect of stock options and warrants	60	706	67	482
Weighted average of shares outstanding diluted	17,396	18,772	17,624	18,219

Comprehensive Income

Comprehensive income/ (loss) is computed as follows:

	Three Months Ended March 31, 2009	Three Months Ended March 31, 2010	Nine Months Ended March 31, 2009	Nine Months Ended March 31, 2010
Net income	$ 2,573	$ 6,112	$ 6,867	$ 15,574
Foreign currency translation adjustments	(2,199)	(1,560)	(21,579)	(1,765)
Minimum pension liability adjustment	(42)	(153)	556	(48)
Other	(162)	(623)	(162)	(220)
Comprehensive income (loss)	$ 170	$ 3,776	$ (14,318)	$ 13,541

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 and investments held in retirement benefit plans fall into the Level 1 category, which values assets at the quoted prices in active markets for identical assets. The fair value of these assets totaled $6.6 million as of March 31, 2010 and $3.2 million as of June 30, 2009. The Company s derivative instruments fall into the Level 2 category, which values assets and liabilities from observable inputs other than quoted market prices. The fair value of the Company s derivative instruments totaled $(0.2) million as of March 31, 2010 and $ (0.3) million as of June 30, 2009. There were no assets or liabilities for which Level 3 valuation techniques were used and there were no assets or liabilities measured at fair value on a non-recurring basis.

Derivative Instruments and Hedging Activity

The Company s use of derivatives consists primarily of foreign exchange contracts and interest rate swap agreements. As of March 31, 2010, the Company had outstanding foreign currency forward contracts totaling $1.2 million. These forward contracts were not considered cash flow hedges, thus, the changes in the estimated fair values of these contracts were recorded as other expense in the condensed consolidated financial statements. In addition, to reduce the unpredictability of cash flows for interest payments related to variable, LIBOR-based debt, the Company has outstanding an interest rate swap agreement under which the Company incurs interest expense based upon a fixed 1.69% rate for a portion of its term loan. The interest rate swap matures in March 2012. The interest rate derivative contract was considered an effective cash flow hedge. As a result, the net gain or loss on such derivative contract has been reported as a component of other comprehensive income in the condensed consolidated financial statements and will be reclassified into net earnings when the hedged transaction settles.

Business Combinations

On July 1, 2009 the Company adopted Accounting Standards Codification, Topic 805, Business Combinations (ASC 805), which requires the use of significant estimates and assumptions, including fair value estimates, as of the business combination date. Under this method of accounting the Company recognizes separately from goodwill the identifiable assets acquired and the liabilities

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assumed at the acquisition date fair value. Costs incurred to complete the business combination such as investment banking, legal and other professional fees are not considered part of consideration and are charged to general and administrative expense as they are incurred.

The Company made an acquisition during the first quarter of fiscal year 2010 that was not considered material as of nor for the three and nine months ended March 31, 2010. The fair value of contingent consideration related to this acquisition was estimated to be $5.8 million and was recorded at the time of the acquisition as a component of other long-term liabilities in the condensed consolidated balance sheet. During the three months ended March 31, 2010, the fair value of this contingent liability was reduced to $5.1 million. The $0.7 million associated with this reduction was recorded as other income in the condensed consolidated statement of operations.

Recent Accounting Updates Not Yet Adopted

In October 2009, the Financial Accounting Standards Board issued an accounting standards update amending revenue recognition requirements for multiple-deliverable revenue arrangements. This update provides guidance about how to properly separate multiple deliverables and the appropriate method for measuring and allocating consideration from such arrangements, particularly for sales that include both products sold and services rendered. The update is effective for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. Early adoption is permitted. The Company has not yet adopted this update and is currently evaluating the impact it may have on its financial condition and results of operations.

2. Balance Sheet Details

The following tables provide details of selected balance sheet accounts:

	June 30, 2009	March 31, 2010
Accounts receivable		
Trade receivables	$ 116,140	$ 118,052
Receivables related to long term contracts unbilled costs and accrued profit on progress completed	1,209	1,429
Total	117,349	119,481
Less: allowance for doubtful accounts	(6,896)	(6,694)
Accounts receivable, net	$ 110,453	$ 112,787

The Company expects to bill and collect the receivables for unbilled costs and accrued profits at March 31, 2010, during the next twelve months.

	June 30, 2009	March 31, 2010
Inventories, net		
Raw materials	$ 77,488	$ 69,483

Work-in-process		24,648		17,503
Finished goods		48,627		35,818
Total	$	150,763	$	122,804

		June 30, 2009		March 31, 2010
Property and equipment				
Land	$	5,426	$	5,055
Buildings		8,927		8,568
Leasehold improvements		12,628		13,317
Equipment and tooling		48,659		62,149
Furniture and fixtures		4,802		4,811
Computer equipment		16,773		17,272
Software		11,032		13,137
Total		108,247		124,309
Less: accumulated depreciation and amortization		(66,015)		(73,002)
Property and equipment, net	$	42,232	$	51,307

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3. Goodwill and Intangible Assets

The changes in the carrying value of goodwill for the nine month period ended March 31, 2010, are as follows:

	Security	Healthcare	Optoelectronics and Manufacturing	Consolidated
Balance as of June 30, 2009	$ 17,112	$ 35,736	$ 7,347	$ 60,195
Goodwill acquired during the period			4,597	4,597
Foreign currency translation adjustment	(209)	(353)	27	(535)
Balance as of March 31, 2010	$ 16,903	$ 35,383	$ 11,971	$ 64,257

Intangible assets consisted of the following:

		June 30, 2009			March 31, 2010		
	Weighted Average Lives	Gross Carrying Value	Accumulated Amortization	Intangibles Net	Gross Carrying Value	Accumulated Amortization	Intangibles Net
Amortizable assets:							
Software development costs	5 years	$ 9,754	$ 3,198	$ 6,556	$ 11,261	$ 3,764	$ 7,497
Patents	9 years	921	334	587	1,338	372	966
Core technology	10 years	2,224	977	1,247	2,016	1,037	979